Treasury Department : : : : Bureau of Internal Revenue

# Internal Revenue Bulletin

## Cumulative Bulletin XV-1

JANUARY–JUNE, 1936

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

 Treasury Department : : : : : Bureau of Internal Revenue

# Internal Revenue Bulletin



## Cumulative Bulletin XV-1



JANUARY-JUNE, 1936

IN THIS ISSUE



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

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

In addition to publishing all Internal Revenue Treasury Decisions, it is the policy of the Bureau of Internal Revenue to publish all rulings and decisions, including opinions of the Assistant General Counsel for the Bureau of Internal Revenue, which, because they announce a ruling or decision upon a novel question or upon a question in regard to which there exists no previously published ruling or decision, or for other reasons, are of such importance as to be of general interest. It is also the policy of the Bureau to publish all rulings or decisions which revoke, modify, amend, or affect in any manner whatever any published ruling or decision. In many instances opinions of the Assistant General Counsel for the Bureau of Internal Revenue are not of general interest because they announce no new ruling or no new construction of the revenue laws but simply apply rulings already made public to certain situations of fact which are without special significance. It is not the policy of the Bureau to publish such opinions. Therefore, the numbers assigned to the published opinions of the Assistant General Counsel for the Bureau of Internal Revenue are not consecutive. No unpublished ruling or decision will be cited or relied upon by any officer or employee of the Bureau of Internal Revenue as a precedent in the disposition of other cases. Unless otherwise specifically indicated, all published rulings and decisions have received the consideration and approval of the Assistant General Counsel for the Bureau of Internal Revenue.

UNITED STATES GOVERNMENT PRINTING OFFICE, WASHINGTON : 1936

For sale by the Superintendent of Documents, Washington, D. C. - - - - - See back of title for prices

The Internal Revenue Bulletin service for 1936 will consist of weekly bulletins and semiannual cumulative bulletins.

The weekly bulletins will contain the rulings and decisions to be made public and all Treasury Department decisions (known as Treasury decisions) pertaining to Internal Revenue matters. The semiannual cumulative bulletins will contain all rulings and decisions (including Treasury decisions) published during the previous six months.

The complete Bulletin service may be obtained, on a subscription basis, from the Superintendent of Documents, Government Printing Office, Washington, D. C., for $2 per year. Single copies of the weekly Bulletin, 5 cents each.

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

Persons desiring to obtain the Sales Tax Cumulative Bulletins for January–June and July–December, 1921, may procure them from the Superintendent of Documents at 5 cents per copy.

Persons desiring to obtain the Internal Revenue Bulletin service for the years 1922, 1923, 1924, 1925, 1926, 1927, 1928, 1929, 1930, 1931, 1932, 1933, 1934, 1935, and 1936, may do so at prices as follows:

| | |
|---|---|
| Cumulative Bulletin I–1 (January–June, 1922) | 40 cents |
| Cumulative Bulletin I–2 (July–December, 1922) | 30 cents |
| Cumulative Bulletin II–1 (January–June, 1923) | 30 cents |
| Cumulative Bulletin II–2 (July–December, 1923) | 40 cents |
| Cumulative Bulletin III–1 (January–June, 1924) | 50 cents |
| Cumulative Bulletin III–2 (July–December, 1924) | 50 cents |
| Digest No. 13 (January, 1922–December, 1924) | 60 cents |
| Cumulative Bulletin IV–1 (January–June, 1925) | 40 cents |
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| Digest No. 17 (January–December, 1925) | 25 cents |
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| Cumulative Bulletin V–2 (July–December, 1926) | 30 cents |
| Digest No. 21 (January–December, 1926) | 15 cents |
| Cumulative Bulletin VI–1 (January–June, 1927) | 40 cents |
| Cumulative Bulletin VI–2 (July–December, 1927) | 40 cents |
| Digest No. 22 (January, 1925–December, 1927) | 35 cents |
| Cumulative Bulletin VII–1 (January–June, 1928) | 35 cents |
| Cumulative Bulletin VII–2 (July–December, 1928) | 50 cents |
| Cumulative Bulletin VIII–1 (January–June, 1929) | 50 cents |
| Cumulative Bulletin VIII–2 (July–December, 1929) | 55 cents |
| Cumulative Bulletin IX–1 (January–June, 1930) | 50 cents |
| Cumulative Bulletin IX–2 (July–December, 1930) | 50 cents |
| Cumulative Bulletin X–1 (January–June, 1931) | 65 cents |
| Cumulative Bulletin X–2 (July–December, 1931) | 30 cents |
| Cumulative Bulletin XI–1 (January–June, 1932) | 30 cents |
| Cumulative Bulletin XI–2 (July–December, 1932) | 30 cents |
| Cumulative Bulletin XII–1 (January–June, 1933) | 30 cents |
| Cumulative Bulletin XII–2 (July–December, 1933) | 50 cents |
| Cumulative Bulletin XIII–1 (January–June, 1934) | 50 cents |
| Cumulative Bulletin XIII–2 (July–December, 1934) | 50 cents |
| Cumulative Bulletin XIV–1 (January–June, 1935) | 50 cents |
| Cumulative Bulletin XIV–2 (July–December, 1935) | 50 cents |
| Cumulative Bulletin XV–1 (January–June, 1936) | 55 cents |
| Digest A (income tax rulings only, April, 1919, to December 1930, inclusive | $1.50 |

All inquiries in regard to these publications and subscriptions should be sent to the Superintendent of Documents, Government Printing Office, Washington, D. C.

# INTRODUCTORY NOTES.

The Internal Revenue Cumulative Bulletin XV-1, in addition to all decisions of the Treasury Department (called Treasury decisions) pertaining to Internal Revenue matters, contains Assistant General Counsel's opinions, and rulings and decisions pertaining to income, estate, gift, sales, and miscellaneous taxes, as indicated on the title page of this Bulletin, published in the weekly Bulletins (Volume XV, Nos. 1 to 26, inclusive) for the period January 1 to June 30, 1936. It also contains a cumulative list of announcements relating to decisions of the United States Board of Tax Appeals published in the Internal Revenue Bulletin Service from January 1, 1932, to June 30, 1936.

Income Tax rulings are printed in four parts. Rulings under the Revenue Acts of 1936, 1935, and 1934 are printed as Part I ("A," 1936 Act, "B," 1935 Act, and "C," 1934 Act), the section headings corresponding with the sections of those Acts. The rulings under the latter Act are published under the article headings corresponding to the article headings of Regulations 86. Rulings under the Revenue Act of 1932 are published as Part II, the section and article headings corresponding with the section and article headings of the Revenue Act of 1932 and Regulations 77. Rulings under the Revenue Act of 1928 are printed as Part III, the section and article headings corresponding with the section and article headings of the Revenue Act of 1928 and Regulations 74. Rulings under the Revenue Act of 1926 and prior Acts are printed as Part IV, the section and article headings corresponding with the section and article headings of the Revenue Act of 1926 and Regulations 69.

Rulings under Title IX of the Social Security Act will be published under article headings of Regulations 90 and rulings under Title III of the Revenue Act of 1936—Tax on unjust enrichment—will be coded under the sections of that Act and the article headings of Regulations 95.

## ABBREVIATIONS.

The following abbreviations are used throughout the Bulletin:

A, B, C, etc.—The names of individuals.
A. R. M.—Committee on Appeals and Review memorandum.
A. R. R.—Committee on Appeals and Review recommendation.
B. T. A.—Board of Tax Appeals.
C. B.—Cumulative Bulletin.
Ct. D.—Court decision.
C. S. T.—Capital Stock Tax Division.
D. C.—Treasury Department circular.
E. T.—Estate Tax Division.
G. C. M.—General Counsel's or Assistant General Counsel's memorandum.
I. R. B.—Internal Revenue Bulletin.
I. T.—Income Tax Unit.

M, N, X, Y, Z, etc.—The names of corporations, places, or businesses, according to context.
Mim.—Mimeographed letter.
MS.—Miscellaneous Division.
O. or L. O.—Solicitor's law opinion.
O. D.—Office decision.
Op. A. G.—Opinion of the Attorney General.
P. T.—Processing Tax Division.
S. T.—Sales Tax Division.
Sil.—Silver Tax Division.
S. M.—Solicitor's memorandum.
Sol. Op.—Solicitor's opinion.
S. R.—Solicitor's recommendation.
S. S. T.—Social Security tax and Carriers tax.
T.—Tobacco Division.
T. B. M.—Advisory Tax Board memorandum.
T. B. R.—Advisory Tax Board recommendation.
T. D.—Treasury decision.
*x* and *y* are used to represent certain numbers, and when used with the word "dollars" represent sums of money.

The practice of promulgating Treasury Decisions that embody court decisions relating to the internal revenue has been discontinued. Hereafter opinions of the courts, with appropriate headnotes for the information and guidance of taxpayers and officers and employees of the Bureau of Internal Revenue, will be published in the Internal Revenue Bulletin without formal approval and promulgation by the Secretary of the Treasury.

ANNOUNCEMENT RELATING TO BOARD OF TAX APPEALS DECISIONS.

Under the provisions of the recent Revenue Acts, relating to appeals to the Board of Tax Appeals, the Commissioner may acquiesce in the decision of the Board or he may, if the appeal was heard by the Board prior to the passage of the 1926 Act, cause to be instituted a proceeding in court for the collection of any part of a tax determined by the Commissioner to be due but disallowed by the Board, provided that such proceeding is commenced within one year after final decision of the Board. As to appeals heard by the Board after the passage of the 1926 Act, the Commissioner may, within six months after the Board's decision is rendered, file a petition for a review of the decision by a Circuit Court of Appeals or by the United States Court of Appeals for the District of Columbia; however, as to decisions rendered on and after June 7, 1932, petitions for review must be filed within three months after the decision is rendered. In order that taxpayers and the general public may be informed as to whether or not the Commissioner has acquiesced in a decision of the Board of Tax Appeals disallowing a tax determined by the Commissioner to be due, announcement will be made in the weekly Bulletin at the earliest practicable date. A notice that the Commissioner has acquiesced or has nonacquiesced in a Board decision relates, however, only to the issue or issues decided in favor of the taxpayer. Decisions so acquiesced in should be relied upon by officers and employees of the Bureau of Internal Revenue as precedents in the disposition of other cases before the Bureau.

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

# CONTENTS.

[1] And 19 related dockets.

CONTENTS OF CUMULATIVE BULLETINS (I. T.) 1 TO 5; S. T. FOR 1920 AND 1921; INTERNAL REVENUE I-1, I-2, II-1, II-2, III-1, III-2, IV-1, IV-2, V-1, V-2, VI-1, VI-2, VII-1, VII-2, VIII-1, VIII-2, IX-1, IX-2, X-1, X-2, XI-1, XI-2, XII-1, XII-2, XIII-1, XIII-2, XIV-1, XIV-2, AND XV-1.

# BOARD OF TAX APPEALS.

## CUMULATIVE LIST OF ANNOUNCEMENTS RELATING TO DECISIONS OF THE UNITED STATES BOARD OF TAX APPEALS PUBLISHED IN THE INTERNAL REVENUE BULLETIN SERVICE FROM JANUARY 1, 1932, TO JUNE 30, 1936, INCLUSIVE.

[Announcements relating to the acquiescence or nonacquiescence of the Commissioner in decisions of the United States Board of Tax Appeals, as published in the weekly Internal Revenue Bulletin, from December 22, 1924, to December 31, 1931, inclusive, are printed in Cumulative Bulletin X-2, pages 1-106. The list below, therefore, contains only such announcements published in the weekly Bulletins from January 1, 1932, to June 30, 1936, inclusive.]

[a] XV-26-8139

The Commissioner acquiesces in the following decisions of the United States Board of Tax Appeals:

| Taxpayer. | Docket No. | Board of Tax Appeals. | |
|---|---|---|---|
| | | Volume. | Page. |
| A. | | | |
| Abeles, Charles T | 40546 | 24 | 435 |
| Abeles, Clifford | 37695 | 24 | 435 |
| Abeles, Francis, estate of | 37693 | 24 | 435 |
| Abeles, John T | 37694 | 24 | 435 |
| Abeles, Katherine | 37696 | 24 | 435 |
| Abeles, Willicmene H | 41034 | 24 | 435 |
| Acme Manifolding Co., Inc | 25194<br>38687 | 24 | 429 |
| Adelaide Park Land et al., trustees | 39980 | 25 | 211 |
| Afremow, David, estate of | 39593 | 25 | 1246 |
| Afremow, Sarah, executrix | 39593 | 25 | 1246 |
| Alabama Mineral Land Co | 56960<br>69007 | 28 | 586 |
| Albers, William H.[1] | 74759 | 33 | 373 |
| Albert Lea Packing Co., Inc | 20765 | 24 | 376 |
| Albrecht et al., Katherine B., executrices [2] | 41295 | 27 | 1091 |
| Alcoma Corporation | 60700 | 28 | 1291 |
| Alexander, J. F., estate of | 39019 | 27 | 1210 |
| Allegheny Garbage Co | 44860 | 30 | 636 |
| Allen, Irene C | 25414 | 25 | 834 |
| Allied American Corporation | 31704 | 25 | 1276 |
| Ambassador Petroleum Co | 40039 | 28 | 868 |
| American Central Life Insurance Co.[3] | 30133<br>31998<br>56024<br>63436 | 30 | 1182 |

[1] Acquiescence relates to deduction for contributions.
[2] Estate tax decision; acquiescence relates to deduction of $133,000.
[3] Acquiescence relates to issue whether petitioner received interest on mortgages when it bid in property upon foreclosure.

[a] Ruling No. 8139 includes all acquiescence and nonacquiescence notices published in the Internal Revenue Bulletin service from January 1, 1932, to June 30, 1936.

ACQUIESCENCES—Continued.

| Taxpayer. | Docket No. | Board of Tax Appeals. Volume. | Page. |
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| American Cigar Co | 16229 | 21 | 464 |
| American Feature Film Co | 27623 | 24 | 18 |
| American Gas & Electric Co. and subsidiary companies. | 67368, 67369, 69800 | 33 | 471 |
| American Printing Co | 39721 | 27 | 1270 |
| American Security & Trust Co. et al., executors [1] | 39167 | 24 | 334 |
| American South African Line, Inc | 62955, 68830, 70701 | 30 | 753 |
| Anco Investment Co | 58647 | 30 | 988 |
| Anderson, C. K | 33242 | 27 | 1305 |
| Anderson, Gustave | 36224 | 26 | 1208 |
| Anderson, J. H | 63827 | 30 | 1274 |
| Anderson, Stanley S | 42053 | 33 | 88 |
| Ann Arbor R. R. Co | 25869 | 29 | 331 |
| Arguimbau, Frank M | 73614 | 31 | 604 |
| Armstrong, C. George | 58400 | 31 | 418 |
| Armstrong, William B | 58603 | 32 | 1261 |
| Arnold & Winsor Co | 61553 | 29 | 670 |
| Ashforth, Albert B., estate of [2] | 47190, 48009, 49354 | 26 | 1188 |
| Ashforth et al., Mable A., executors [2] | 47190, 48009, 49354 | 26 | 1188 |
| Atkins, J. B., estate of | 38520 | 28 | 500 |
| Atkins, Mrs. J. B | 38519 | 28 | 500 |
| Atlantic Coast Line R. R. Co | 58958, 65310, 65311 | 31 | 730 |
| Axton, Edwin D | 56160 | 32 | 613 |
| Axton, Robert L | 56162 | 32 | 613 |
| Axton, Wood F | 56441 | 32 | 613 |
| B. | | | |
| Babbitt, Inc., B. T. (Delaware) | 74047 | 32 | 693 |
| Babbitt, Inc., B. T. (New York) | 74047 | 32 | 693 |
| Baker, I. B | 56348 | 32 | 613 |
| Baldwin, Florence G | 32387 | 23 | 512 |
| Balfour, Sir Robert | 40230 | 25 | 154 |
| Ball, Philip D. C | 36737 | 27 | 388 |
| Baltimore & Ohio R. R. Co | 53702 | 29 | 368 |
| Baltimore & Ohio R. R. Co.[3] | 37239 | 30 | 194 |
| Bankers Dairy Credit Corporation | 48329 | 26 | 886 |
| Barber, Arthur | 26747 | 25 | 513 |
| Barber, Philip C | 26755 | 25 | 513 |
| Barber, St. George | 26757 | 25 | 513 |
| Barber Trusts, Sarah P | 26747–26757 | 25 | 513 |
| Barclay, W. L | 8743 | 26 | 970 |
| Barker, Fred | 51102 | 28 | 657 |
| Barnes, Henry H | 56440 | 32 | 613 |
| Basch, N. J | 45928 | 30 | 305 |
| B & B Ice & Coal Co | 67637 | 27 | 1346 |
| Beasley, W. E | 60061 | 31 | 580 |

[1] Estate tax decision.
[2] Nonacquiescence published in Bulletin XII-1, withdrawn.
[3] Acquiescence relates to issue involving contributions by shippers for construction of side and spur tracks; and deduction for internal-revenue stamps affixed to bonds.

ACQUIESCENCES—Continued.

| Taxpayer. | Docket No. | Board of Tax Appeals. Volume. | Page. |
|---|---|---|---|
| Beaumont, Louis D | 31931, 46569, 49422 | 25 | 474 |
| Bebb, Richard E., estate of [1] | 41295 | 27 | 1091 |
| Beggs, John I. (Trusts) | 65675 | 30 | 370 |
| Behr, Charles B | 39534 | 30 | 1290 |
| Bell, Ivor B.[2] | 22335 | 27 | 377 |
| Bellows Falls Power Co | 18592, 29104 | 25 | 195 |
| Benedum, M. L.[3] | 30990 | 28 | 917 |
| Bent Co., R. G | 57312, 59796 | 26 | 1369 |
| Berdell, Jr., Charles P | 70298 | 32 | 600 |
| Bernstein, Isaac M | 36729 | 28 | 744 |
| Best, Frank E | 36746 | 26 | 1070 |
| Billups, George W | 54917 | 29 | 804 |
| Bingham, Robert W | 51051 | 27 | 186 |
| Birckhead, Oliver W | 72389 | 33 | 466 |
| Birdneck Realty Corporation | 46079 | 25 | 1084 |
| Biscayne Bay Islands Co | 27616, 35098, 40147 | 23 | 731 |
| Blair, Jr., Mrs. Wiley | 69682 | 31 | 212 |
| Bloodgood, Edith B | 26750 | 25 | 513 |
| Blum, Julius, trustee | 39242, 40939, 45741, 51507 | 25 | 119 |
| Blumenthal, Lucy A | 64975 | 30 | 591 |
| Boehringer, Rudolph [4] | 49891 | 29 | 8 |
| Boos Bros. Cafeteria Co | 39200 | 25 | 651 |
| Borg & Beck Co | 24223, 34964 | 24 | 995 |
| Bostick, Jr., John, trustee | 68382 | 31 | 25 |
| Bowden, Paul Akers | 54923 | 26 | 1410 |
| Bowen, Edwin L.[5] | 62985 | 33 | 208 |
| Braun, Arthur E., trustee | 54556 | 29 | 1161 |
| Brinton, Lillian McDonald | 53715 | 28 | 472 |
| Brown, Berenice | 24667, 36637 | 25 | 814 |
| Bryan et ux., C. A | 24036 | 19 | 111 |
| Bryan et ux., L. J | 24037 | 19 | 111 |
| Buck, John A., estate of [6] | 32584, 44153, 44684 | 25 | 780 |
| Buck et al., Mary M., executors [6] | 32584, 44153, 44684 | 25 | 780 |
| Buena Vista Land & Development Co | 2025 | 13 | 895 |
| Buffalo Union Iron Furnace Co.[7] | 16075, 16076 | 23 | 439 |

[1] Estate tax decision; acquiescence relates to deduction of $133,000.
[2] Acquiescence relates to that part of decision holding that Walter E. Hettman is not liable as a transferee; and to limitation issue.
[3] Acquiescence relates to right of overriding royalty owners to benefit of section 211(b), Revenue Act of 1918.
[4] Acquiescence relates to issue involving section 115(g) of the Revenue Act of 1928.
[5] Acquiescence relates to issue as to basic values of stock.
[6] Estate tax decision; acquiescence relates to value of certain real estate in San Francisco and value of stock of Langendorf Baking Co. for estate tax purposes; and reasonableness of Commissioner's allowance for support of the widow.
[7] Acquiescence relates to issue regarding deductions for obsolescence of blast furnaces.

ACQUIESCENCES—Continued.

| Taxpayer. | Docket No. | Board of Tax Appeals. | |
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| Bullington, Orville | 69684 | 31 | 212 |
| Bullington, Mrs. Sadie | 69679 | 31 | 212 |
| Bullis, Helen H | 68164<br>73954 | 32 | 501 |
| Bullock, George [1] | 31209 | 23 | 710 |
| Burdick, Ella P., trustee | 46322 | 29 | 731 |
| Burdick, Joel W., estate of | 46322<br>61009 | 29 | 731 |
| Burnham, Silas H | 53795 | 29 | 605 |
| Burroughs, Ambrose H., estate of | 59797 | 29 | 190 |
| Burton, Benjamin T | 61055 | 28 | 1241 |
| Butler, U. H | 46055 | 24 | 506 |
| Byers Trust, A. T | 68382 | 31 | 25 |
| C. | | | |
| California Coast Oil Co | 25018 | 25 | 902 |
| Camp Manufacturing Co | 35955 | 25 | 537 |
| Canaday, Inc., Ward M | 58632 | 29 | 355 |
| Canfield et al., Frances Marshall, executors | 68415 | 31 | 724 |
| Canfield, George F., estate of | 68415 | 31 | 724 |
| Canning, John F | 41482 | 29 | 99 |
| Capital Compress Co | 49303 | 31 | 273 |
| Carman, F. J | 44321<br>44939<br>50178 | 25 | 162 |
| Carnie, Goudie Manufacturing Co | 20074<br>27095 | 24 | 679 |
| Carol, Sue (Mrs. Nick Stuart) | 63963<br>71025 | 30 | 443 |
| Carolina, Clinchfield & Ohio Ry | 71649<br>71650 | 31 | 730 |
| Carolina Contracting Co | 77638 | 32 | 1171 |
| Carter Publications, Inc | 44838<br>66891 | 28 | 160 |
| Caspar Lumber Co | 57729 | 30 | 579 |
| Cathey, George | 46056 | 24 | 506 |
| Cathey, Luke | 46057 | 24 | 506 |
| Catlin, Daniel K | 25421 | 25 | 834 |
| Catlin, Theron E | 25413 | 25 | 834 |
| Central Market Street Co. [2] | 24837 | 25 | 499 |
| Central National Bank | 42587 | 29 | 530 |
| Central National Bank, trustee | 28701 | 25 | 1123 |
| Central Rendering Corporation | 20776 | 24 | 376 |
| Central Trust & Savings Bank | 42588 | 29 | 530 |
| Century Circuit, Inc., of Delaware | 69345 | 31 | 764 |
| Champion, David J. [3] | 55569<br>63818 | 27 | 1312 |
| Champion, T. Pierre [3] | 55568 | 27 | 1312 |
| Chapman & Dewey Land Co | 37403<br>51059 | 25 | 1166 |
| Chapman & Dewey Lumber Co | 33466<br>37402<br>47130<br>50196<br>51058 | 25 | 1166 |

[1] Acquiescence relates to issue 2 of decision.
[2] Acquiescence relates to issue regarding apportionment of taxes among affiliated corporations.
[3] Acquiescence relates to basis upon which gain or loss upon redemption of stock should be computed.

ACQUIESCENCES—Continued.

| Taxpayer. | Docket No. | Board of Tax Appeals. | |
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| | | Volume. | Page. |
| Chicago & Northwestern Ry. Co.[1] | 36343 | 22 | 1407 |
| Christopher, Rachel S.[2] | 47704 | 26 | 292 |
| City Bank Farmers Trust Co., executor | 59797 | 29 | 190 |
| City Bank Farmers Trust Co. et al., executors [2] | 31869 | 23 | 663 |
| Clark et al., James, executors | 34499 | 24 | 1235 |
| Cleland Estate Co., Inc., Henry A.[3] | 33585<br>40890<br>51197 | 29 | 436 |
| Clements, W. L | 46058 | 24 | 506 |
| Cleveland Trinidad Paving Co.[4] | 41962<br>46297 | 20 | 772 |
| Clinchfield Securities Co | 40554 | 25 | 446 |
| Clinton Cotton Mills, Inc | 54880 | 28 | 1311 |
| Coats, Inc. (R. I.), J. & P.[5] | 38904 | 28 | 1127 |
| Colgate, Mary | 61882 | 27 | 506 |
| Colorado & Utah Coal Co | 53799 | 26 | 588 |
| Columbian Carbon Co.[6] | 42743 | 25 | 456 |
| Columbus Brick & Tile Co.[7] | 42707 | 26 | 794 |
| Commercial Investment Trust Corporation [8] | 43495<br>50051 | 28 | 143 |
| Community Mausoleum Co.[9] | 70384 | 33 | 19 |
| Cone, Emma S., executrix [2] | 68034 | 31 | 515 |
| Cone, Irving H., estate of [2] | 68034 | 31 | 515 |
| Connally, Mary W. T | 60434 | 32 | 920 |
| Connecticut River Power Co | 18591<br>29106 | 25 | 195 |
| Connelly, James A.[10] | 44081<br>45833<br>46267<br>51967<br>60566<br>66948 | 30 | 331 |
| Connelly, L. B.[10] | 44083<br>45834 | 30 | 331 |
| Connelly, Mary B.[10] | 44082 | 30 | 331 |
| Conservative Gas Co | 72391 | 30 | 552 |
| Continental Legal and Protective Association | 44859 | 30 | 636 |
| Contractors Construction & Supply Co.[4] | 41963 | 20 | 772 |
| Cook, Elizabeth E.[11] | 38579 | 25 | 1351 |
| Cook, M. M., estate of | 53044 | 27 | 33 |
| Cook, P. W | 54740<br>60228 | 32 | 100 |
| Cooke, Beatrice B | 26751 | 25 | 513 |
| Coombs, Elizabeth M | 44768 | 25 | 1320 |
| Coombs, J. Howard | 44769 | 25 | 1320 |

[1] Acquiescence relates to following issues: Material and supplies adjustment; amortization of bond premium; assessment of Association of Railway Executives; railroad Y. M. C. A.

[2] Estate tax decision.

[3] Acquiescence does not relate to basis of property devised subject to a life estate.

[4] Nonacquiescence notice published in Cumulative Bulletin X-2 revoked.

[5] Acquiescence relates to contributions issue and issue respecting deduction of amount paid to treasurer of Rhode Island on account of increasing capital stock.

[6] Nonacquiescence published in Internal Revenue Bulletin XI-14 revoked.

[7] Acquiescence relates to inclusion in consolidated invested capital of capital stock issued for a tile and brick manufacturing plant, etc.

[8] Acquiescence relates to the following issues: Deduction of expenses in connection with issuance of preferred stock; deduction for dividends credited to accounts of employees for purchase of stock.

[9] Acquiescence relates to issue whether a sale of a cemetery crypt is a sale of realty entitling the taxpayer to the installment basis when total amounts received in basic year do not exceed 40 per cent of gross price.

[10] Acquiescence relates to question whether the value of rights to subscribe to certain bonds constitutes income.

[11] Acquiescence relates to issues regarding allocation of total cost between common and preferred stocks purchased.

ACQUIESCENCES—Continued.

| Taxpayer. | Docket No. | Board of Tax Appeals. Volume. | Page. |
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| Cooper, John I | 32610<br>40115 | 24 | 216 |
| Corbett, Elliott R | 40926 | 27 | 388 |
| Corning Trust Co., trustee | 29252 | 26 | 1359 |
| Cornwell, F. L | 30303 | 24 | 915 |
| Cosmopolitan Bond & Mortgage Co.[1] | 44617 | 30 | 717 |
| Costello, Joseph [2] | 22640 | 27 | 377 |
| Cotton, G. E | 59655 | 25 | 866 |
| Couchman, William Venning | 67729<br>70957 | 30 | 118 |
| Coursey, Sarah A. W.[3] | 71755 | 33 | 1068 |
| Cox, Attilla | 69698 | 31 | 819 |
| Cox, Carrie G | 69698 | 31 | 819 |
| Crane, Alexander B., estate of [4] | 71718 | 30 | 29 |
| Crane et al., Alexander M., executor [4] | 71718 | 30 | 29 |
| Crews, Charles | 66766 | 30<br>31<br>33 | 615<br>187<br>441 |
| Crews, Everett | 66767 | 33 | 36 |
| Crews, Ralph W | 66701 | 30<br>31<br>33 | 615<br>187<br>441 |
| Crews, Robert E | 66702 | 30<br>31<br>33 | 615<br>187<br>441 |
| Croker, Bula E | 41121 | 27 | 588 |
| Cromwell et al., William Nelson, executors [5] | 42619 | 24 | 461 |
| Cronan, Mr. and Mrs Francis M | 78185 | 33 | 668 |
| Crouse, George N | 43446<br>51419 | 26 | 477 |
| Crowley, Joseph J., estate of [6] | 35472 | 25 | 340 |
| Crowninshield Shipbuilding Co | 18987 | 24 | 925 |
| Culver, Wilmer T | 37574 | 24 | 1013 |
| Cunard Coal Co.[7] | 26874<br>26875<br>28792 | 26 | 234 |
| Curtis, Laura M | 56314 | 28 | 631 |
| **D.** | | | |
| Dahl, Andrew H., estate of | 44845 | 24 | 1167 |
| Dahl et al., Julia, executors | 44845 | 24 | 1167 |
| Daley, Eugene S., executor | 26645 | 25 | 949 |
| Daly, Margaret P | 65213 | 32 | 965 |
| Dana, Myer | 50248 | 30 | 83 |
| Dancer, Edith M., estate of [6] | 70456 | 30 | 1277 |
| Davis, John A | 20703 | 24 | 36 |
| De Forest, Kate R.[8] | 37284 | 27 | 373 |
| Delaware & Hudson Co. [9] | 50553<br>50629 | 26 | 520 |

[1] Acquiescence relates to issue involving method of accounting used by taxpayer.
[2] Acquiescence relates to that part of decision holding that Walter E. Hettman is not liable as a transferee; and to limitation issue.
[3] Acquiescence relates to the following issue: Inclusion in petitioner's taxable net income for 1930, the total profit received from sale of real estate by the trust.
[4] Nonacquiescence published in Cumulative Bulletin XIII-1 withdrawn.
[5] Estate tax decision; nonacquiescence published in Cumulative Bulletin X-2 revoked.
[6] Estate tax decision.
[7] Acquiescence relates to deductions for additional royalties and officers' salaries and directors' fees.
[8] Gift tax decision.
[9] Nonacquiescence published in Comulative Bulletin XI-2, withdrawn.

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| Dennett, Carl P.[1] | 71858 | 30 | 49 |
| Dennett, Marie G.[1] | 72023 | 30 | 49 |
| Dennis, Frank H., estate of [2] | 50263 | 26 | 1120 |
| Dennis, Merry M., executrix [2] | 50263 | 26 | 1120 |
| Denny, Reginald [3] | 49516 | 33 | 738 |
| Detroit Trust Co. et al., executors [2] | 35472 | 25 | 340 |
| Dickey, Walter S., estate of | 51643 | 32 | 1283 |
| Dickinson, Albert G | 35015<br>43176 | 23 | 1211 |
| Dillon, Herbert L | 58025<br>59280 | 32 | 1254 |
| Dirksen, Anna L., executrix | 17717 | 24 | 1152 |
| Dirksen, Theodore H., estate of | 17717 | 24 | 1152 |
| Dittmar, Emmy | 63931 | 32 | 349 |
| Dockweiler et al., Isidore B., executors and trustees [2] | 50828 | 30 | 1136 |
| Doernbecher Manufacturing Co | 34853<br>43527<br>46421<br>50607<br>63628<br>71534 | 30 | 973 |
| Dohme, Alfred R. L | 68159 | 31 | 671 |
| Dolese & Shepherd Co. Syndicate No. 3 | 41136 | 30 | 1171 |
| Dome Co | 41887 | 26 | 967 |
| Dominion National Bank | 52165 | 26 | 421 |
| Donnelly, Catherine, estate of | 56443 | 31 | 577 |
| Donnelly et al., Garrett J., executors | 56443 | 31 | 577 |
| Doric Apartment Co | 44655 | 32 | 1187 |
| Douglas Co., John | 38726 | 23 | 1307 |
| Drake, Francis E | 46804 | 30 | 475 |
| Drexel Packing Co | 20775 | 24 | 376 |
| Duff, Robert C.[4] | 37552 | 23 | 1342 |
| Duncan, T. P | 65921 | 31 | 212 |
| Duncan, Mrs. T. P | 65924 | 31 | 212 |
| Dunham, Walter E | 66308 | 27 | 1068 |
| Dunne, Finley Peter | 54444 | 29 | 1109 |
| du Pont, Pierre S.[5] | 26996 | 18 | 1028 |
| F. | | | |
| Eagle Pass & Piedras Negras Bridge Co | 42460 | 23 | 1337 |
| Easterwood, Jr., W. E | 40181<br>63416 | 28 | 1283 |
| Easterwood, Jr., Mrs. W. E | 40182<br>63417 | 28 | 1283 |
| Eisendrath, Edwin W | 36726 | 28 | 744 |
| Eisendrath et al., Edwin W., executors | 36724 | 28 | 744 |
| Eisendrath, Marion | 36727 | 28 | 744 |
| Eisendrath et al., Rose L., trustees | 36728 | 28 | 744 |
| Eisendrath, William B | 36725 | 28 | 744 |
| Eisendrath, William N., estate of | 36724 | 28 | 744 |

[1] Acquiescence relates to deductibility of losses sustained by petitioners upon alleged sales of stock to each other during the tax year.
[2] Estate tax decision.
[3] Acquiescence relates to issue involving deduction of operating expenses of aeroplane and depreciation thereon; and whether amounts expended for costumes, make-up, and wigs are deductible as ordinary and necessary expenses.
[4] Acquiescence relates to issue 1 of decision.
[5] Nonacquiescence published in Cumulative Bulletin IX-2 revoked.

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| Eldridge, A. S.[1] | 64778 | 30 | 1321 |
| Elgin Compress Co | 49302 | 31 | 273 |
| Elliott-Granite Linen Corporation | 48212 | 26 | 936 |
| Elmore Milling Co | 46768<br>52972 | 27 | 84 |
| Enameled Metals Co | 19011 | 25 | 186 |
| Ennis Ice Co | 22021<br>22022<br>26259<br>42184 | 24 | 40 |
| Erb et al., Ray L., executors [2] | 29260 | 29 | 1350 |
| Evans, A. T | 64397 | 30 | 746 |
| Evans et al., Anson, trustees | 62664 | 29 | 710 |
| Evans Products Co | 43044 | 29 | 992 |
| Evergreen Cemetery Association | 30726 | 25 | 544 |
| F. | | | |
| Falck, Alexander D | 20452 | 26 | 1359 |
| Falls City Ice & Beverage Co | 67636 | 27 | 1346 |
| Fame Canning Co | 20774 | 24 | 376 |
| Farmers Educational and Cooperative State Union of Nebraska | 10596<br>18105<br>27194<br>31748 | 30 | 1051 |
| Farmers Life Insurance Co.[3] | 43317 | 27 | 423 |
| Farmers' Loan & Trust Co., trustee | 29465 | 26 | 1359 |
| Farmers Union State Exchange | 18105 | 30 | 1051 |
| Fawsett, Charles F | 64474 | 31 | 139 |
| Federal Street & Pleasant Valley Passenger Ry. Co | 29758 | 24 | 262 |
| Fidelity Savings & Loan Association | 14862<br>31801<br>39406<br>45215 | 23 | 1059 |
| Fidelity Union Trust Co., executor | 69193 | 33 | 304 |
| Fifth Avenue Bank of New York, executor [4] | 69166 | 32 | 208 |
| First Citizens Bank & Trust Co | 71599 | 32 | 335 |
| First National Bank of Boston, administrator | 36438<br>46583 | 25 | 252 |
| First National Bank of Key West | 45186 | 26 | 370 |
| First National Bank in Mobile | 63732 | 30 | 632 |
| Fisher, Charles D., estate of | 68338 | 32 | 82 |
| Fitch, Florence H | 51670 | 29 | 1299 |
| Florence Manufacturing Co | 15383<br>26079 | 25 | 676 |
| Folk, H. B | 28396<br>31018 | 25 | 599 |
| Fordyce et al., William C., trustees | 58647 | 30 | 988 |
| Forest Products Chemical Co | 46621 | 27 | 638 |
| Forres, Lord | 40229<br>43973 | 25 | 154 |
| Forrester, W. A | 73591 | 32 | 745 |
| Foster, L. B.[5] | 43086 | 26 | 1328 |
| Foster, N. C., estate of [4] | 32984 | 25 | 414 |

[1] Acquiescence relates to issue whether dividends declared in 1929 constituted income to the petitioners in 1929 or 1930.
[2] Acquiescence relates to market value of oil and gas leases on March 1, 1913.
[3] Acquiescence relates to issue in connection with option payment received for purchase of land.
[4] Estate tax decision.
[5] Acquiescence relates to issue regarding filing of separate return for 1925.

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| Foster et al., Willard, executor [1] | 32984 | 25 | 414 |
| Fox, Fontaine [2] | 71084 | 30 | 451 |
| Francke, Charles F | 56438 | 32 | 613 |
| Frank, Emil | 50224 | 27 | 1158 |
| Franklin Telegraph Co | 29695 | 26 | 914 |
| Franklin Title & Trust Co.[3] | 51947<br>60167<br>67805 | 32 | 266 |
| Frischkorn Development Co | 30496<br>35170<br>42452 | 30 | 8 |
| Fuhlage, Alfred E.[4] | 61754 | 32 | 222 |
| **G.** | | | |
| Gambill, A. A | 47902 | 26 | 995 |
| Gamble, Cecil H., executor [1] | 60840 | 33 | 94 |
| Gamble, James N., estate of | 55595 | 32 | 892 |
| Gamble, Mary H., estate of [1] | 60840 | 33 | 94 |
| Gamble & Stockton Co.[5] | 42707 | 26 | 794 |
| Gardner, Charles E.[6] | 38575 | 25 | 1351 |
| Garron et al., Isabel K. J., executors [1] | 47705 | 26 | 292 |
| Gaston, William A | 52163<br>62309 | 34 | 57 |
| Gay, D. J | 58787 | 31 | 580 |
| Gay, E. C | 58788 | 31 | 580 |
| General Outdoor Advertising Co., Inc.[7] | 66511 | 32 | 1011 |
| George, Jerome R | 45240 | 27 | 765 |
| George Machinery Co., R. B | 61218 | 26 | 594 |
| Gibbs, G. Wildy | 31329 | 28 | 18 |
| Gillette Rubber Co | 43052<br>50073 | 31 | 483 |
| Ginsberg, Albert A | 27628 | 24 | 18 |
| Ginsberg, Nathan A | 27629 | 24 | 18 |
| Given, T. H., estate of | 54556 | 29 | 1161 |
| Glancy, Inc., A. R | 62062 | 31 | 236 |
| Globe Construction Co | 43438<br>51694<br>53310 | 25 | 146 |
| Gold & Stock Telegraph Co | 29470 | 26 | 914 |
| Golden, Edward A | 27625 | 24 | 18 |
| Goldman, Maxwell | 30302 | 24 | 915 |
| Goldsmith, Max | 59722 | 29 | 804 |
| Gordon, Alfred W | 57483 | 29 | 275 |
| Gordon, Kizzie [8] | 22332 | 27 | 377 |
| Gordon, Max L.[8] | 22333 | 27 | 377 |
| Gore Bros., Inc | 39538 | 30 | 1290 |
| Gottlieb Realty Co | 42528 | 28 | 418 |
| Graeper, W. A | 46619 | 27 | 632 |
| Grand River Gravel Co | 23085 | 22 | 1124 |

[1] Estate tax decision.
[2] Acquiescence relates to deduction for depreciation on premises; and inclusion in year 1930 in petitioner Fox's income, $7,400 representing rental value of premises occupied by him.
[3] Acquiescence relates to issue involving deduction of commissions paid on sale of mortage notes.
[4] Acquiescence relates to issue whether taxpayer is entitled to the statutory personal exemption as the head of a family.
[5] Acquiescence relates to inclusion in consolidated invested capital of capital stock issued for a tile and brick manufacturing plant, etc.
[6] Acquiescence relates to issues regarding allocation of total cost between common and preferred stocks purchased.
[7] Acquiescence relates to issue whether petitioner realized gain on transfer of certain of its assets to Central Outdoor Advertising Co. for stock of that company.
[8] Acquiescence relates to that part of decision holding that Walter E. Hettman is not liable as a transferee; and to limitation issue.

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| Great Southern Life Insurance Co.[1] | 56540, 64064, 71114 | 33 | 512 |
| Green, Robert D.[2] | 53647 | 24 | 719 |
| Green, W. S | 43786, 46373, 63487 | 26 | 1017 |
| Grey Bull Corporation | 47376 | 27 | 853 |
| Griffis, Stanton[3] | 38577 | 25 | 1351 |
| Griffiths, Eva Lavino | 63354 | 30 | 852 |
| Griffiths, George W | 42498 | 25 | 1292 |
| Griffiths, John | 43074 | 25 | 1292 |
| Griswold Co | 68628 | 33 | 537 |
| Guaranty Building & Loan Co | 55352 | 27 | 754 |
| Gudeon, Walter T | 54739, 60229 | 32 | 100 |
| Gulf Coast Irrigation Co.[4] | 33694, 40081, 41343 | 24 | 958 |
| Gullett, C. E | 52517 | 31 | 1067 |
| Gullett, W. J | 52518 | 31 | 1067 |
| Gummey, Frank B.[5] | 61056 | 26 | 894 |
| Gurnee, Augustus Coe, estate of[6] | 42619 | 24 | 461 |
| H. | | | |
| Haberland, Paul | 29289 | 25 | 1370 |
| Hafner, Alfred | 48389, 57132 | 31 | 338 |
| Hailey-Ola Coal Co | 30962 | 24 | 895 |
| Halladay, Sarah P | 26754 | 25 | 513 |
| Hamburg, Jr., Sam | 30304 | 24 | 915 |
| Handly, Franklin Miller | 66810, 67671, 74406 | 30 | 1271 |
| Hanna, R. J., estate of | 62718 | 31 | 1126 |
| Hanna, Virginia W., executrix | 62718 | 31 | 1126 |
| Hanscom, Edward E., estate of[7] | 44992 | 24 | 173 |
| Hanscom et al., Melville, executors[7] | 44992 | 24 | 173 |
| Harbeson Lumber Co., W. B | 33076, 51012 | 24 | 542 |
| Harkness, Edward S | 65169, 71310 | 31 | 1100 |
| Harkness, Mary S | 71311 | 31 | 1100 |
| Harnischfeger, Henry, estate of[7] | 69636 | 31 | 224 |
| Harnischfeger et al., Marie [illegible]., executors[7] | 69636 | 31 | 224 |
| Harper, H. T | 62784 | 31 | 1126 |
| Harrah, Marie E | 25269 | 27 | 1305 |
| Harrah, William F | 21643 | 27 | 1305 |
| Harrison, Inc., J. M | 50594 | 30 | 455 |
| Hartford-Empire Co | 29958, 41736, 53600 | 26 | 134 |

[1] Acquiescence in issue involving deductibility of interest paid on matured coupons surrendered.
[2] Acquiescence relates to transactions 1, 2, 3, and 4.
[3] Aquiescence relates to issues regarding allocation of total cost between common and preferred stocks purchased.
[4] Acquiescence relates to all issues except affiliation issue.
[5] Nonacquiescence published in Cumulative Bulletin XII-1, withdrawn.
[6] Estate tax decision; nonacquiescence published in Cumulative Bulletin X-2, revoked.
[7] Estate tax decision.

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| Hastings, Clive, estate of | 63789 | 29 | 163 |
| Hastings, E. E | 63790 | 29 | 163 |
| Hastings, Frederick A | 38864 | 27 | 1305 |
| Hatfield J. T | 72788 | 32 | 1 |
| Havard, Charles | 32841 | 25 | 1161 |
| Hawk, Henry C., estate of | 60690 | 29 | 1061 |
| Hawk, Ida W., executrix | 60690 | 29 | 1061 |
| Hay, W. H | 37499 | 25 | 96 |
| Hayman Co , B | 16552 | 25 | 736 |
| Hazelwood, N. H | 61334 | 29 | 595 |
| Helck, Edwin J | 56161 | 32 | 613 |
| Hemphill, Clifford [1] | 38573 | 25 | 1351 |
| Henke Trust, Mrs. Catherine | 63321 | 33 | 73 |
| Henke, Henry, estate of | 63321 | 33 | 73 |
| Henningsen, Walter F | 56668<br>62845 | 30 | 301 |
| Herff & Dittmar Land Co | 60729<br>68821 | 32 | 349 |
| Hervey, W. R | 46806 | 25 | 1282 |
| Hess, Nathaniel J | 33279 | 24 | 475 |
| Hettman, Walter E.[2] | 22341 | 27 | 377 |
| Hewitt, Ers ine | 57032<br>63141 | 30 | 962 |
| Hickman, Fannie Snyder | 16253 | 24 | 438 |
| Hillman, F. D., estate of | 62676 | 31 | 1126 |
| Hillman et al., Judson McClintock, administrators | 62676 | 31 | 1126 |
| Himelhoch Bros. & Co | 41728<br>42769<br>45663 | 26 | 541 |
| Hires Co., Charles E | 47781 | 26 | 1351 |
| Hobbs, Henry | 27352 | 26 | 241 |
| Hobbs, Teck | 27351 | 26 | 241 |
| Hoffer, Anita Owens | 33374 | 24 | 22 |
| Hoffer, T. B | 33375 | 24 | 22 |
| Holliday, John H | 64127 | 29 | 1272 |
| Hollingsworth, A. E | 54282 | 27 | 621 |
| Hollister, George Buell | 29461 | 26 | 1359 |
| Holly Development Co | 42771<br>52661 | 33 | 774 |
| Holmby Corporation | 51303 | 28 | 1091 |
| Holmes, George W | 53797 | 29 | 605 |
| Houghton, Alanson B | 29445 | 26 | 1359 |
| Houghton, Jr., Amory, estate of | 29444 | 26 | 1359 |
| Houghton, Arthur A | 29446 | 26 | 1359 |
| Houghton, Charles F., estate of | 29465 | 26 | 1359 |
| Houston Bros.[3] | 12052 | 22 | 51 |
| Houston, George T.[3] | 13104<br>22008 | 22 | 51 |
| Houston, Horace K.[3] | 22009 | 22 | 51 |
| Houston Land & Trust Co., trustee | 63321 | 33 | 73 |
| Houston, Philip D.[3] | 22007 | 22 | 51 |
| Howard et al., John K | 52163<br>62309 | 34 | 57 |
| Hubbard, Edward, estate of | 63878<br>67569 | 30 | 619 |

[1] Acquiescence relates to issues regarding allocation of total cost between common and preferred stocks purchased.
[2] Acquiescence relates to that part of decision holding that Walter E. Hettman is not liable as a transferee; and to limitation issue.
[3] Acquiescence relates only to deduction for business expenses in 1920 and to number of feet of timber cut during 1919.

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| Hubbard, Mildred M., formerly executrix | 63878 | 30 | 619 |
| Hubbard, Mildred M., transferee | 67569 | 30 | 619 |
| Hughes, E. A | 67335 | 32 | 1248 |
| Hunter, C. W., executor | 45417 | 26 | 417 |
| Hunter, George H., estate of | 45417 | 26 | 417 |
| Hunter, Jr., Thomas A.[1] | 58490 | 33 | 941 |
| Huntington, Henry E., estate of [2] | 45429 | 28 | 289 |
| Huntting, Henry R | 75304 | 32 | 495 |
| Hurlbut, E. M | 71788 | 33 | 868 |
| Hurt et al., Mrs. A. B., executors | 28099 | 30 | 653 |
| Hurt, Joel, estate of | 28099 | 30 | 653 |
| Huyler's, Inc | 28369<br>29154<br>39841 | 24 | 425 |
| **I.** | | | |
| Illinois Central R. R. Co | 62023<br>62991 | 30<br>34 | 1107<br>1 |
| Illinois Power & Light Corporation | 56299<br>59687 | 33 | 1189 |
| Independent Ice & Coal Co | 67639 | 27 | 1346 |
| Indiana Lamp Corporation | 52761 | 28 | 491 |
| Ingalls, Charles C., estate of [3] | 57835 | 25 | 773 |
| Insull, Margaret A | 68002<br>68504 | 32 | 47<br>1070 |
| Insull, Samuel | 68003<br>68503 | 32 | 47<br>1070 |
| Insull, Jr., Samuel | 68001<br>68505 | 32 | 47<br>1070 |
| International Ocean Telegraph Co | 29585 | 26 | 914 |
| Interstate Realty Co | 46272<br>50981 | 25 | 728 |
| Iten Biscuit Co | 16429<br>20899 | 25 | 880 |
| Iverson, I. C | 48838 | 29 | 863 |
| Iverson, Ruphane B | 48837 | 29 | 863 |
| **J.** | | | |
| James, William L | 70278 | 30 | 491 |
| Johnson, Florence D., estate of | 75969 | 33 | 1003 |
| Jones, Chester Addison [4] | 50206 | 31 | 55 |
| Jones, R. D | 69858 | 29 | 928 |
| **K.** | | | |
| Hammerdiner, J | 41643<br>46555 | 25 | 495 |
| Kansas City Leasehold & Improvement Co.[5] | 35718 | 17 | 213 |
| Kansas City & Memphis Farms Co | 51060 | 25 | 1166 |

[1] Acquiescence in issue as to whether petitioner received a taxable distribution from Marshall Field & Co. on January 5, 1927, in the amount of $1,118.51.

[2] Acquiescence relates to issue regarding loss from operation of a farm in 1925 and 1926 and issue regarding increasing deficiency for 1925 by amount of interest accrued on bonds exchanged for art objects.

[3] Estate tax decision.

[4] Acquiescence as to issue whether petitioner should be allowed to file his return on community property basis.

[5] Acquiescence relates to March 1, 1913, value for purposes of calculating gain or loss upon sale of land at Versailles, Mo.; whether the invested capital of the Simcoe Realty Co. should be increased for 1918; and the March 1, 1913, value for amortization purposes of a leasehold belonging to Kansas City Leasehold & Improvement Co.

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| Kansas City Southern Railway Co. and affiliated companies [1] | 22668, 35527, 35528, 35529, 35530, 35531 | 22 | 929 |
| Kasch, Ed | 48293 | 25 | 284 |
| Kasch, Theodora | 48293 | 25 | 284 |
| Kell, Frank | 69677 | 31 | 212 |
| Kell, Mrs. Frank | 69678 | 31 | 212 |
| Kell, Joe A | 69681 | 31 | 212 |
| Kell, Willie May | 69685 | 31 | 212 |
| Kelley, John P | 38233 | 26 | 212 |
| Kent, Everett E | 39576, 42589, 46064 | 26 | 482 |
| Kessler, J. M | 52640 | 31 | 849 |
| Kibele, O. B.[2] | 24882 | 27 | 377 |
| King, Henrietta M., estate of | 52632 | 31 | 95 |
| Kingsbury, K. R | 56382 | 31 | 1126 |
| Kinney Co., Inc., G. R | 31397, 32980 | 26 | 1091 |
| Kirchner, Julius C | 25428 | 27 | 1305 |
| Kleberg et al., Robert J., executors | 52632 | 31 | 95 |
| Knight, E. D | 56865 | 28 | 188 |
| Kraemer, Samuel | 37822 | 25 | 686 |
| Kuhn, Ida L | 32609, 40267 | 24 | 216 |
| Kunau et al., Oscar F. C., trustees | 64815 | 27 | 509 |
| L. | | | |
| Lake Charles Naval Stores | 34630, 36940 | 25 | 173 |
| Landers, Douglas J., estate of [3] | 35443 | 21 | 1347 |
| Lang et al., Florence O. R., executors [3] | 71117 | 32 | 527 |
| Lang, Henry, estate of [3] | 71117 | 32 | 527 |
| Langworthy, Marjorie C.[4] | 71961 | 30 | 1216 |
| Lawrence, Gladys G | 75494 | 33 | 868 |
| Lawson, John | 40232 | 25 | 154 |
| Leamington Hotel Co | 48413 | 26 | 1004 |
| Leidesdorf, Samuel D | 48305 | 26 | 881 |
| Leonard Holding Corporation, George B., estate of | 48871 | 26 | 46 |
| Letts, Jr., Arthur | 62106 | 30 | 800 |
| Lewis, Sr., A. S | 56163 | 32 | 613 |
| Ley, George W.[5] | 22336 | 27 | 377 |
| Ley, Mary C.[5] | 22337 | 27 | 377 |
| Liberty Farms Co | 26717, 29899 | 22 | 1298 |
| Liberty Hosiery Mills | 66546 | 31 | 64 |
| Lido Building Co., Inc | 53385 | 31 | 461 |

[1] Acquiescence relates to the following issues: Deduction of contributions to Y. M. C. A., Priests of Palace, and Association of Railway Executives; and amortization of commissions and expenses incurred in sale of bonds.
[2] Acquiescence relates to that part of decision holding that Walter E. Hettman is not liable as a transferee; and to limitation issue.
[3] Estate tax decision.
[4] Acquiescence relates to reorganization issue.
[5] Acquiescence relates to that part of decision holding that Walter E. Hettman is not liable as a transferee; and to limitation issue.

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| Lincoln, Robert Todd, estate of [1] | 39167 | 24 | 334 |
| Lippincott et al., J. Bertram, executors [1] | 49233 | 27 | 735 |
| Lippincott, Walter, estate of [1] | 49233 | 27 | 735 |
| Littauer, Eugene, estate of [2] | 51858 | 25 | 21 |
| Littauer et al., Lucius N., executors [2] | 51858 | 25 | 21 |
| Little, C. B | 61821 | 27 | 1022 |
| Lloyd, S. Rose | 75765 | 32 | 887 |
| Lloyd, Walter [3] | 44089 | 30 | 331 |
| Loeb, Jr., et al., William, trustees | 34161 | 26 | 635 |
| Logel, Joseph F | 37762<br>40071 | 24 | 798 |
| Longyear, Jr., John M | 47117<br>56027<br>62410 | 28 | 1085 |
| Longyear, Mary B., estate of | 36438<br>46583 | 25 | 252 |
| Loughborough Development Corporation | 51064 | 29 | 95 |
| Lourie, David A | 27630 | 24 | 18 |
| Luhrig Collieries Co | 40048 | 26 | 194 |
| M. | | | |
| MacCallum Gauge Co | 70437 | 32 | 544 |
| Malta Temple Association [4] | 29476 | 16 | 408 |
| Manhattan Life Insurance Co | 32940 | 32 | 492 |
| Manistique & Lake Superior R. R. Co | 35337 | 29 | 331 |
| Markham Irrigation Co.[5] | 41344 | 24 | 958 |
| Marston, Edgar L | 61961 | 29 | 976 |
| Martin Hotel Co. and affiliated corporations | 16275 | 24 | 899 |
| Martin et al., J. Earle, trustees | 44583 | 24 | 862 |
| Martin, T. S., estate of | 44583 | 24 | 862 |
| Martins, Andy [6] | 22334 | 27 | 377 |
| Marvin, Walter S.[7] | 38578 | 25 | 351 |
| Masoni, Paul | 58413 | 33 | 843 |
| Matagarda Canal Co.[5] | 40082<br>41345 | 24 | 958 |
| Matchette, Franklin J | 40710 | 26 | 909 |
| Matthews, J. P | 26250 | 22 | 858 |
| Mauldin, I. M | 26239 | 22 | 858 |
| McAuliffe, Agnes A | 49071 | 29 | 624 |
| McCall, Florence [1] | 47702 | 26 | 292 |
| McCarter, Uzal H | 69193 | 33 | 304 |
| McConnell, Stella H | 43478 | 29 | 32 |
| McCool, Bess | 46059 | 24 | 506 |
| McDonald, L. G | 25427 | 27 | 1305 |
| McEwan, Anna B | 25996 | 26 | 727 |
| McEwan et al., Anna B., executors | 25997 | 26 | 727 |
| McEwan, A. F | 25995 | 26 | 727 |
| McEwan, Lillian G | 25994 | 26 | 727 |
| McEwan, W. H., estate of | 25997 | 26 | 727 |
| McGrew, Elizabeth W | 26753 | 25 | 513 |

[1] Estate tax decision.
[2] Estate tax decision; acquiescence relates to issues 4, 5, and 7 of decision.
[3] Acquiescence relates to question whether the value of rights to subscribe to certain bonds constitutes income.
[4] Nonacquiescence published in Cumulative Bulletin VIII-2 withdrawn.
[5] Acquiescence relates to all issues except affiliation issue.
[6] Acquiescence relates to that part of decision holding that Walter E. Hettman is not liable as a transferee; and to limitation issue.
[7] Acquiescence relates to issues regarding allocation of total cost between common and preferred stocks purchased.

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| McLaughlin, Thomas J | 59788 | 29 | 247 |
| McLennan, A. R | 26730 | 25 | 1052 |
| McMillan, William Northrup, estate of [1] | 45966 | 27 | 318 |
| McRae, Louise C., executrix [2] | 32303 | 30 | 1087 |
| McRae, Philip, estate of [2] | 32303 | 30 | 1087 |
| Mead Coal Co., C. H | 42718<br>42719<br>54660 | 28 | 599 |
| Memphis Memorial Park | 49259<br>53458 | 28 | 1037 |
| Mente & Co., Inc | 51305 | 29 | 804 |
| Mente, Eugene W | 54701 | 29 | 804 |
| Mente, J. G | 54708 | 29 | 804 |
| Mercantile-Commerce National Bank in St. Louis et al., executors and trustees [2] | 35443 | 21 | 1347 |
| Mercantile Trust Co. of Baltimore et al | 68338 | 32 | 82 |
| Merrill, Isaac L | 61722 | 31 | 530 |
| Messer, Richard B., estate of [2] | 42513 | 27 | 556 |
| Metropolitan Properties Corporation | 45032 | 24 | 220 |
| Michigan Central R. R. Co.[3] | 19930 | 28 | 437 |
| Michigan Trust Co. et al., executors [2] | 42513 | 27 | 556 |
| Milby & Dow Coal & Mining Co | 22021<br>22022<br>26259<br>42184 | 24 | 40 |
| Milgrim & Bros., Inc., H.[4] | 33177 | 24 | 853 |
| Milliken, Sallie Gibbs | 31330 | 28 | 18 |
| Minneapolis, St. Paul & Sault Ste. Marie Ry. Co | 74118 | 34 | 177 |
| Mississippi Packing Co., Inc | 20772 | 24 | 376 |
| Missouri State Life Insurance Co.[5] | 58241<br>62386 | 29 | 401 |
| Mitchell, L. C | 41610 | 28 | 767 |
| Mitchell, Oscar [6] | 41680<br>41874<br>54673 | 27 | 101 |
| Mobile Light & Railroad Co.[7] | 41026<br>42062 | 23 | 543 |
| Moore, Edward W., estate of [8] | 58720 | 33 | 108 |
| Moore, Louise C., executrix [8] | 58720 | 33 | 108 |
| Moorehead, William A | 25853 | 22 | 858 |
| Moorshead, O | 57045 | 28 | 253 |
| Mossman, B. Paul [2] | 59747 | 32 | 596 |
| Mossman, William E., estate of [2] | 59747 | 32 | 596 |
| Muchnic, H. E., administrator | 63789 | 29 | 163 |
| Munroe, Grace Johnson | 76942 | 32 | 995 |
| Murchison, Mrs. A. H | 62838 | 28 | 257 |

[1] Estate tax decision; acquiescence, except in so far as concerns the question of situs.
[2] Estate tax decision.
[3] Acquiescence relates to the following issues: Whether amount paid by New York Central R. R. Co. to State of Illinois in connection with issuance of bonds was a tax or fee; salvage recovered from ore docks; credit representing depreciation on property retired in 1918.
[4] Acquiescence relates to issue 1 of decision.
[5] Acquiescence does not relate to following issues: Deduction for reserve set up to meet liability upon matured coupons; adjustment of income for rental of space occupied in home office building and depreciation upon such building.
[6] Acquiescence relates to issues regarding assignment of earnings of iron mines in payment of legal services and deduction of amount paid to son for alleged services rendered.
[7] Acquiescence relates to following issues: 1. Whether payments received by a trustee on behalf of petitioner in the taxable years in accordance with a written agreement entered into by and between petitioner and another in 1906 constitute taxable payments of rent or nontaxable payments on the selling price of assets. 2. Whether petitioner sustained statutory net losses for 1924 and 1926 which can be deducted from its income for 1925 and 1926, respectively.
[8] Estate tax decision; acquiescence in holding that the commuted values of the installment policies in the first two groups should be included in the gross estate.

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| Murphy, Mae A. Kelley | 38222 | 26 | 212 |
| Murray, Edward J | 40176, 58858 | 28 | 624 |
| Murray, Rebecca J | 40174, 58857 | 28 | 624 |
| Murtha & Schmohl Co | 17911 | 17 | 442 |
| Musgrove, Floyd L | 42591 | 27 | 554 |
| Mutual Assurance Society of Virginia | 43911 | 24 | 1102 |
| N. | | | |
| Nail et al., R. F., executors | 53044 | 27 | 33 |
| National Capital Insurance Co. of the District of Columbia | 50748 | 28 | 1078 |
| National Casket Co., Inc.[1] | 50320 | 29 | 139 |
| National Contracting Co.[2] | 24520 | 25 | 407 |
| National Mill Supply Co | 37001 | 23 | 1362 |
| National Packing Corporation | 31668, 33971 | 24 | 952 |
| National Tile Co | 64013 | 30 | 32 |
| Neracher, George A | 74411 | 32 | 236 |
| Netcher, Charles, estate of | 38053 | 26 | 101 |
| Netcher, Gladys Oliver, executrix | 38053 | 26 | 101 |
| Netcher, Irving | 38052 | 26 | 101 |
| Netcher, Townsend | 38050 | 26 | 101 |
| Newaygo Portland Cement Co | 36319 | 27 | 1097 |
| Newblock Oil Co. of Texas[3] | 28045 | 26 | 696 |
| Newbury, Mollie Netcher | 38049 | 26 | 101 |
| Newbury, Mollie Netcher, trustee | 38052 | 26 | 101 |
| Newell et al., Sterling, executors[4] | 57835 | 25 | 773 |
| New England Power Co | 18593, 29105 | 25 | 195 |
| Newman et al., Rose, executors[4] | 59598 | 31 | 772 |
| Newman, Samuel, estate of[4] | 59598 | 31 | 772 |
| New Market Investment Co.[5] | 35719 | 17 | 213 |
| Newton, Elizabeth K.[4] | 47703 | 26 | 292 |
| Newton, Joseph R., estate of[4] | 47705 | 26 | 292 |
| New York Central R. R. Co.[6] | 19932, 34437, 62040 | 28 | 437 |
| New York, Chicago & St. Louis R. R. Co | 21047 | 23 | 177 |
| Niagara Share Corporation of Maryland | 70813 | 31 | 832 |
| Nibley-Mimnaugh Lumber Co | 17527 | 32 | 791 |
| Nicodemus, Jr., F. C.[7] | 52326, 62569 | 26 | 125 |
| Nippert et al., Alfred K., executors and trustees | 55595 | 32 | 892 |
| Noonan Estate Trust, F. R | 62664 | 29 | 710 |

[1] Acquiescence relates to deduction of corporation excise taxes.

[2] Acquiescence in Board's decision that petitioner had the right to allocate overhead expenses to each contract on completed basis and that formula used by petitioner was permissible; and issue relative to negligence.

[3] Nonacquiescence published in Cumulative Bulletin XI-2 revoked.

[4] Estate tax decision.

[5] Acquiescence relates to March 1, 1913, value for purposes of calculating gain or loss upon sale of land at Versailles, Mo.; whether the invested capital of the Simcoe Realty Co. should be increased for 1918; and the March 1, 1913, value for amortization purposes of a leasehold belonging to Kansas City Leasehold & Improvement Co.

[6] Acquiescence relates to the following issues: Whether amount paid by New York Central R. R. Co. to State of Illinois in connection with issuance of bonds was a tax or fee; salvage recovered from ore docks; credit representing depreciation on property retired in 1918.

[7] Nonacquiescence published in Cumulative Bulletin XI-2 withdrawn.

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| North Side Lumber & Timber Co | 34924 | 27 | 1187 |
| Northern Coal Co.[1] | 34945 | 24 | 307 |
| Noyes, Jansen[2] | 38574 | 25 | 1351 |
| O. | | | |
| Oakley, Richard H | 45778 | 24 | 1082 |
| O'Donohoe, John F | 69686 | 31 | 212 |
| O'Donohoe, Mrs. John F | 69680 | 31 | 212 |
| Olmsted, George W.[3] | 44090<br>45745<br>48121<br>54714<br>60746 | 30 | 331 |
| Olmsted, Iva C.[3] | 44089<br>45746<br>48143<br>54713<br>60745 | 30 | 331 |
| Olympia Harbor Lumber Co | 64272 | 30 | 114 |
| Ontario Realty Co.[4] | 35721 | 17 | 213 |
| O'Rear, E. C.[5] | 32335 | 28 | 698 |
| Osborne, Owen, estate of[6] | 59957 | 29 | 374 |
| P. | | | |
| Pacific & Atlantic Telegraph Co. of the United States | 29586 | 26 | 914 |
| Pacific Coast Biscuit Co. et al.[7] | 71588 | 32 | 39 |
| Package Machinery Co | 54334 | 28 | 980 |
| Paine et al., Francis Ward, executors | 34113 | 25 | 764 |
| Paine, William A., estate of | 34113 | 25 | 764 |
| Palm Beach Mather Co | 43850 | 24 | 536 |
| Palmer, Bradley W.[8] | 62652 | 32 | 550 |
| Parke, Davis & Co | 62717 | 31 | 427 |
| Parker, Clara B., executrix[9] | 58604 | 31 | 644 |
| Parker, George D., estate of[9] | 58604 | 31 | 644 |
| Parkland Ice & Coal Storage Co | 67640 | 27 | 1346 |
| Parriott, F. B.[10] | 30989 | 28 | 917 |
| Patterson, Elizabeth P | 76058 | 33 | 57 |
| Peavy-Byrnes Lumber Co | 15824<br>16354<br>25984 | 25 | 223 |

[1] Acquiescence relates to inventory issue.

[2] Acquiescence relates to issues regarding allocation of total cost between common and preferred stocks purchased.

[3] Acquiescence relates to question whether the value of rights to subscribe to certain bonds constitutes income.

[4] Acquiescence relates to March 1, 1913, value for purposes of calculating gain or loss upon sales of land at Versailles, Mo.; whether the invested capital of the Simcoe Realty Co. should be increased for 1918; and the March 1, 1913, value for amortization purposes of a leasehold belonging to Kansas City Leasehold & Improvement Co.

[5] Acquiescence relates to issue as to allowable deduction of cost of operating automobile partly used in taxpayer's business in 1924.

[6] Nonacquiescence published in Cumulative Bulletin XIII-1 withdrawn.

[7] Acquiescence with respect to deduction of expense incident to amendment of petitioner's charter.

[8] Acquiescence relates to issue whether stock rights were capital assets where the stock in respect of which they were issued had been held for more than two years prior to sale of the rights.

[9] Acquiescence relates to all questions wherein decision was not wholly in favor of Commissioner expect decision regarding existence of partnership of George D. Parker Co.

[10] Acquiescence relates to right of overriding royalty owners to benefit of section 211(b), Revenue Act of 1918.

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| Peavy-Moore Lumber Co | 15823<br>16355<br>25986 | 25 | 223 |
| Peavy-Wilson Lumber Co | 15822<br>16356<br>25985 | 25 | 223 |
| Peck, Clara S., estate of | 61520<br>61521 | 31 | 87 |
| Peck et al., Fremont C., executors | 61520<br>61521 | 31 | 87 |
| Pegg, Albert O.[1] | 22338 | 27 | 377 |
| Penn Mutual Life Insurance Co | 52577<br>59670 | 32 | 839<br>876 |
| Pennsylvania Indemnity Co | 71992 | 30 | 413 |
| Pennsylvania Investors Co | 20766 | 24 | 376 |
| Peoples Life Insurance Co.[2] | 66969<br>71744 | 31 | 706 |
| Perata, John M | 57923 | 33 | 843 |
| Perkins et al., Jacob | 28701 | 25 | 1123 |
| Perkins et al., Thomas N.[3] | 57848<br>58305<br>58306<br>58443<br>58475<br>58770<br>58772<br>58904<br>58905<br>58906<br>58907<br>58917<br>58918<br>58925 | 33 | 606 |
| Perry, Howard E | 69855 | 33 | 394 |
| Perry, Raymond A., estate of | 63645 | 32 | 442 |
| Pershouse, Alice E | 26749 | 25 | 513 |
| Pershouse, Mabel B | 26748 | 25 | 513 |
| Peters, Andrew J.[4] | 54050 | 28 | 976 |
| Phillips, C. J | 47901 | 26 | 995 |
| Phoenix Insurance Co | 48867 | 29 | 291 |
| Pictorial Review Co | 43995 | 26 | 472 |
| Piggly Wiggly Corporation | 25126<br>43860 | 28 | 412 |
| Pitkin, George P | 65173 | 31 | 403 |
| Pittsburgh Athletic Co.[4] | 60569<br>66964<br>67422 | 27 | 1074 |
| Pittsburgh Melting Co | 44858 | 30 | 636 |
| Pittsburgh & West Virginia Ry. Co | 72157<br>72158 | 32 | 66 |
| Pizitz Dry Goods Co., Louis | 46585 | 22 | 161 |

[1] Acquiescence relates to that part of decision holding that Walter E. Hettman is not liable as a transferee; and to limitation issue.
[2] Acquiescence relates only to treatment of rental value.
[3] Acquiescence relates to the following issues:
Is any part of the deficiency as to Eastern Carbon Black Co., Thompson Oil Co., G. H. M. Co., and Davis Bros. Co. due to fraud with intent to evade tax?
Did the shares of Interstate Gas Co. stock received by G. H. M. Co. as a dividend from Eastern Carbon Black Co. constitute in part a liquidating dividend?
[4] Nonacquiescence published in Cumulative Bulletin XII-2 revoked.

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| P-M-K Petroleum Co.[1] | 50576<br>54779 | 24 | 360 |
| Polar Ice & Coal Co | 67638 | 27 | 1346 |
| Pope, Olive R | 29274 | 25 | 1161 |
| Powell, Benjamin I | 50380 | 26 | 509 |
| Powel, T. I. Hare [2] | 64464 | 27 | 55 |
| Prairie Oil & Gas Co | 57117 | 29 | 113 |
| Price, Laura M | 40659 | 24 | 216 |
| Price, W. E | 41072 | 24 | 216 |
| Prophylactic Brush Co | 32996<br>47845<br>47846 | 25 | 676 |
| Prosperity Co., Inc.[3] | 45896<br>59468 | 27 | 28 |
| Prosser, Constance B | 26752 | 25 | 513 |
| Provident Trust Co. of Philadelphia, executor[4] | 59957 | 29 | 374 |
| Putnam Trust Co | 34743 | 26 | 655 |
| Putty, Mrs. Malcolm | 69683 | 31 | 212 |
| Q. | | | |
| Quinn, Evan V | 8544 | 26 | 970 |
| Quinn, Martin M | 8598 | 26 | 970 |
| Quinn, Paul H | 8574 | 26 | 970 |
| R. | | | |
| Ramish, Adolph | 39568 | 30 | 1290 |
| Ramish, Inc., Adolph | 39569 | 30 | 1290 |
| Randall, Marjorie G.[5] | 38971 | 27 | 475 |
| Rapp, John W., estate of | 28618 | 24 | 1061 |
| Rauh Realty Co | 32822 | 26 | 48 |
| Ray Oil Co.[6] | 34332 | 28 | 1204 |
| Reardon & Sons Co., John | 20773 | 24 | 376 |
| Record Petroleum Co | 50962 | 32 | 1270 |
| Reese, Augusta Bliss | 62424 | 29 | 565 |
| Remco Steamship Co | 57728 | 30 | 579 |
| Reynard Corporation [7] | 67386<br>70795 | 30 | 451 |
| Reynolds Cattle Co | 68445<br>71463 | 31 | 206 |
| Rhea, Isaac T | 54960 | 29 | 804 |
| Rhea, Mrs. Isaac T | 54959 | 29 | 804 |
| Rhodes, Herman M | 54899 | 34 | 212 |
| Rialto Mining Corporation | 48692<br>56877 | 25 | 980 |
| Richards & Hirschfeld, Inc | 21715 | 24 | 1280 |
| Richardson, Amy S., executrix [8] | 64023 | 31 | 245 |
| Richardson, Charles W., estate of [8] | 64023 | 31 | 245 |
| Richmond, Fredericksburg & Potomac R. R. Co.[9] | 68876 | 33 | 895 |
| Riggs National Bank [10] | 30903 | 17 | 615 |

[1] Acquiescence relates to third issue of decision.
[2] Nonacquiescence published in Cumulative Bulletin XII-1 withdrawn.
[3] Acquiescence relates to deduction of loss resulting from liquidation of one of its subsidiaries.
[4] Nonacquiescence published in Cumulative Bulletin XIII-1 withdrawn.
[5] Acquiescence in that part of decision relating to deductibility of loss sustained in 1924 from sale of residence.
[6] Acquiescence relates to issue whether petitioner was taxable in 1923 as a trust or as an association.
[7] Acquiscence relates to deduction for depreciation on premises; and inclusion in year 1930 in petitioner Fox's income, $7,400, representing rental value of premises occupied by him.
[8] Estate tax decision.
[9] Acquiescence relates to increased deduction for loss on retirements of roadway property.
[10] Nonacquiescence published in Cumulative Bulletin X-2 withdrawn.

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| Ritter Lumber Co. et al., W. M | 42833<br>42834<br>42835<br>42836<br>43604<br>43605<br>43606<br>48749<br>57319<br>57320<br>57321<br>57322 | 30<br>33 | 231<br>117 |
| Roach Studios, Inc., Hal | 61750 | 31 | 828 |
| Robertson, Callie E | 42496 | 28 | 635 |
| Robertson, R. R | 42497 | 28 | 635 |
| Robison, Lester L | 53878 | 33 | 1107 |
| Robson, Clara P., estate of | 26645 | 25 | 949 |
| Rodeo-Vallejo Ferry Co.[1] | 36411<br>48528 | 24 | 936 |
| Rogers, Brown & Crocker Bros., Inc | 67581 | 32 | 207 |
| Rolandelli, Guiliano [2] | 57479<br>67286 | 33 | 843 |
| Rosenberg, Louis | 27626 | 24 | 18 |
| Rosenbloom Finance Corporation [3] | 35778<br>40903 | 24 | 763 |
| Rossheim, Irving D.[4] | 57503 | 31 | 857 |
| Roth, Gorton | 22568 | 26 | 631 |
| Roy & Titcomb, Inc | 29138 | 24 | 969 |
| Ruiz, M | 67097 | 30 | 746 |
| Russell, C. C | 46060 | 24 | 506 |
| Russell, Mrs. C. C | 46061 | 24 | 506 |
| S. | | | |
| St. Johns Investment Co | 50613 | 30 | 973 |
| St. Louis Union Trust Co. et al., cotrustees | 65675 | 30 | 370 |
| St. Louis Union Trust Co., executor [5] | 45966 | 27 | 318 |
| Sanders, W. C | 26651 | 25 | 949 |
| San Marcos Compress Co | 49304 | 31 | 273 |
| San Martinez Oil Co | 37447<br>43121 | 25 | 218 |
| Sappington, G. Ridgely | 51944 | 25 | 1385 |
| Savings Feature of the Relief Department of the Baltimore & Ohio R. R. Co | 59486<br>61156 | 32 | 295 |
| Scatena, Elvira [6] | 63920 | 32 | 675 |
| Schepp Co., L | 42908 | 25 | 419 |
| Schermerhorn, Harriet Pullman | 43145 | 26 | 1031 |
| Schumacher, J. P | 59612 | 32 | 1242 |
| Scovill Manufacturing Co | 29854<br>30238 | 25 | 265 |
| Scruggs, Gross R | 33610 | 24 | 1174 |
| Scruggs Investment Co | 46270 | 24 | 1174 |

[1] Acquiescence relates to deduction of contribution to Victory Highway Association.

[2] Acquiescence relates to reduction of profit of members of syndicate by the 2½ per cent commission due syndicate manager; and whether portion of the syndicate income consisting of dividends should be taxed to the individuals only at surtax rates.

[3] Acquiescence relates to holding of Board that distributions received from Joseph H. Finch & Co. were not partial liquidating dividends.

[4] Acquiescence relates to issue whether petitioner realized additional compensation on sale of stock of Warner Bros. Pictures, Inc., in 1928.

[5] Estate tax decision; acquiescence, except in so far as concerns the question of situs.

[6] Acquiescence relates to issue involving inclusion of fair market value of rights to buy bonds in petitioner's income.

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| Seaconnet Coal Co.[1] | 18089 | 24 | 307 |
| Searles Real Estate Trust | 24489 | 25 | 1115 |
| Second National Bank of Philadelphia | 76825 | 33 | 750 |
| Securities Co | 40553 | 25 | 446 |
| Security First National Bank of Los Angeles et al., executors [2] | 45429 | 28 | 289 |
| Selbert, Ltd | 57059 | 29 | 319 |
| Sells Sporting Goods Co | 20771 | 24 | 376 |
| Shaffer, C. B.[3] | 29259 | 29 | 1350 |
| Shand, Gadsden | 26238 | 22 | 858 |
| Shapiro, Samuel | 65158 | 29 | 1012 |
| Shaw, David, estate of | 34499 | 24 | 1235 |
| Shea, R. P | 37835<br>40034 | 24 | 798 |
| Shepherd, Cettie G., estate of [4] | 69166 | 32 | 208 |
| Simcoe Realty Co.[5] | 35720 | 17 | 213 |
| Simmons, II, et al., Edward C., executors | 47210 | 32 | 320 |
| Simmons, Edward H | 47211 | 32 | 320 |
| Simmons, George W., estate of | 47212 | 32 | 320 |
| Simmons et al., Richard W., executors | 47212 | 32 | 320 |
| Simmons, Wallace D., estate of | 47210 | 32 | 320 |
| Simms Oil Co.[6] | 61497 | 28 | 1106 |
| Simms Petroleum Co.[6] | 61496 | 28 | 1106 |
| Sinclaire et al., Helen B., executors | 37703 | 26 | 1359 |
| Sinclaire, Henry P., estate of | 29252 | 26 | 1359 |
| Sinclaire, Jr., Henry P., estate of | 37520 | 26 | 1359 |
| Sinclaire et al., Murray, executors | 37520 | 26 | 1359 |
| Sinclaire, Reginald | 37864 | 26 | 1359 |
| Sinclaire, William, estate of | 37703 | 26 | 1359 |
| Sioux Falls Metal Culvert Co | 41070 | 26 | 1324 |
| Sipes, Jasper | 72605 | 31 | 709 |
| Sloss, Hattie Hecht [7] | 64835 | 33 | 830 |
| Smathers, E. E., estate of [3] | 29260 | 29 | 1350 |
| Smathers Power Typewriter Co | 43968 | 28 | 327 |
| Smith et al., Elizabeth D., executors | 39291<br>49668 | 25 | 291 |
| Smith, I. N., estate of | 39291<br>49668 | 25 | 291 |
| Smith, Jessie, executrix | 18876 | 24 | 807 |
| Smith, Mrs. Jessie | 22313 | 24 | 807 |
| Smith, Louis, estate of | 18876 | 24 | 807 |
| Smoot, Lewis E | 32578 | 25 | 1038 |
| Sneed, Jr., J. T | 45694 | [8] 30<br>[9] 33 | 1121<br>478 |
| South Memphis Land Co | 44500 | 27 | 897 |
| Southard, Jennie | 42592 | 27 | 554 |

[1] Acquiescence relates to inventory issue.

[2] Acquiescence relates to issue regarding loss from operation of a farm in 1925 and 1926 and issue regarding increasing deficiency for 1925 by amount of interest accrued on bonds exchanged for art objects.

[3] Acquiescence relates to market value of oil and gas leases on March 1, 1913.

[4] Estate tax decision.

[5] Acquiescence relates to March 1, 1913, value for purposes of calculating gain or loss upon sale of land at Versailles, Mo.; whether the invested capital of the Simcoe Realty Co. should be increased for 1918; and the March 1, 1913, value for amortization purposes of a leasehold belonging to Kansas City Leasehold & Improvement Co.

[6] Acquiescence relates to basis for computing depreciation on assets acquired by Simms Oil Co. in 1925 from Clayton Oil & Refining Co.

[7] Acquiescence relates to the following question: Did petitioner receive a dividend from Hecht Broadway Corporation in 1929 in the amount of $1,503?

[8] Acquiescence relates to Board's holding that bonuses should be taxed as separate or community property in accordance with the classification of the properties under the lease; and issue in connection with assessment of deficiency for 1925.

[9] Acquiescence relates to issue involving deduction for depletion from advanced royalties or bonuses.

ACQUIESCENCES—Continued.

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| Southern & Atlantic Telegraph Co | 29694 | 26 | 914 |
| Southern Railway Co. et al.[1] | 21481, 29951, 37887–37898 | 27 | 673 |
| Spangler, Georgia M | 56320 | 29 | 263 |
| Spangler, J. W | 56321 | 29 | 263 |
| Sprague-Sells Corporation | 42006, 42434 | 30 | 1165 |
| Sprague & Son Co., C. H.[2] | 34946 | 24 | 307 |
| Sprunt & Son, Inc., Alexander | 38408 | 24 | 599 |
| Standard Beef Co | 20770 | 24 | 376 |
| Standard Conveyor Co | 33159, 36393, 40873 | 25 | 281 |
| Standifer Construction Corporation, G. M | 51636 | 30 | 184 |
| Starr, Frank C | 69259 | 31 | 671 |
| Stauffen, Theodora B | 26756 | 25 | 513 |
| Stearns, Robert L | 37573 | 24 | 1013 |
| Steege, W. E | 67098 | 30 | 746 |
| Stegeman, A. V | 26643 | 25 | 949 |
| Stegeman, Jr., Albert V | 26650 | 25 | 949 |
| Stegeman, Fannie L | 26644 | 25 | 949 |
| Stegeman, H. M | 26647 | 25 | 949 |
| Stegeman, H. R | 26646 | 25 | 949 |
| Stegeman, Mabel K | 26649 | 25 | 949 |
| Stegeman, William L | 26648 | 25 | 949 |
| Stephenson, Ida | 62825 | 33 | 252 |
| Sternberg, Herman J | 55758 | 32 | 1039 |
| Stevens, John H | 29685 | 24 | 52 |
| Stevenson Consolidated Oil Co.[3] | 43416 | 23 | 610 |
| Stewart, Maco, executor | 63645 | 32 | 442 |
| Stewart, Theodore E | 70297 | 32 | 600 |
| Stock Yards Bank of Cincinnati | 41085 | 25 | 964 |
| Stockham, Elijah | 22569 | 26 | 631 |
| Stone et al., Irving K., executors and trustees[4] | 43830 | 26 | 1 |
| Stone, Irving Lee, estate of[4] | 43830 | 26 | 1 |
| Stoneman, David | 27627 | 24 | 18 |
| Storey, H. M | 62813 | 31 | 1126 |
| Straubel, F. L. G | 56867 | 29 | 516 |
| Stromeyer, Irene | 55341 | 28 | 472 |
| Stromeyer, William A | 55342 | 28 | 472 |
| Strong, Harold C.[5] | 38576 | 25 | 1351 |
| Stuart, Charles | 53796 | 29 | 605 |
| Stuart, Jr., Willoughby H | 73869 | 32 | 573 |
| Sugar Creek Coal & Mining Co | 73758 | 31 | 344 |
| Sullivan, Eugene C | 29389 | 26 | 1359 |
| Summerfield Co | 58711 | 29 | 77 |
| Sunburst Oil & Refining Co | 45979 | 23 | 829 |
| Sweinhart, James | 54784 | 29 | 1179 |

[1] Acquiescence relates to following issues: 1. Did petitioner realize taxable income from unrefunded portions of amounts deposited by shippers for construction of facilities for use of such shippers? 2. Where bonds were sold at a premium prior to March 1, 1913, is the amortized portion of such premium taxable income? 3. Did Commissioner erroneously exclude from adjustment for material and supplies an amount equivalent to inflation contained in book value of such materials and supplies as were not used during 1920?

[2] Acquiescence relates to inventory issue.

[3] Acquiescence relates to issues regarding reduction of income for fiscal year ending November 30, 1924, by loss sustained for 11 months ending November 30, 1922, and inclusion in income for all years of $1 par value of capital stock of Sunburst Oil & Gas Co. received by petitioner as a premium.

[4] Estate tax decision; acquiescence relates to issue involving deductions from gross estate.

[5] Acquiescence relates to issues regarding allocation of total cost between common and preferred stocks purchased.

ACQUIESCENCES—Continued.

| Taxpayer. | Docket No. | Board of Tax Appeals. | |
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| | | Volume. | Page. |
| **T.** | | | |
| Talbot, J. A.[1] | 36191 | 23 | 792 |
| Teague, E. B | 73034 | 32 | 641 |
| Texas Irrigation Co.[2] | 40083<br>41346 | 24 | 958 |
| Thiele, Walter | 67506 | 32 | 134 |
| Thompson, Edward W | 51103 | 28 | 657 |
| Thompson, W. L | 51104 | 28 | 657 |
| Three Rivers Security Corporation | 44857<br>44880 | 30 | 636 |
| Thrift Realty Co | 50653 | 29 | 545 |
| Tifft, Charles | 31029<br>33464<br>42340<br>45957 | 25 | 986 |
| Tifft, Lewis E | 31030<br>33465<br>42341<br>45958 | 25 | 986 |
| Times-Picayune Publishing Co | 48892<br>49539 | 27 | 277 |
| Tobey, Maurice | 27624 | 24 | 18 |
| Tolerton & Warfield Co.[3] | 45320 | 23 | 892 |
| Torrens, James H.[4] | 53778 | 31 | 787 |
| Tracy, David E., estate of | 54828<br>62982 | 30 | 1156 |
| Tracy et al., Gertrude Hemler, trustee | 54828<br>62982 | 30 | 1156 |
| Tracy, William R | 45513 | 25 | 1055 |
| Tresner, Amy | 66703 | 30<br>31<br>33 | 615<br>187<br>441 |
| Tricou, Sallie S | 28093<br>40258 | 25 | 713 |
| Trinity Drilling Co.[5] | 61498 | 28 | 1106 |
| Troll, Annie | 61215 | 33 | 598 |
| Trost, Edward E | 73848 | 34 | 24 |
| Trout, H. W | 39020 | 27 | 1210 |
| True, Edward C | 68501 | 31 | 671 |
| Turbeville, Allie M | 43733<br>47900<br>55553<br>64334<br>64560 | 31 | 283 |
| Turner, Kathleen M.[6] | 22340 | 27 | 377 |
| Turrish, Henry | 44742 | 24 | 913 |
| Twin Bell Oil Syndicate | 29518 | 26 | 165 |
| Twining, Edmund S | 70296 | 32 | 600 |
| **U.** | | | |
| Ulster & Delaware R. R. Co | 28927 | 25 | 109 |
| Union Lard Corporation | 20769 | 24 | 376 |

[1] Acquiescence relates to loss incurred in sale of a boat.
[2] Acquiescence relates to all issues except affiliation issue.
[3] Acquiescence relates to issue regarding deduction of loss sustained by petitioner during nonaffiliated period.
[4] Acquiescence in Board's decision in so far as it holds that petitioner was not taxable on any part of the proceeds of the 100 shares preferred stock given by him to his four sons in 1928.
[5] Acquiescence relates to basis for computing depreciation on assets acquired by Simms Oil Co. in 1925 from Clayton Oil & Refining Co.
[6] Acquiescence relates to that part of decision holding that Walter E. Hettman is not liable as a transferee; and to limitation issue.

ACQUIESCENCES—Continued.

| Taxpayer. | Docket No. | Board of Tax Appeals. | |
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| | | Volume. | Page. |
| Union Pacific R. R. Co.[1] | 51530<br>70183<br>70219 | 32 | 383 |
| Union Pacific R. R. Co. et al [2] | 35639–<br>35649<br>35684<br>35685<br>40060<br>40061<br>40062 | 26 | 1126 |
| Union & Peoples National Bank of Jackson et al., administrators [3] | 70456 | 30 | 1277 |
| Union Trust Co. of Pittsburgh, trustee | 61009 | 29 | 731 |
| United Autographic Register Co | 30384 | 27 | 433 |
| United States Trust Co. of New York, trustee | 26747–<br>26757 | 25 | 513 |
| **V.** | | | |
| Vaillant, Ethel Netcher | 38051 | 26 | 101 |
| Vermont Hydro-Electric Corporation | 59638 | 29 | 1006 |
| Virginia Iron, Coal & Coke Co | 51576 | 29 | 1087 |
| **W.** | | | |
| Walker, George H., estate of [3] | 31869 | 23 | 663 |
| Walker Products Corporation | 44856 | 30 | 636 |
| Ward Bros. Co | 30992 | 24 | 989 |
| Warner Co.[4] | 53039<br>53040<br>59190 | 26 | 1225 |
| Warner, Ralph C | 62510 | 31 | 1126 |
| Washington Market Co | 43912 | 25 | 576 |
| Waterbury, Charlotte M.[5] | 73381 | 33 | 208 |
| Waterbury, Donald N.[5] | 73380 | 33 | 208 |
| Waterbury, Eugene W.[5] | 73383 | 33 | 208 |
| Waterbury, Whitford N.[5] | 73382 | 33 | 208 |
| Watson, Jr., John H | 53414 | 27 | 463 |
| Wayne County & Home Savings Bank [6] | 49144 | 26 | 761 |
| Wedding, G. G | 56442 | 32 | 613 |
| Weeks, Alanson | 63916 | 31 | 627 |
| Weis, Samuel W | 62126 | 30 | 478 |
| Wheelock, R. L | 37806 | 28 | 611 |
| Wheelock, Mrs. R. L | 37805 | 28 | 611 |
| White Oak Transportation Co.[7] | 18088 | 24 | 307 |
| Whitman, Ward & Lee Co | 61552 | 29 | 670 |
| Whitney, Williard M | 37927 | 26 | 212 |
| Whitson, Thomas J | 40233 | 25 | 154 |
| Wilcox, C. B | 46371 | 27 | 580 |
| Williams, Jr., Alford J | 66915 | 29 | 892 |

[1] Acquiescence relates to issues with respect to loss sustained by O. & W. R. R. Co. on exchange of land in Seattle in 1925; amount of loss sustained by O. & W. Railroad and Navigation Co. in 1925 on sale of land in Multnomah County, Oreg.; contributions to hospital departments in 1924, 1925, and 1926; amortization of discount on bonds issued prior to March 1, 1913, and commissions; unrefundable portion of deposit made with petitioner in connection with construction of branch line.

[2] Acquiescence relates to donations issue; amortization of discount on bonds issued prior to 1913; computation of tax for 1920.

[3] Estate tax decision.

[4] Nonacquiescence published in Cumulative Bulletin XII-1, withdrawn.

[5] Acquiescence relates to issue as to basic values of stock.

[6] Nonacquiescence published in Cumulative Bulletin XI-2, revoked.

[7] Acquiescence relates to inventory issue.

ACQUIESCENCES—Continued.

| Taxpayer | Docket No. | Board of Tax Appeals. Volume. | Page. |
|---|---|---|---|
| Williams, Ella J | 29273 | 25 | 1161 |
| Williams, L. H | 58789 | 31 | 580 |
| Williams, W. W | 46062 | 24 | 506 |
| Williamson, Alexander B | 40231<br>43972 | 25 | 154 |
| Williamson, Archibald (Lord Forres) | 40229<br>43973 | 25 | 154 |
| Willis, Mary | 66718 | 30<br>31<br>33 | 615<br>187<br>441 |
| Wilson & Co., Inc., of California | 20768 | 24 | 376 |
| Wilson & Co., Lee | 33826 | 25 | 840 |
| Wilson Commission Co | 20767 | 24 | 376 |
| Wilson Furs, Inc | 57058 | 29 | 319 |
| Wilson, George S., estate of [1] | 50828 | 30 | 1136 |
| Wilson Shipbuilding Co.[2] | 34337 | 25 | 182 |
| Winne, Walter G | 60900 | 27 | 369 |
| Winslow, Mary N | 76059 | 33 | 57 |
| Wolf, A. C | 56439 | 32 | 613 |
| Wood, Fred T | 38808 | 27 | 162 |
| Wood Lumber Co., E. K | 23605<br>24156 | 25 | 1013 |
| Woodard, John S.[3] | 71962 | 30 | 1216 |
| Woodward, Arthur P | 54741<br>60227 | 32 | 100 |
| Wray, Eliza J | 25881 | 24 | 94 |
| Wright, George M | 25854 | 22 | 858 |
| Wright, Leonard Marshall | 45508 | 26 | 21 |
| Y. | | | |
| Yazoo & Mississippi Valley Ry. Co | 62023<br>62991 | 30<br>34 | 1107<br>1 |
| Young, Ethel P | 38868 | 24 | 815 |
| Yukon Alaska Trust | 34161 | 26 | 635 |
| Z. | | | |
| Zinsser & Co | 5242 | 21 | 152 |

[1] Estate tax decision.
[2] Acquiescence does not relate to issue 5 of decision.
[3] Acquiescence relates to reorganization issue.

The Commissioner has withdrawn his acquiescence in the following decisions of the United States Board of Tax Appeals:

| Taxpayer. | Docket No. | Board of Tax Appeals. Volume. | Page. |
|---|---|---|---|
| McIlhenny et al., Frances Plumer, executors [1] | 45008 | 22 | 1093 |
| McIlhenny, John D., estate of [1] | 45008 | 22 | 1093 |
| Wade, Jeptha H., estate of [1] | 43164 | 21 | 339 |
| Wade, Jr., et al., Jeptha H., executors [1] | 43164 | 21 | 339 |

[1] Estate tax decision; acquiescence published in Cumulative Bulletin X-2.

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The Commissioner does NOT acquiesce in the following decisions of the United States Board of Tax Appeals:

| Taxpayer. | Docket No. | Board of Tax Appeals. | |
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| A. | | | |
| Abelson Realty Co., Inc | 53792 | 24 | 686 |
| Abelson's, Inc | 53793 | 24 | 686 |
| Ackerman, Irving C | 30311<br>31634<br>40948<br>40949 | 24 | 512 |
| Alameda Park Co | 8355 | 25 | 850 |
| Albers, William H.[1] | 74759 | 33 | 373 |
| Albrecht et al., Katherine B., executrices[2] | 41295 | 27 | 1091 |
| Alker, Vera M. Kohler | 36116 | 25 | 243 |
| Allied Furriers Corporation | 50059 | 24 | 457 |
| American Brick & Tile Corporation | 29994 | 22 | 1121 |
| American Central Life Insurance Co.[3] | 30133<br>31998<br>56024<br>63436 | 30 | 1182 |
| American Gas & Electric Securities Corporation | 62604 | 33 | 245 |
| American Ideal Cleaning Co | 49205 | 30 | 529 |
| American Railways Co | 67662 | 30 | 939 |
| American Refrigerator Transit Co | 64782<br>67602<br>72861 | 31 | 465 |
| American Seating Co.[4] | 14676 | 14 | 328 |
| Ames, Muriel Oakes | 71811 | 30 | 516 |
| Ames, Jr., Ward | 49817 | 27 | 624 |
| Apartment Corporation | 42024 | 26 | 849 |
| Appleby, Francis S | 73089 | 31 | 533 |
| Arabol Manufacturing Co | 50489 | 26 | 1068 |
| Archbald, Edward B | 61660<br>65064 | 27 | 837 |
| Archbald, Joseph A | 61661<br>65062 | 27 | 837 |
| Archbald, Jr., Joseph A | 61673<br>65063 | 27 | 837 |
| Armstrong, William M | 40419 | 25 | 928 |
| Ashton, Willard H | 39148 | 28 | 582 |
| Atlas Life Insurance Co | 40544<br>40751<br>67199 | 29 | 750 |
| Auto Strop Safety Razor Co., Inc | 57374 | 28 | 621 |
| B. | | | |
| Babson, Fred K | 52224 | 27 | 859 |
| Babson, Gustavus | 52223 | 27 | 859 |
| Babson, Henry B | 52222 | 27 | 859 |
| Ballinger, Bessie M., executrix[5] | 32177 | 23 | 1311 |
| Ballinger, Walter F., estate of[5] | 32177 | 23 | 1311 |
| Baltimore & Ohio R. R. Co.[6] | 37239 | 30 | 194 |

[1] Nonacquiescence relates to issue concerning loss on sale of stock of A. Nash & Co.
[2] Estate tax decision; nonacquiescence relates to State inheritance tax issue.
[3] Nonacquiescence relates to issue whether certain funds denominated "Insured's personal benefit fund" were reserve funds required by law; and issue whether the petitioner's liability on outstanding unsurrendered unpaid coupons constitutes a reserve fund required by law.
[4] Acquiescence published in Cumulative Bulletin VIII-2 withdrawn.
[5] Estate tax decision.
[6] Nonacquiescence relates to deductibility as expense for year 1920 of amount for maintenance of ways and structures.

NONACQUIESCENCES—Continued.

| Taxpayer. | Docket No. | Board of Tax Appeals. | |
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| | | Volume. | Page. |
| Bank of California, National Association | 55537<br>60699 | 30 | 556 |
| Bankers Trust Co., trustee | 32459 | 24 | 10 |
| Bartlett, J. Kemp | 63632 | 28 | 285 |
| Bashford, Raymond I | 71565 | 33 | 10 |
| Bass, Francis M | 73626 | 30 | 4 |
| Bateman, F. L | 47772 | 34 | 351 |
| Bay, Robert P | 66014 | 28 | 1168 |
| Bebb, Richard E., estate of [1] | 41295 | 27 | 1091 |
| Beebe, Junius, trustee | 52707 | 26 | 190 |
| Beebe, Marcus, estate of | 52707 | 26 | 190 |
| Behan, Thomas W | 75428 | 32 | 1088 |
| Belfast Investment Co.[2] | 19128 | 17 | 213 |
| Bell, Frederic D., estate of | 69534 | 31<br>32 | 945<br>701 |
| Bell & Sons, Samuel | 38056<br>41647<br>45616 | 22 | 793 |
| Beresford, Vivien Helen de la Poer, estate of [3] | 67259 | 31 | 329 |
| Berkeley Hall School, Inc | 47415 | 31 | 1116 |
| Bindley, Mary M., estate of | 58871 | 28 | 113 |
| Bismarck Tribune Co | 59660 | 33 | 281 |
| Blair, Cecil Charles | 69803 | 29 | 1096 |
| Blair, Edward T | 42313<br>63741 | 31 | 1192 |
| Bliss, Sydney R | 55902 | 26 | 962 |
| Bliss, Valentine | 53422 | 26 | 732 |
| Blum, Bessie | 52221 | 29 | 580 |
| Blum, David | 52220 | 29 | 580 |
| Board of Fire Underwriters of the City of Duluth | 43150 | 26 | 860 |
| Boca Ceiga Development Co | 40446 | 25 | 941 |
| Boehringer, Rudolph [4] | 49891 | 29 | 8 |
| Bonwit, Paul J | 53661 | 33 | 507 |
| Boston Safe Deposit & Trust Co. et al., executors [3] | 49272 | 30 | 679 |
| Bowen, Edwin L.[5] | 62985 | 33 | 208 |
| Bowman-Biltmore Hotels Corporation | 41472<br>43629 | 24 | 1193 |
| Bowman Hotel Corporation | 10651<br>24912<br>28971<br>38006 | 24 | 1193 |
| Brackman, J. W | 45714 | 24 | 259 |
| Bradbury, I. C | 45780 | 23 | 1351 |
| Briskey Co | 60899 | 29 | 987 |
| British-American Tobacco Co., Ltd | 41224 | 27 | 226 |
| Brooklyn City R. R. Co | 20353 | 27 | 77 |
| Brooklyn & Queens Transit Corporation | 20353 | 27 | 77 |
| Brooklyn Radio Service Corporation | 61229 | 31 | 269 |
| Brooks, Reginald | 68560 | 31 | 70 |
| Brown, Frank A., estate of | 47677 | 26 | 901 |
| Brown, H. C | 33343 | 25 | 631 |
| Brown, Harry A | 48136 | 26 | 901 |
| Brown, Pearl B., executrix | 47677 | 26 | 901 |
| Browning, John N | 72713 | 31 | 927 |

[1] Estate tax decision; nonacquiescence relates to State inheritance tax issue.
[2] Nonacquiescence in issue as to whether petitioner is entitled to deduction for amortization of the Lee tract warehouse for 1918.
[3] Estate tax decision.
[4] Nonacquiescence relates to issue involving reorganization.
[5] Nonacquiescence relates to issue whether gains on sale of stock of the Waterbury Chemical Co. were taxable to petitioners or to trusts created by them.

NONACQUIESCENCES—Continued.

| Taxpayer. | Docket No. | Board of Tax Appeals. Volume. | Board of Tax Appeals. Page. |
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| Browning, S. P | 72714 | 31 | 927 |
| Buck, John A., estate of [1] | 32584<br>44153<br>44684 | 25 | 780 |
| Buck et al., Mary M., executors [1] | 32584<br>44153<br>44684 | 25 | 780 |
| Buckhardt, August | 76255 | 32 | 1272 |
| Buffalo Union Iron Furnace Co.[2] | 16075<br>16076 | 23 | 439 |
| Bullock, George [3] | 31209 | 23 | 710 |
| Bunge North American Grain Corporation | 47800 | 27 | 150 |
| Burdette, Clara | 37321 | 25 | 692 |
| Burley, Blanche B., executrix | 44909 | 26 | 615 |
| Burrill, Edward L | 58795 | 26 | 1401 |
| Busche, F. C.[4] | 9447<br>10202<br>10755 | 10 | 1345 |
| Business Real Estate Trust of Boston | 33469<br>42684<br>50305 | 25 | 191 |
| Butler-Veitch Co | 45169<br>45170 | 23 | 953 |
| C. | | | |
| Cadwalader, Mary Helen | 46327 | 27 | 1078 |
| Cadwalader, Jr., Richard M | 71800 | 32 | 1157 |
| Carey, Robert | 54033<br>60432<br>67415 | 31 | 839 |
| Carey Fibre Products Co., Emerson | 36381 | 26 | 675 |
| Carey Salt Co | 36382 | 26 | 675 |
| Carroll, J. J | 51880 | 27 | 65 |
| Carroll, Lena Carter | 51881 | 27 | 65 |
| Carson Estate Co | 47444<br>53489 | 31 | 607 |
| Carson, John E | 45393 | 28 | 236 |
| Carson, Rose L | 45392 | 28 | 236 |
| Carter, A. L | 51882 | 27 | 65 |
| Carter, A. L., administrator | 47669 | 27 | 65 |
| Carter, Mrs. A. L | 51883 | 27 | 65 |
| Carter, E. A | 51884 | 27 | 65 |
| Carter, Lillie N | 51885 | 27 | 65 |
| Carter, Maude H., estate of | 47669 | 27 | 65 |
| Carter, Jr., W. T | 51886 | 27 | 65 |
| Cassels, Robert | 58793 | 26 | 1401 |
| Central Market Street Co.[5] | 24837 | 25 | 499 |
| Central Union Trust Co. of New York, executor | 31736 | 25 | 757 |
| Central United National Bank | 69212<br>71063 | 33 | 588 |
| Champion, David J.[6] | 55569<br>63818 | 27 | 1312 |
| Champion, T. Pierre [6] | 55568 | 27 | 1312 |
| Chandler, Constance | 67471 | 32 | 720 |

[1] Estate tax decision; nonacquiescence relates to deduction of amount of a claim filed against the estate and allowed by probate court.
[2] Nonacquiescence relates to issue regarding deduction from gross income of fiscal year ended April 30, 1919, of reserve for relining blast furnaces.
[3] Nonacquiescence relates to issue 1 of decision.
[4] Acquiescence published in Cumulative Bulletin X-1 withdrawn.
[5] Nonacquiescence relates to issue regarding Board's jurisdiction of subsidiaries.
[6] Nonacquiescence relates to issue whether redemption of stock was equivalent to taxable dividend.

NONACQUIESCENCES—Continued.

| Taxpayer. | Docket No. | Board of Tax Appeals. | |
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| Chandler, Harrison Gray | 67470 | 32 | 720 |
| Chandler, Helen | 67475 | 32 | 720 |
| Chandler, Marian Otis | 67468 | 32 | 720 |
| Chandler, Norman | 67473 | 32 | 720 |
| Chandler, Philip | 67476 | 32 | 720 |
| Chapman, C. F | 52496 | 28 | 53 |
| Charavay, Marius A | 70005<br>71592 | 29 | 1255 |
| Chemical National Bank of New York | 45604 | 30 | 178 |
| Chenowith, H. C | 38349 | 26 | 301 |
| Chicago Dock & Canal Co | 48268 | 32 | 231 |
| Chicago & North Western Ry. Co.[1] | 36343 | 22 | 1407 |
| Chidlaw, Harry K | 69782 | 29 | 1096 |
| Christensen, Niels A | 72424 | 33 | 79 |
| Clark, Percy H | 65177 | 31 | 1082 |
| Clark Thread Co.[2] | 38903<br>47974 | 28 | 1127 |
| Cleland Estate Co., Inc., Henry A.[3] | 33585<br>40890<br>51197 | 29 | 436 |
| Clovis, C. H | 68433 | 32 | 646 |
| Coastwise Transportation Corporation | 39916 | 28 | 725 |
| Cobleigh, Margaret Edwards, estate of [4] | 40765 | 24 | 176 |
| Cochrane, David K.[5] | 60428 | 26 | 1167 |
| Columbia Pacific Shipping Co | 50968 | 29 | 964 |
| Columbus Brick & Tile Co.[6] | 42707 | 26 | 794 |
| Commercial Garage Co | 41646 | 22 | 793 |
| Commercial Investment Trust Corporation [7] | 43495<br>50051 | 28 | 143 |
| Community Bond & Mortgage Corporation | 43784 | 27 | 480 |
| Community Mausoleum Co.[8] | 70384 | 33 | 19 |
| Community Telephone Co | 77568 | 32 | 164 |
| Community Water Service Co | 77560 | 32 | 164 |
| Cone, Edward K | 58777 | 26 | 1401 |
| Connelly, James A.[9] | 44081<br>45833<br>46267<br>51967<br>60566<br>66948 | 30 | 331 |
| Connelly, L. B.[9] | 44083<br>45834 | 30 | 331 |
| Connelly, Mary B.[9] | 44082 | 30 | 331 |
| Cook, Elizabeth E.[10] | 38579 | 25 | 1351 |
| Cook, Sam | 35014 | 25 | 92 |

[1] Nonacquiescence relates to following issues: Undermaintenance; profit and loss on bonds retired; amortization of bond discount.
[2] Nonacquiescence relates to issue respecting depreciation.
[3] Nonacquiescence relates to basis for determination of gain or loss on the sale of property devised subject to a life estate.
[4] Estate tax decision.
[5] Acquiescence published in Cumulative Bulletin XII-1 revoked.
[6] Nonacquiescence relates to inclusion in consolidated invested capital of capital stock issued for promissory notes.
[7] Nonacquiescence relates to deduction in 1926 of excess of market value over sale price of stock sold to employees.
[8] Nonacquiescence relates to issue whether the final installment on the sale price of mausoleum crypts to be retained by a trustee as a perpetual care fund should be excluded from the full contract price in computing profit, the taxpayer reporting on the accrual installment basis.
[9] Nonacquiescence relates to issue involving the amounts paid to stockholders by J. G. Curtis Leather Co. upon cancellation of certain stock.
[10] Nonacquiescence relates to value of common stock of American Chain Co., Inc., and the basis of allocation of cost between said common stock and preferred stock of said company acquired at the same time and under the same agreement.

NONACQUIESCENCES—Continued.

| Taxpayer. | Docket No. | Board of Tax Appeals. | |
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| Cooper, A. T. [1] | 3144 | 7 | 798 |
| Cosmopolitan Bond & Mortgage Co.[2] | 44617 | 30 | 717 |
| Coughlin, R. Lawrence and Evelyn W | 76106 | 32 | 1048 |
| Coursey, Sarah A. W.[3] | 71755 | 33 | 1068 |
| Crile, Grace McBride | 43136 | 26 | 1020 |
| Crispin, Mrs. Egerton | 45267 | 28 | 236 |
| Crosby, Oscar T | 51317 | 27 | 1234 |
| Cross, Maurice | 32735 | 24 | 1079 |
| Cunard Coal Co.[4] | 26874, 26875, 28792 | 26 | 234 |
| Cuppia, Jerome C | 58545 | 26 | 1401 |
| Curlee, Shelby H., trustee | 48833 | 28 | 773 |
| Czajke, I. T., transferee | 64639 | 33 | 564 |
| D. | | | |
| Davidson, Watson P | 46486 | 27 | 158 |
| Davis, C. R.[5] | 10299 | 10 | 1233 |
| | 32950 | 20 | 931 |
| Davis, Frederick H | 37324 | 24 | 405 |
| Davis, Thomas L | 37395 | 24 | 405 |
| Degener, John F., estate of [6] | 38500 | 26 | 185 |
| Degener, Jr., et al., John F., executors [6] | 38500 | 26 | 185 |
| De Lisser, Horace, estate of [7] | 2459 | 2 | 102 |
| de Mille, Cecil B.[8] | 52995, 61291, 65122, 71951 | 31 | 1161 |
| de Mille Productions, Inc., Cecil B.[8] | 52996, 61290, 65123 | 31 | 1161 |
| de Mille Productions, Inc., William C | 53108, 61321 | 30 | 826 |
| Dennett, Marie G.[9] | 72023 | 30 | 49 |
| Denny, Reginald [10] | 49516 | 33 | 738 |
| Depew, Ganson | 50860 | 27 | 515 |
| Des Moines Improvement Co. [1] | 8573 | 7 | 279 |
| Dohrmann, Andrew B. C | 20658 | 19 | 507 |
| | 23969 | 19 | 466 |
| Dolomite, Inc | 60661 | 28 | 1270 |
| Donner, Carroll E | 60237 | 32 | 364 |
| Donner et al., Carroll E., executors | 60236 | 32 | 364 |
| Donner et al., Carroll E., guardians | 60235 | 32 | 364 |
| Donner, Joseph W | 60236 | 32 | 364 |
| Donner, Jr., Joseph W | 60235 | 32 | 364 |
| Dort, J. Dallas, estate of [6] | 44735 | 26 | 1321 |
| Douglass, Howard W., estate of [6] | 40031 | 30 | 1143 |
| Drawoh, Inc | 45014 | 28 | 666 |

[1] Acquiescence published in Cumulative Bulletin VII-1 withdrawn.
[2] Nonacquiescence relates to issue involving commissions charged on real estate loans.
[3] Nonacquiescence relates to the following issue: Computation of taxable profit to petitioner from sale of land by the trust during 1930 on the basis of the value of said land as of March 1, 1913.
[4] Nonacquiescence relates to expenditures for mine equipment.
[5] Acquiescence published in Cumulative Bulletin X-1 withdrawn.
[6] Estate tax decision.
[7] Estate tax decision; acquiescence published in Cumulative Bulletin X-2 recalled.
[8] Nonacquiescence does not relate to the case of Constance A. de Mille, Docket 71952, which was disposed of by stipulation.
[9] Nonacquiescence relates to deductibility of $10,000 because of the fact that a bond in which petitioner had invested became worthless in 1930, although that fact was not ascertained until 1931.
[10] Nonacquiescence relates to deduction of amount expended for dental bridge work and amount expended in keeping petitioner in first-class physical condition.

NONACQUIESCENCES—Continued.

| Taxpayer. | Docket No. | Board of Tax Appeals. | |
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| Drunheller, George | 41515<br>45752 | 27 | 209 |
| Duff, Robert C. [1] | 37552 | 23 | 1342 |
| Dunham et al., Lucy Belle, executors [2] | 46603 | 26 | 286 |
| Dunham, Mary Virginia, estate of [2] | 46603 | 26 | 286 |
| Dye, Clarke E | 74911 | 33 | 824 |
| E. | | | |
| East Coast Oil Co., S. A | 58180 | 31 | 558 |
| Edison Securities Corporation | 52662 | 29 | 483 |
| Edward Securities Corporation | 71208 | 30 | 918 |
| Eifert, Earl C | 45781 | 23 | 1351 |
| Eldridge, Alice H.[3] | 64779 | 30 | 1321 |
| Eldridge, A. S.[3] | 64778 | 30 | 1321 |
| Elkins, Hallie D.[4] | 39255 | 24 | 572 |
| Elkins, William L., estate of | 56449 | 28 | 367 |
| Ely, Elizabeth Taylor | 76546 | 33 | 249 |
| Emery, Mary M., estate of [4] | 40899 | 25 | 585 |
| Equitable Life Assurance Society of the United States | 31110<br>33241<br>57867 | 33 | 708 |
| Equitable Trust Co., of New York, ancillary administrator [2] | 67259 | 31 | 329 |
| Erb et al., Ray L., executors [5] | 29260 | 29 | 1315 |
| Ethel D. Co | 32032 | 27 | 25 |
| Eustis, Augustus H.[6] | 71637 | 30 | 820 |
| Evening Star Newspaper Co | 61870<br>66855 | 28 | 762 |
| Everhart, James William | 26675 | 26 | 318 |
| F. | | | |
| Fairmount Cemetery Association | 30925<br>42811 | 25 | 1272 |
| Farmers Cotton Oil Co | 42679 | 27 | 105 |
| Farmers Life Insurance Co.[7] | 43317 | 27 | 423 |
| Fawsett, Charles F | 72057 | 30 | 908 |
| Feldman, Henry O | 45359 | 28 | 236 |
| Ferree, C. B | 61542 | 32 | 725 |
| Fidelity & Columbia Trust Co., trustee | 65041<br>65042 | 30 | 562 |
| Fidelity Union Trust Co. et al., executors [2] | 72236 | 31 | 171 |
| Field, Marshall | 36908 | 26 | 116 |
| Fifth Avenue Bank of New York, executor | 69534 | 31<br>32 | 945<br>701 |
| Fifth Street Building | 16627<br>29264<br>45537 | 24 | 876 |
| First National Bank in St. Louis [8] | 44278<br>48078 | 23 | 1124 |

[1] Nonacquiescence relates to issue 2 of decision.
[2] Estate tax decision.
[3] Nonacquiescence relates to deduction of loss in transfer of securities to a corporation in which petitioner owned all the stock except qualifying shares.
[4] Acquiescence published in Cumulative Bulletin XI-2 revoked.
[5] Nonacquiescence relates to the following issues: Reduction of cost basis (March 1, 1913, value) of assets sold by a partnership in 1919 by depreciation allowed in computing income for period March 1, 1913, to December 1, 1915; computation of 1919 partnership profit on sale of assets by considering as part of the sale price taxes of the partners paid in 1920 by the vendee.
[6] Acquiescence published in Cumulative Bulletin XIII-2 withdrawn.
[7] Nonacquiescence does not relate to issue in connection with option payment received for purchase of land.
[8] Acquiescence notice published in Cumulative Bulletin X-2 recalled.

NONACQUIESCENCES—Continued.

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| First National Bank of Boston, administrator [1] | 44746 | 25 | 612 |
| First Peoples Trust | 45403 | 26 | 551 |
| Fisher & Fisher, Inc | 60929 | 32 | 211 |
| Fisher, Irving | 61622 | 30 | 433 |
| Fitzgerald, Thomas | 62075 | 29 | 1113 |
| Fleitmann, William M., estate of [2] | 28449 | 22 | 1291 |
| Fleitmann, Jr., et al., William M., executors [2] | 28449 | 22 | 1291 |
| Fleming, William | 61042<br>65676 | 31 | 623 |
| Fleming, Mrs. William | 61043<br>65677 | 31 | 623 |
| Fletcher, Salathiel R | 33041 | 24 | 75 |
| Flintermann, Carl H. L., estate of [1] | 75516 | 32 | 996 |
| Folger & Co., J. A | 22212<br>30721 | 27 | 1 |
| Folger Estate Co | 31200<br>35147 | 27 | 1 |
| Forest Glen Creamery Co | 51833 | 33 | 564 |
| Foster, Caroline B., estate of [1] | 46672 | 26 | 708 |
| Foster et al., Charles H. W., executors [1] | 46672 | 26 | 708 |
| Foster, L. B.[3] | 43086 | 26 | 1328 |
| Founders Associates | 62684 | 29 | 326 |
| Fox, Fontaine [4] | 71084 | 30 | 451 |
| Fox River Paper Co | 20878 | 28 | 1183 |
| Franklin Title & Trust Co.[5] | 51947<br>60167<br>67805 | 32 | 266 |
| Franks, Jack M | 53685 | 32 | 260 |
| Fuhlage, Alfred E.[6] | 61754 | 32 | 222 |
| Fuller, Alvan T | 73759 | 31 | 154 |
| Furniture Corporation of America, Ltd | 72800<br>72801 | 30 | 878 |
| G. | | | |
| Gale, Emily A | 61672 | 27 | 837 |
| Gamble & Stockton Co.[7] | 42707 | 26 | 794 |
| Garcin, Edward H | 21657 | 22 | 1027 |
| Gardner, Charles E.[8] | 38575 | 25 | 1351 |
| Garrie, Daniel T., estate of | 31736 | 25 | 757 |
| Garvan, John Joseph, estate of [1] | 44746 | 25 | 612 |
| Gary, Virginia V., executrix [1] | 40031 | 30 | 1143 |
| Gassner, Louis [9] | 4017 | 4 | 1071 |
| General Machinery Corporation | 70449 | 33 | 1215 |
| General Outdoor Advertising Co., Inc.[10] | 66511 | 32 | 1011 |
| General Utilities & Operating Co | 52770 | 29 | 934 |
| Gerard, Erle | 45221 | 28 | 236 |

[1] Estate tax decision.
[2] Acquiescence notice published in Cumulative Bulletin X–2 recalled.
[3] Nonacquiescence relates to deductions in 1924 and 1925 on account of losses resulting from alleged sales of securities.
[4] Nonacquiescence relates to inclusion in income of corporation for years ended March 31, 1930, and March 31, 1931, amounts representing rental of premises occupied by its president.
[5] Nonacquiescence relates to the question whether Franklin Bond & Mortgage Co. was entitled to deduct commissions paid on the sale of its bonds instead of prorating cost over the life of the bonds.
[6] Nonacquiescence relates to issue whether redemption of shares of stock represents payment in partial liquidation of a corporation or a taxable dividend.
[7] Nonacquiescence relates to inclusion in consolidated invested capital of capital stock issued for promissory notes.
[8] Nonacquiescence relates to value of common stock of American Chain Co., Inc., and the basis of allocation of cost between said common stock and preferred stock of said company acquired at the same time and under the same agreement.
[9] Acquiescence published in Cumulative Bulletin X–1 withdrawn.
[10] Nonacquiescence in issue involving counsel fees paid in connection with litigation.

NONACQUIESCENCES—Continued.

| Taxpayer. | Docket No. | Board of Tax Appeals. Volume. | Page. |
|---|---|---|---|
| Gerlach, Theodore R. | 38042 41641 | 27 | 565 |
| Gerstle et al., Mark L.[1] | [2] 62854 | 33 | 830 |
| Gessner, Herman | 77506 | 32 | 1258 |
| Girard Trust Co. et al., administrators | 75624 | 32 | 926 |
| Gladding, Mary D., estate of [3] | 31435 | 27 | 385 |
| G. M. & S. Co | 16383 | 26 | 223 |
| Goetjen & Metson Co | 17875 | 26 | 223 |
| Goforth, Mary B | 52316 | 32 | 1206 |
| Goforth, R. S | 52316 | 32 | 1206 |
| Goldberg, Harry S.[4] | 5389 | 4 | 1073 |
| Goldschmidt et al., Georgette, executors [5] | 16138 | 14 | 1010 |
| Goldschmidt, Henry P., estate of [5] | 16138 | 14 | 1010 |
| Goodan, May Chandler | 67472 | 32 | 720 |
| Graham, M. H | 38335 | 26 | 301 |
| Grant, Helen E | 62029 65577 68324 | 29 | 760 |
| Great Southern Life Insurance Co.[6] | 56540 64064 71114 | 33 | 512 |
| Great Western Power Co. of California | 48617 | 30 | 503 |
| Green, H. A | 74910 | 33 | 824 |
| Green, Robert D.[7] | 53647 | 24 | 719 |
| Greenleaf Textile Corporation | 46746 | 26 | 737 |
| Gregory, Evelyn F | 55299 | 27 | 223 |
| Griffis, Stanton [8] | 38577 | 25 | 1351 |
| Grosvenor, Theodore P | 60381 | 31 | 574 |
| Guitar Trust Estate | 35102 | 25 | 1213 |
| Gulf Coast Irrigation Co.[9] | 33694 40081 41343 | 24 | 958 |
| Gulf, Mobile & Northern R. R. Co.[10, 11] | 24887 42150 | 22 | 233 |
| H. | | | |
| Hale, Ernest H | 67105 | 33 | 504 |
| Hale, R. W | 67750 | 32 | 356 |
| Hale, W. T | 67751 | 32 | 356 |

[1] Nonacquiescence relates to the following question: Are petitioners entitled to deduct on their individual returns the operating and capital losses sustained by real estate syndicates of which they were members?

[2] And 19 related dockets.

[3] Estate tax decision.

[4] Acquiescence published in Cumulative Bulletin X-1 withdrawn.

[5] Estate tax decision; acquiescence published in Cumulative Bulletin X-2 recalled.

[6] Nonacquiescence in following issues:
Did the taxpayer realize interest accrued upon a loan where it foreclosed liens on certain bonds pledged as collateral?
Did taxpayer realize interest as taxable net income where notes were exchanged for new notes which included interest and the new notes were not paid during the taxable year?
Where taxpayer acquired the assets and business of three other insurance companies during the taxable year, was income realized upon the collection of interest that was accrued but not paid as of date of purchase?

[7] Nonacquiescence relates to transaction 5.

[8] Nonacquiescence relates to value of common stock of American Chain Co., Inc., and the basis of allocation of cost between said common stock and preferred stock of said company acquired at the same time and under the same agreement.

[9] Nonacquiescence relates to affiliation issue.

[10] Nonacquiescence relates to issues involving award of Interstate Commerce Commission in 1920 for transportation of United States mails in 1916 and 1917; and deduction in 1926 for depreciation on ways and structures.

[11] Nonacquiescence applies to the entire decision of the Board in so far as it is adverse to the Commissioner. Partial acquiescence published in Bulletin XI-28 revoked.

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| Taxpayer. | Docket No. | Board of Tax Appeals. Volume. | Page. |
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| Hall, Harry E. R., estate of | 70004, 71598 | 29 | 1255 |
| Hall, Martha M | 64501 | 31 | 1013 |
| Hancock, G. Allan | 36867 | 25 | 607 |
| Hanson, Charles C | 15398 | 23 | 590 |
| Harbison, Ralph W.[1] | 54346 | 26 | 896 |
| Harbison, William Albert [1] | 54347 | 26 | 896 |
| Hardwick, Marjory Taylor | 76545 | 33 | 249 |
| Harlan, George H | 60500 | 30 | 804 |
| Harris, Allen [2] | 10980 | 10 | 1374 |
| Harris, Simon | 31632 | 24 | 512 |
| Harrison, James M | 66193 | 30 | 966 |
| Harrison, J. E | 45361 | 28 | 236 |
| Hart, John H | 52795, 60115 | 27 | 528 |
| Hartley, Cavour, executor | 42343 | 27 | 952 |
| Hartley, G. G., estate of | 42343 | 27 | 952 |
| Hauser, W. E | 43301, 43302 | 26 | 1178 |
| Hawley Investment Co | 45169, 45170 | 23 | 953 |
| Hazeltine Corporation | 42277, 47011, 51931, 60313 | 32 | 4 |
| Hedrick, J. T | 33533 | 24 | 444 |
| Heffelfinger, Frank T | 41145, 44852, 53881, 63407, 69694, 73479 | 32 | 1232 |
| Heller, B. G | 40634 | 25 | 259 |
| Hemphill, Clifford [3] | 38573 | 25 | 1351 |
| Hendrickson, Joseph G., estate of | 73029 | 32 | 449 |
| Henn, A. W | 37102 | 20 | 1133 |
| Henritze, J. B | 60609 | 28 | 1172 |
| Henritze, Nell | 60607 | 28 | 1172 |
| Henritze, T. R | 60608 | 28 | 1172 |
| Henritze, T. W | 60606 | 28 | 1172 |
| Hermann, John C | 51959 | 27 | 409 |
| Hertenstein, Freda M | 55938 | 29 | 216 |
| Hertenstein, Frederick | 55936 | 29 | 216 |
| Hickman, Howard C | 37369 | 27 | 807 |
| Hieronymus, Carl Richard, estate of | 48930 | 24 | 269 |
| Highlands, Evanston-Lincolnwood Subdivision, First Addition, Trust No. 1546, et al | 74464 | 32 | 760 |
| Highlands, Evanston-Lincolnwood Subdivision, Trust No. 1521, et al | 74465 | 32 | 760 |
| Highway Trailer Co | 44568 | 28 | 792 |
| Higley & Co., E. B | 51003 | 25 | 127 |
| Hill, D. F., estate of [4] | 29399 | 24 | 1144 |
| Hill et al., Paul F., executors [4] | 29399 | 24 | 1144 |
| Hinds, Walter DeWitt, estate of [4] | 49860 | 32 | 254 |

[1] Acquiescence published in Cumulative Bulletin XII-1 withdrawn.
[2] Acquiescence published in Cumulative Bulletin X-1 withdrawn.
[3] Nonacquiescence relates to value of common stock of American Chain Co., Inc., and the basis of allocation of cost between said common stock and preferred stock of said company acquired at the same time and under the same agreement.
[4] Estate tax decision.

NONACQUIESCENCES—Continued.

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| Hittell, John B | 70820 | 33 | 276 |
| Hodges, Agnes Wiley, executrix | 38336 | 26 | 301 |
| Hodges, W. L., estate of | 38336 | 26 | 301 |
| Hodges, W. L., trustee | 38337 | 26 | 301 |
| Hoge, Arthur K., estate of | 68435 | 32 | 646 |
| Hoge, Blanche C., executrix | 68435 | 32 | 646 |
| Hoge et al., Ethel H., executors | 58118<br>58119 | 33 | 718 |
| Hoge, James D., estate of | 58118<br>58119 | 33 | 718 |
| Holding Corporation, O. P. P | 60674 | 30 | 337 |
| Holmes Bakery & Confectionery | 44943<br>52861 | 27 | 1229 |
| Holmes, Carl F | 51473<br>53395 | 27 | 660 |
| Holmes, E. A., trustee | 44943<br>52861 | 27 | 1229 |
| Holmes, Margaret A | 48631<br>51570<br>53394 | 27 | 660 |
| Home Title Insurance Co | 63737 | 33 | 318 |
| Honnold, W. L | 55211 | 30 | 774 |
| Household Products, Inc | 44809 | 24 | 594 |
| Housman, Clarence J | 58798 | 26 | 1401 |
| Housman, Frederick | 58774 | 26 | 1401 |
| Houston Baseball Association | 43985<br>45430 | 24 | 69 |
| Houston Bros.[1] | 12052 | 22 | 51 |
| Houston, George T.[1] | 13104<br>22008 | 22 | 51 |
| Houston, Horace K.[1] | 22009 | 22 | 51 |
| Houston, Philip D.[1] | 22007 | 22 | 51 |
| Hulburd, Charles H., estate of | 22028 | 27 | 1123 |
| Hulburd, De Forest, individually and as executor and trustee | 22028 | 27 | 1123 |
| Hummel-Ross Fibre Corporation | 59865 | 31 | 451 |
| Humphrey, Dudley T | 64376 | 32 | 280 |
| Hunter, G. W., estate of [2] | 33564 | 25 | 1078 |
| Hunter, Jr., Thomas A.[3] | 58490 | 33 | 941 |
| Huntington, Henry E., estate of [4] | 45429 | 28 | 289 |
| Hutchison Coal Co | 34939 | 24 | 973 |
| Hyde, James H | 65495<br>69952 | 31 | 256 |
| I. | | | |
| Illinois Life Insurance Co | 67201 | 30 | 1160 |
| Imperial Elevator Co | 35688 | 25 | 234 |
| Imperial Investment Co | 29291 | 23 | 1281 |
| Indianapolis, Crawfordsville & Danville Electric Ry. Co | 33859 | 24 | 197 |
| Indianapolis & Northwestern Traction Co | 33861 | 24 | 197 |
| Ingram, Thomas J | 56943 | 32 | 1063 |
| Irvington Investments Co | 77557 | 32 | 1165 |

[1] Nonacquiescence relates to March 1, 1913, value, and to the basis for the deduction for depletion and for the computation of gain or loss upon subsequent sale of the timber.
[2] Estate tax decision.
[3] Nonacquiescence in issue involving question of realization of taxable profit on exchange of class "B" common stock for class "A" stock.
[4] Nonacquiescence relates to issue whether taxpayer sustained a net loss in any business regularly carried on in 1924 which could be carried forward and deducted from taxable income in 1925.

NONACQUIESCENCES—Continued.

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| Iten Biscuit Co | 43667<br>45164 | 25 | 870 |
| Ives, Charles E | 51527 | 29 | 822 |
| Ives Dairy, Inc | 39873 | 23 | 579 |
| Iwicki, E. W., transferee | 64653 | 33 | 564 |
| **J.** | | | |
| Jackson & Eastern Ry. Co | 38295<br>[1] 42149 | 22 | 233 |
| Jackson, Paul Wilde, trust | 74928 | 33 | 311 |
| Jackson, Wermich Trust | 32307 | 24 | 150 |
| Jamison Coal & Coke Co | 31690<br>34088 | 24 | 554 |
| Janotta, Stella S.[2] | 51172 | 28 | 39 |
| Jefferson Standard Life Insurance Co | 43149 | 25 | 1335 |
| Johnson, A. M | 61345 | 32 | 156 |
| Johnston, F. Harold, executor | 79029 | 33 | 551 |
| Johnston, F. M., estate of | 79029 | 33 | 551 |
| Johnston, Hugh McBirney, individually and as executor and trustee | 22028 | 27 | 1123 |
| Jones, Bessie R | 58285 | 27 | 171 |
| Jones, Chester Addison [3] | 50206 | 31 | 55 |
| Junge, Claus, transferee | 64637 | 33 | 564 |
| **K.** | | | |
| Kansas City Southern Ry. Co. and affiliated companies [4] | 22668<br>35527<br>35528<br>35529<br>35530<br>35531 | 22 | 949 |
| Keener Oil & Glass Co | 60789 | 32 | 186 |
| Keeys, Edward L | 45360 | 28 | 236 |
| Kehoe, John | 64609 | 34 | 59 |
| Kehoe, Sarah | 64609 | 34 | 59 |
| Kelly, Francis J., executor [5] | 70899 | 31 | 941 |
| Kelly, Rose A., estate of [5] | 70899 | 31 | 941 |
| Kerbaugh, Henry S | 68976 | 29 | 1014 |
| Kerrigan, Arthur L | 58794 | 26 | 1401 |
| King, John M | 41549 | 26 | 1158 |
| Kirkpatrick, John L | 67474 | 32 | 720 |
| Kitselman, C. M., estate of | 77812 | 33 | 494 |
| Knapp, Kittie A.[6] | 2775 | 7 | 790 |
| Knox, Seymour H | 65203 | 33 | 972 |
| Koch, Harry A | 55318 | 26 | 1025 |
| Kountze, Charles T | 37323 | 24 | 405 |
| Kountze et al., Charles T., executors | 37535 | 24 | 405 |
| Kountze, Luther L., estate of | 37535 | 24 | 405 |
| Krause et al., Frances A., executors [5] | 49860 | 32 | 254 |
| Krug, George F | 46713 | 30 | 1375 |
| Krull, Francis [7] | 16985 | 10 | 1096 |

[1] Nonacquiescence relates to issue involving deduction for depreciation on ways and structures.
[2] Gift tax decision.
[3] Nonacquiescence as to issue regarding deduction for depletion.
[4] Nonacquiescence relates to the following issues: Deduction of amounts expended to restore petitioner's property notwithstanding the fact that the Director General of Railroads made payment to petitioner for his failure to maintain the property; exclusion from gross income of intercompany freight charges on material and supplies used in making additions and betterments to petitioner's property.
[5] Estate tax decision.
[6] Acquiescence published in Cumulative Bulletin VII-1 withdrawn.
[7] Acquiescence published in Cumulative Bulletin X-1 withdrawn.

NONACQUIESCENCES—Continued.

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| **L.** | | | |
| Lafayette Life Insurance Co | 41721<br>42663 | 26 | 946 |
| Langford Investment Co., trustee | 57203 | 28 | 222 |
| Langford, Jr., et al., Pierce P | 57203 | 28 | 222 |
| Langworthy, Marjorie C.[1] | 71961 | 30 | 1216 |
| Laube, Justus | 70007<br>71595 | 29 | 1255 |
| Laun, Alfred A | 45347 | 26 | 764 |
| Laun, J. B | 45348 | 26 | 764 |
| Lazarus & Co., F. & R | 69481<br>69750 | 32 | 633 |
| Leeper, Frank E., estate of | 45266 | 28 | 236 |
| Leeper, Pearl E | 45265 | 28 | 236 |
| Leetonia Furnace Co | 32272 | 23 | 979 |
| Lembcke, George A | 75365 | 33 | 700 |
| Leon & Son, Inc., Albert | 53440 | 29 | 251 |
| Levine, Hyman [2] | 7435 | 8 | 298 |
| Liberty Marine Insurance Co | 67263 | 32 | 736 |
| Liebes & Co., H | 28544<br>35038 | 23 | 787 |
| Linderman, William S., executor | 58871 | 28 | 113 |
| Littauer, Eugene, estate of [3] | 51858 | 25 | 21 |
| Littauer et al., Lucius N., executors [3] | 51858 | 25 | 21 |
| Livingood, Charles J., executor [4] | 40899 | 25 | 585 |
| Lloyd, Walter [5] | 48120 | 30 | 331 |
| Loffland, J. M.[6] | 13425 | 10 | 14 |
| Loffland, T. S.[6] | 13426 | 10 | 14 |
| Louis, Cora K | 49179 | 29 | 1200 |
| Louisville Trust Co. et al., trustees | 65040 | 30 | 562 |
| Lustig, David L., estate of [7] | 70582 | 33 | 1225 |
| **M.** | | | |
| Malernee, D. B | 63553 | 31 | 662 |
| Mallory, L. W., estate of | 33231 | 27 | 750 |
| Malloy & Co | 57906 | 33 | 1130 |
| Manchester Coal Co | 33392 | 24 | 577 |
| Manhattan Life Insurance Co | 60827 | 28 | 129 |
| Mann, George D | 54223<br>63370 | 33 | 281 |
| Manus-Muller & Co., Inc | 59778 | 30 | 1015 |
| Margay Oil Corporation | 44891 | 26 | 199 |
| Markham Irrigation Co.[8] | 41344 | 24 | 958 |
| Marvin, Walter S.[9] | 38578 | 25 | 1351 |
| Matagarda Canal Co.[8] | 40082<br>41345 | 24 | 958 |
| Matheson, Hugh M | 71353 | 31 | 493 |
| Mathews, Susan H., executrix | 43208 | 33 | 682 |

[1] Nonacquiescence relates to question whether distribution of stock had the effect of distribution of a taxable dividend.
[2] Acquiescence published in Cumulative Bulletin X-1 withdrawn.
[3] Estate tax decision; nonacquiescence in respect to that part of decision which holds that accrued interest paid on Federal income taxes for 1927 and 1928 from date of decedent's death to November 5, 1930, is a proper allowable administrative expense.
[4] Acquiescence published in Cumulative Bulletin XI-2 revoked.
[5] Nonacquiescence relates to issue involving the amounts paid to stockholders by J. G. Curtis Leather Co. upon cancellation of certain stock.
[6] Nonacquiescence relates to depreciation allowable under the Revenue Act of 1913; acquiescence published in Cumulative Bulletin VIII-1 withdrawn in so far as it applies to this issue.
[7] Estate tax decision.
[8] Nonacquiescence relates to affiliation issue.
[9] Nonacquiescence relates to value of common stock of American Chain Co., Inc., and the basis of allocation of cost between said common stock and preferred stock of said company acquired at the same time and under the same agreement.

NONACQUIESCENCES—Continued.

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| Mathews, W. B., estate of | 43208 | 33 | 682 |
| McCabe, Ben C | 69783 | 29 | 1096 |
| McCabe, George H., estate of | 69779 | 29 | 1096 |
| McCabe, James | 69778 | 29 | 1096 |
| McCabe, James Roscoe | 69781 | 29 | 1096 |
| McCabe, Milton Mathew | 69777 | 29 | 1096 |
| McCabe, William John | 69780 | 29 | 1096 |
| McCabe, Jr., William John | 69784 | 29 | 1096 |
| McCormick et al., Cyrus H., trustees | 44139 | 26 | 1172 |
| McCrory, Luke W., trustee | 32444 | 25 | 994 |
| McCurdy, William H., estate of [1] | 67681 | 31 | 379 |
| McGrath, James W. and Antonette | 65040 | 30 | 562 |
| McGrath, Marie Louise | 65042 | 30 | 562 |
| McGrath, Robert E | 65039 | 30 | 562 |
| McIlvaine et al., William B., trustees | 52931<br>57226 | 29 | 304 |
| McKinney, Ida I | 45823 | 32 | 450 |
| McLister, Frank | 48562 | 27 | 155 |
| McMillan, William Northrup, estate of [2] | 45966 | 27 | 318 |
| Merner, Delight Ward | 73406 | 32 | 658 |
| Merrell, Irving S | 70103 | 33 | 1151 |
| Metropolitan Ice Co.[3] | 53936<br>69525 | 32 | 587 |
| Meyer, George L., transferee | 64654 | 33 | 564 |
| Meyer, Robert R | 44032 | 27 | 44 |
| Michigan Central R. R. Co.[4] | 19930 | 28 | 437 |
| Miglietta, Olga K | 36379 | 25 | 243 |
| Miles Realty Co | 51394 | 31 | 443 |
| Miller, Albert | 45368 | 28 | 236 |
| Mills, J. H. Goadby | 58797 | 26 | 1401 |
| Minnesota Tea Co | 54227 | 34 | 145 |
| Missouri State Life Insurance Co.[5] | 58241<br>62386 | 29 | 401 |
| Mitchell, Charles E | 74720 | 32 | 1093 |
| Mitchell, J. F. B | 65834 | 33 | 806 |
| Mitchell, Oscar [6] | 41680<br>41874<br>54673 | 27 | 101 |
| Mitchell, William | 58799 | 26 | 1401 |
| Mitten Management, Inc | 42494<br>53990<br>61861 | 29 | 576 |
| Modjeski, Ralph | 49517 | 28 | 1051 |
| Moore, Alma V | 64790<br>68219 | 30 | 1197 |
| Moore Bread Co | 41645 | 22 | 793 |
| Moore, Edward W., estate of [7] | 58720 | 33 | 108 |
| Moore, G. H | 38351 | 26 | 301 |
| Moore, John R | 64791<br>68218 | 30 | 1197 |
| Moore, Louise C., executrix [7] | 58720 | 33 | 108 |

[1] Estate tax decision.

[2] Estate tax decision; nonacquiescence as to question of situs.

[3] Acquiescence published in Cumulative Bulletin XIV-2 withdrawn.

[4] Nonacquiescence relates to following issues: Whether mail pay received in 1921 constituted income in 1920; rental interest received on completed addition and betterments in final settlement with the Director General.

[5] Nonacquiescence relates to deduction for reserve set up to meet liability upon matured coupons; adjustment of income for rental of space occupied in home office building and depreciation upon such building.

[6] Nonacquiescence relates to issue regarding deduction from income of sprinkling tax.

Estate tax decision; nonacquiescence in the conclusions on the third group of policies that the proceeds thereof should be excluded from the gross estate.

NONACQUIESCENCES—Continued.

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| Morganite Brush Co., Inc | 26369 | 24 | 776 |
| Moro Realty Holding Corporation | 37406, 44759, 50490 | 25 | 1135 |
| Morris, Arthur J | 64246 | 33 | 241 |
| Morriss et al., Julia L | 41023, 41024, 45863, 45864 | 23 | 1076 |
| Morriss Realty Co. Trust No. 1 | 41023, 45863 | 23 | 1076 |
| Morriss Realty Co. Trust No. 2 | 41024, 45864 | 23 | 1076 |
| Morse, Emma R., estate of [1] | 44652 | 27 | 1070 |
| Moser, Carolyn L | 55937 | 29 | 216 |
| Mosser, Charles F | 55399 | 27 | 513 |
| Mott, Charles Stewart | 51585, 57506 | 30 | 1040 |
| Mueller, Earl W | 45362 | 28 | 236 |
| Murphy et al., Fred T., trustees | 43795 | 25 | 724 |
| Murphy Personal Property Trust | 43795 | 25 | 724 |
| Mutual Life Insurance Co. of New York | 9764 | 23 | 749 |
| Myrick, Julian S | 51526, 63376 | 29 | 822 |
| N. | | | |
| Nashville, Chattanooga & St. Louis Ry | 33799 | 24 | 856 |
| National Casket Co., Inc.[2] | 50320 | 29 | 139 |
| National Contracting Co.[3] | 24520 | 25 | 407 |
| National Grange Mutual Liability Co | 73099 | 31 | 666 |
| National Land & Construction Co | 40126 | 25 | 562 |
| National Outdoor Advertising Bureau, Inc | 65252, 70999 | 32 | 1025 |
| National Pipe & Foundry Co.[4] | 32997 | 19 | 242 |
| Neal et al., J. Henry, trustees | 45403 | 26 | 551 |
| Neill, James [5] | 9290 | 8 | 299 |
| Nelms, Frank Haywood | 51887 | 27 | 65 |
| Nelms, Mrs. Frank Haywood | 51888 | 27 | 65 |
| Netcher, Charles, estate of | 42435 | 31 | 41 |
| Newberry Lumber & Chemical Co | 68511 | 33 | 150 |
| Newbury, Mollie Netcher, trustee | 42435 | 31 | 41 |
| Newport Co | 35431 | 24 | 1246 |
| New York Central R. R. Co.[6] | 19932, 34437, 62040 | 28 | 437 |
| New York Life Insurance Co | 38880 | 24 | 1217 |
| New York, Ontario & Western Ry. Co | 52693 | 30 | 408 |
| Nibley-Mimnaugh Lumber Co | 17527 | 26 | 978 |
| Nichols & Cox Lumber Co | 23601 | 24 | 54 |

[1] Estate tax decision.
[2] Nonacquiescence relates to the application of a net amount of operating losses after applying the profits of a subsidiary during the period of affiliation to reduce the loss sustained by a parent company on the liquidation of a subsidiary company.
[3] Nonacquiescence relates to issue 1 of decision and issue regarding deductibility of overhead costs in 1925.
[4] Acquiescence published in Cumulative Bulletin IX-2 revoked. Revocation of prior acquiescence and present nonacquiescence are due to the failure of the Board's decision to limit the word "distributed" to the cash distributions made to the stockholders.
[5] Acquiescence published in Cumulative Bulletin X-1 withdrawn.
[6] Nonacquiescence relates to following issues: Whether mail pay received in 1921 constituted income in 1920; rental interest received on completed addition and betterments in final settlement with the Director General.

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| Taxpayer. | Docket No. | Board of Tax Appeals. | |
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| Nicholson, James | 66966 | 32 | 977 |
| Nicola, E. F | 57417 | 33 | 1113 |
| Nielsen Co., E. H | 8899 | 26 | 223 |
| North American Investment Co | 30183 | 24 | 419 |
| Northern Coal Co.[1] | 34945 | 24 | 307 |
| Northport Shores, Inc | 64500 | 31 | 1013 |
| Noyes, Jansen [2] | 38574 | 25 | 1351 |
| **O.** | | | |
| Oakman et al., Mamie R | 42917 | 24 | 84 |
| O'Donnell, Thomas A | 52987<br>62979 | 32 | 1277 |
| Ogden, Hugh W | 23943 | 24 | 1239 |
| Old Colony Trust Co., trustee | 74928 | 33 | 311 |
| Old Mission Portland Cement Co | 38853 | 25 | 305 |
| Old National Bank in Evansville, executor [3] | 67681 | 31 | 379 |
| Olinger Mortuary Association | 36502 | 23 | 1281 |
| Oliver, Olive Hume | 65640 | 30 | 1380 |
| Olmsted, George W.[4] | 44090<br>45745<br>48121<br>54714<br>60746 | 30 | 331 |
| Olmsted, Iva C.[4] | 44089<br>45746<br>48143<br>54713<br>60745 | 30 | 331 |
| Olstad, Oscar A | 76683 | 32 | 670 |
| Omaha Coca-Cola Bottling Co | 52641 | 26 | 1123 |
| O'Rear, E. C.[5] | 32335 | 28 | 698 |
| Oregon Terminals Co | 68893 | 29 | 1332 |
| Oswego Falls Corporation | 28301<br>32673<br>34352 | 26 | 60 |
| Owens, J. T | 63149 | 27 | 469 |
| Owens, Mrs. J. T | 63150 | 27 | 469 |
| Owens, O. O | 31986 | 26 | 1147 |
| **P.** | | | |
| Pacific Coast Biscuit Co. et al.[6] | 71588 | 32 | 39 |
| Pacific Nash Motor Co | 45169<br>45170 | 23 | 953 |
| Pacific Rock & Gravel Co | 28776 | 26 | 296 |
| Palmer, Bradley W.[7] | 62652 | 32 | 550 |
| Parker, Clara B., executrix [8] | 58604 | 31 | 644 |
| Parker, George D., estate of [8] | 58604 | 31 | 644 |
| Parker, Herbert L., estate of [3] | 53320 | 30 | 342 |

[1] Nonacquiescense relates to statute of limitations issue.

[2] Nonacquiescene relates to value of common stock of American Chain Co., Inc., and the basis of allocation of cost between said common stock and preferred stock of said company acquired at the same time and under the same agreement.

[3] Estate tax decision.

[4] Nonacquiescence relates to issue involving the amounts paid to stockholders by J. G. Curtis Leather Co. upon cancellation of certain stock.

[5] Nonacquiescense relates to issue regarding amount of loss sustained by petitioner by reason of destruction by fire of his residence and furniture.

[6] Nonacquiescence with respect to deduction of amounts expended in connection with dissolution and liquidation of a corporation.

[7] Nonacquiescence in Board's decision holding that the Superpower rights were not dividends.

[8] Nonacquiescence relates to issue regarding existence of George D. Parker Co. partnership.

NONACQUIESCENCES—Continued.

| Taxpayer. | Docket No. | Board of Tax Appeals. Volume. | Board of Tax Appeals. Page. |
|---|---|---|---|
| Parker et al., Emily King, trustees [1] | 53320 | 30 | 342 |
| Parriott, F. B.[2] | 30989 | 28 | 917 |
| Peabody, Cornelia Haven, estate of [1] | 39647 | 24 | 787 |
| Peabody et al., Stephen, executors [1] | 39647 | 24 | 787 |
| Pennsylvania Co. for Insurances on Lives and Granting Annuities, executor and trustee | 73029 | 32 | 449 |
| Perkins et al., Thomas N.[3] | 57848<br>58305<br>58306<br>58443<br>58475<br>58770<br>58772<br>58904<br>58905<br>58906<br>58907<br>58917<br>58918<br>58925 | 33 | 606 |
| Petaluma & Santa Rosa R. R. Co.[4] | 13830 | 11 | 541 |
| Phelps et al., Luis James, executors [5] | 50336 | 27 | 1224 |
| Phillips, William S | 24446<br>31769 | 24 | 98 |
| Pierce, Edward A | 58796 | 26 | 1401 |
| Pittsburgh & Lake Erie R. R. Co.[6] | 42764 | 28 | 259 |
| Plains Realty Co | 48977<br>65492<br>67197 | 31 | 412 |
| Plant, Henry Bradley | 43889<br>48984<br>52094<br>55659<br>60923 | 30 | 133 |
| Plettner, Maude Brown | 33345 | 25 | 631 |
| P-M-K Petroleum Co.[7] | 50576<br>54779 | 24 | 360 |
| Portland Furniture Manufacturing Co | 61809<br>70367 | 30 | 878 |
| Post & Sheldon Corporation | 56695 | 28 | 26 |
| Price, Harry | 70008<br>71596 | 29 | 1255 |
| Priester, H. C | 55195 | 33 | 230 |

[1] Estate tax decision.

[2] Nonacquiescence relates to interpretation of article 1567, Regulations 45, as applied to exchange of stock of Pittsburgh Texas Oil & Gas Co.

[3] Nonacquiescense relates to the following issues:

Did the statute of limitations, at the time of the mailing of the deficiency notices, bar assessment and collection of the deficiencies as to Thompson Oil Co., Eastern Carbon Black Co., W. H. Davis, Lillian A. Davis, Matilda M. Davis, Alton N. Davis, Emma Luette Davis, executrix, u/w O. L. Davis, Lue Davis and Davis Bros. Co., where the income tax returns were filed with a deputy collector?

Did the statute of limitations, at the time of the mailing of the deficiency notices, bar assessment and collection of the deficiency as to Thompson Oil Co., where a consolidated return was originally filed and the Commissioner later ruled against consolidation?

Is G. H. M. Co. entitled to a deduction greater than $14,179.75 as an additional bonus to its general manager?

[4] Nonacquiescence relates to that part of decision concerning purchase of taxpayer's own bonds at less than par which were held as an investment. Acquiescence notice as to this issue published in Cumulative Bulletin VII-2 revoked.

[5] Estate tax decision; nonacquiescence with respect to the trusts for the son and daughter.

[6] Nonacquiescence relates to rental interest question and Board's decision with respect to portion of mail pay received in 1921.

[7] Nonacquiescence relates to first issue of decision.

NONACQUIESCENCES—Continued.

| Taxpayer. | Docket No. | Board of Tax Appeals. | |
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| Proctor Shop, Inc.[1] | 58909<br>66268 | 30 | 721 |
| Prosperity Co., Inc.[2] | 45896<br>59468 | 27 | 28 |
| Prouty, Olive H | 57829 | 30 | 1068 |
| Prudential Insurance Co. of America | 56641<br>60884<br>67238 | 33 | 332 |
| Pryor & Lockhart Development Co | 38872<br>45668<br>51326 | 26 | 1054 |
| Purse, James N | 54124 | 27 | 725 |
| Q. | | | |
| Quinn, Porte F | 67156 | 31 | 142 |
| R. | | | |
| Rainbow Gasoline Corporation | 65152<br>72365 | 31 | 1050 |
| Randolph, Frankie Carter | 51890 | 27 | 65 |
| Randolph, R. D | 51889 | 27 | 65 |
| Randolph, Virgil P., trust | 48833 | 28 | 773 |
| Ray Oil Co.[3] | 43123<br>45219<br>48015<br>61554 | 28 | 1204 |
| Raymond, Howard W | 58544 | 26 | 1401 |
| Realty Associates, as syndicate manager [4] | 27921 | 17 | 1173 |
| Reed, Latham R | 58800 | 26 | 1401 |
| Reese, Augusta Bliss | 70410 | 30 | 1 |
| Rehtam, Inc | 45016 | 28 | 666 |
| Reybine, Alpheus, estate of [5] | 60660 | 31 | 314 |
| Reybine, Martha H., executrix [5] | 60660 | 31 | 314 |
| Reynard Corporation [6] | 67386<br>70795 | 30 | 451 |
| Richardson et al., Forrest, executors [5] | 44652 | 27 | 1070 |
| Richfield Oil Co | 42921 | 25 | 101 |
| Richmond, Fredericksburg & Potomac R. R. Co.[7] | 68876 | 33 | 895 |
| Riffel, Henry [8] | 3576 | 3 | 436 |
| Riley, Anna E | 61066 | 29 | 160 |
| Riley Stoker Corporation | 36584 | 26 | 749 |
| Riley, Thomas J., transferee | 64638 | 33 | 564 |
| Rio Grande Land & Canal Co | 71350 | 31 | 507 |
| Rio Grande Reservoir & Ditch Co | 71351 | 31 | 507 |
| Robbins, Harwood | 67076 | 33 | 880 |
| Roberts, G. P | 68434 | 32 | 646 |
| Roberts, Walter B | 37534 | 24 | 405 |
| Robertson, J. G | 49552<br>52370 | 28 | 53 |
| Rockwood, George O | 72711 | 31 | 927 |
| Rockwood, William M | 72712 | 31 | 927 |

[1] Acquiescence published in Cumulative Bulletin XIII-2, 33, revoked.
[2] Nonacquiescence relates to overstatement of loss sustained as a result of liquidation of subsidiary.
[3] Nonacquiescence relates to issue whether petitioner was taxable for years 1926 to 1929, inclusive, as a trust or as an association.
[4] Acquiescence published in Cumulative Bulletin X-2 withdrawn.
[5] Estate tax decision.
[6] Nonacquiescence relates to inclusion in income of corporation for years ended March 31, 1930, and March 31, 1931, amounts representing rental of premises occupied by its president.
[7] Nonacquiescence relates to issue involving the question, Are payments made to holders of guaranteed stock designated in certificates as dividends deductible as interest?
[8] Estate tax decision; acquiescence published in Cumulative Bulletin X-2 recalled.

NONACQUIESCENCES—Continued.

| Taxpayer. | Docket No. | Board of Tax Appeals. | |
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| Rodeo-Vallejo Ferry Co.[1] | 36411<br>48528 | 24 | 936 |
| Rogers, May | 45051 | 31<br>32 | 994<br>1176 |
| Rolandelli, Guiliano [2] | 57479<br>67286 | 33 | 843 |
| Roosevelt & Son Investment Fund | 76196 | 34 | 38 |
| Rorimer, Louis | 58850 | 27 | 871 |
| Rosenbloom Finance Corporation [3] | 35778<br>40903 | 24 | 763 |
| Ross, Blanche S.[4] | 51171 | 28 | 39 |
| Ross, Walter L | 73282 | 30 | 562 |
| Rosser, E. M., executor [5] | 40765 | 24 | 176 |
| Rossheim, Irving D.[6] | 57503 | 31 | 857 |
| Roth, W. A.[7] | 45065 | 22 | 587 |
| **S.** | | | |
| Sabatini, Rafael | 50134 | 32 | 705 |
| St. Louis Southwestern Ry. Co | 13319<br>27768<br>33938 | 24 | 917 |
| St. Louis Union Trust Co., executor [8] | 45966 | 27 | 318 |
| Salomon, Leon [7] | 3725<br>12231 | 4<br>8 | 1109<br>979 |
| San Carlos Milling Co., Ltd.[9] | 39525 | 24 | 1132 |
| San Jacinto Life Insurance Co | 75348 | 34 | 186 |
| Sand Springs Ry. Co | 32438<br>32439 | 21 | 1291 |
| Sather Lease—Thomas Sather & Co | 31979 | 26 | 86 |
| Scatena, Elvira [10] | 63920 | 32 | 675 |
| Schoen, Louis | 56776 | 30 | 1075 |
| Schwartz-Kasser Improvement Co | 36876 | 26 | 322 |
| Scott, Thomas B., estate of [11] | 50336 | 27 | 1224 |
| Scovell, Clinton H., estate of [5] | 49272 | 30 | 679 |
| Scripps, Robert P | 77116 | 33 | 963 |
| Seaconnet Coal Co.[12] | 18089 | 24 | 307 |
| Seatree, William Ernest | 22094<br>33640 | 25 | 396 |
| Security First National Bank of Los Angeles et al., executors [13] | 45429 | 28 | 289 |
| Security Savings & Commercial Bank | 59523 | 29 | 176 |
| Selwyn Eddy Co | 21612 | 25 | 1341 |

1 Nonacquiescence relates to first issue of decision.
2 Nonacquiescence as to issue regarding taxability in 1929 of dividends declared in stock in 1928, certificates for which were not delivered until 1929.
3 Nonacquiescence does not relate to the Board's holding that distributions received from Joseph H. Finch & Co. were not partial liquidating dividends.
4 Gift tax decision.
5 Estate tax decision.
6 Nonacquiescence relates to issue whether Commissioner is entitled to increased deficiency as raised by his amended answer filed with the Board.
7 Acquiescence published in Cumulative Bulletin X-1 withdrawn.
8 Estate tax decision; nonacquiescence as to question of situs.
9 Acquiescence as to issue 2 and nonacquiescence as to issue 1 published in Cumulative Bulletin XI-1 withdrawn.
10 Nonacquiescence relates to dividend issue.
11 Estate tax decision; nonacquiescence with respect to the trusts for the son and daughter.
12 Nonacquiescence relates to statute of limitations issue.
13 Nonacquiescence relates to issue whether taxpayer sustained a net loss in any business regularly carried on in 1924 which could be carried forward and deducted from taxable income in 1925.

NONACQUIESCENCES—Continued.

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| Shaffer, C. B.[1] | 29259 | 29 | 1315 |
| Shaffer, John C | 50086<br>59511 | 28 | 1293 |
| Sharp et al., Edith Huggard, executors [2] | 48317 | 30<br>33 | 532<br>290 |
| Sharp, Walter P., estate of [2] | 48317 | 30<br>33 | 532<br>290 |
| Sheaffer Penn Co., W. A | 36604 | 27 | 1056 |
| Shepherd Syndicate | 48332<br>51327 | 26 | 1062 |
| Shlenker, Simon J | 58801 | 26 | 1401 |
| Sibley et al., John R., executors [3] | 24921 | 16 | 915 |
| Sibley, Rufus A., estate of [3] | 24921 | 16 | 915 |
| Silberblatt, Solomon | 46335 | 28 | 73 |
| Skewes-Cox, Edith Page | 61669<br>68335 | 29 | 167 |
| Skiff, Frank V.[4] | 51173 | 28 | 39 |
| Small's, Inc | 53791 | 24 | 686 |
| Smathers, E. E., estate of [1] | 29260 | 29 | 1315 |
| Smiley, Albert K | 74424 | 33 | 198 |
| Smiley, Francis G | 74425 | 33 | 198 |
| Smith, Mrs. Grant | 43300<br>43305<br>43306 | 26 | 1178 |
| Smith, Milton, estate of | 52132 | 28 | 422 |
| Smith, Jr., Milton, executor | 52132 | 28 | 422 |
| Sneed, Jr., J. T.[5] | 45694 | 30 | 1121 |
| Snyder, Inc., H. S. & M. W | 36686 | 26 | 692 |
| Southern California Rock & Gravel Co | 30898 | 26 | 296 |
| Southern Railway Co. et al.[6] | 21481<br>29951<br>37887–<br>37898 | 27 | 673 |
| Spang, Chalfant & Co.[7] | 58790 | 31 | 721 |
| Spencer, George Frinck, estate of [2] | 72236 | 31 | 171 |
| Speyer, James | 56435 | 30 | 517 |
| Sprague, C. O. M | 65833 | 33 | 806 |
| Sprague & Son Co., C. H.[8] | 34946 | 24 | 307 |
| Spring City Foundry Co | 21169 | 25 | 822 |
| Sredies, Inc | 45015 | 28 | 666 |
| Stanley Co. of America | 31516<br>33142<br>40023 | 26 | 705 |
| Stayton, Jr., William H | 71867 | 32 | 940 |
| Stearns, Marshall, administrator | 48930 | 24 | 269 |
| Steele, William, estate of | 73347 | 34 | 173 |
| Stern et al., Samuel E. A., executors [9] | 2459 | 2 | 102 |

[1] Nonacquiescence relates to the following issues: Reduction of cost basis (March 1, 1913, value) of assets sold by a partnership in 1919 by depreciation allowed in computing income for period March 1, 1913, to December 1, 1915; computation of 1919 partnership profit on sale of assets by considering as part of the sale price taxes of the partners paid in 1920 by the vendee.

[2] Estate tax decision.

[3] Acquiescence published in Cumulative Bulletin VIII-2 withdrawn.

[4] Gift tax decision.

[5] Nonacquiescence relates to issue whether certain interest in real estate situated in Texas was acquired by petitioner prior or subsequent to his marriage; and that part of decision which holds that delay rentals received are community income notwithstanding that the lands from which they arise may be the separate property of either spouse.

[6] Nonacquiescence relates to issues involving additional compensation, rental interest on additions and betterments, and back mail pay for use of properties during Federal control.

[7] Acquiescence published in Cumulative Bulletin XIV-2 withdrawn.

[8] Nonacquiescence relates to statute of limitations issue.

[9] Estate tax decision; acquiescence published in Cumulative Bulletin X-2 recalled.

NONACQUIESCENCES—Continued.

| Taxpayer. | Docket No. | Board of Tax Appeals. Volume. | Page. |
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| Stetson, Iola Wise | 41743 | 26<br>27 | 390<br>173 |
| Stevens, Byam K | 70006<br>71593 | 29 | 1255 |
| Stevens, William D | 70009<br>71594 | 29 | 1255 |
| Stevenson Consolidated Oil Co.[1] | 43416 | 23 | 610 |
| Stewart, John B | 57531 | 29 | 809 |
| Stewart, William Rhinelander, estate of [2 3] | 67776 | 31 | 201 |
| Stewart, Jr., et al., William Rhinelander, executors [2 3] | 67776 | 31 | 201 |
| Stifel, Arthur C | 60738 | 29 | 1145 |
| Stifel, Edward W | 60739 | 29 | 1145 |
| Stifel, Henry G | 60740 | 29 | 1145 |
| Stine, Dollie M | 62694 | 32 | 482 |
| Stine, M. Josephine | 62695 | 32 | 482 |
| Stockholms Enskilda Bank | 55755 | 25 | 1328 |
| Stone, H. C., estate of | 38336 | 26 | 301 |
| Stone, Mrs. H. C., executrix | 38336 | 26 | 301 |
| Stone et al., Irving K., executors and trustees [4] | 43830 | 26 | 1 |
| Stone, Irving Lee, estate of [4] | 43830 | 26 | 1 |
| Straub, Tecla M | 55935 | 29 | 216 |
| Straus, Aaron | 65091 | 27 | 1116 |
| Strayer, Walter A | 48564 | 27 | 155 |
| Streefkerk, Mrs. S | 45363 | 28 | 236 |
| Strong, Harold C.[5] | 38576 | 25 | 1351 |
| Sturgeon-Hubbard Trust | 37095 | 25 | 368 |
| Sturgeon et al., Rollin S., trustees | 37095 | 25 | 368 |
| Sullivan, Joseph J | 56671 | 33 | 629 |
| Suncrest Lumber Co | 33244 | 25 | 375 |
| Swartz, Inc., Edward G | 36650 | 25 | 1065 |
| Swift, Mary Dodson, estate of | 44909 | 26 | 615 |
| Swisky, Toby W | 42032 | 25 | 259 |
| Swiss Oil Corporation | 60177<br>61002<br>63038<br>70998 | 32 | 777 |
| T. | | | |
| Taft, Anna S., estate of [6] | 77923 | 33 | 671 |
| Taft, Robert A., executor [6] | 77923 | 33 | 671 |
| Talbot, Frederick C., estate of | 20411 | 27 | 829 |
| Talbot, J. A.[7] | 36191 | 23 | 792 |
| Talbot et al., Susan D., executors | 20409 | 27 | 829 |
| Talbot, William H., estate of | 20409 | 27 | 829 |
| Taylor, H. Seldon, estate of [6] | 64444 | 27 | 220 |
| Taylor, Jr., et al., H. Seldon, executors [6] | 64444 | 27 | 220 |
| Taylor, Jessie Carter | 51891 | 27 | 65 |
| Taylor, Judson L | 51892 | 27 | 65 |

[1] Nonacquiescence relates to issue regarding inclusion in income for 1926 of $180,823.35 received upon exchange by petitioner of 250,000 shares of Sunburst Oil & Gas Co. stock with that corporation.
[2] Estate tax decision; nonacquiescence relates to fair market value of an undivided or fractional interest in certain real property.
[3] Estate tax decision; nonacquiescence relates to fair market value of 3,639 shares of stock of Rhinelander Real Estate Co. as of September 4, 1929. Acquiescence as to this issue published in Bulletin XIV-7 withdrawn.
[4] Estate tax decision; nonacquiescence relates to issue involving property transferred by trust agreement.
[5] Nonacquiescence relates to value of common stock of American Chain Co., Inc., and the basis of allocation of cost between said common stock and preferred stock of said company acquired at the same time and under the same agreement.
[6] Estate tax decision.
[7] Nonacquiescence relates to depreciation allowance in computing loss in sale of a boat.

NONACQUIESCENCES—Continued.

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| Ten Eyck, Peter G | 68197 | 29 | 1113 |
| Tennessee Consolidated Coal Co | 33383 | 24 | 369 |
| Terminal Railroad Association of St. Louis | 49832<br>53429<br>63699 | 33 | 906 |
| Terminal Realty Corporation | 43766<br>50762<br>60596<br>71157. | 32 | 623 |
| Terre Haute, Indianapolis & Eastern Traction Co | 33858 | 24 | 197 |
| Terre Haute Traction & Light Co | 33860 | 24 | 197 |
| Terry, Anna Davis | 45446 | 26 | 1418 |
| Terry, Jr., J. T | 65835 | 33 | 806 |
| Texas Irrigation Co.[1] | 40083<br>41346 | 24 | 958 |
| Texas Pipe Line Co | 59457 | 32 | 125 |
| Thatcher & Son, John | 56888<br>65545 | 30 | 510 |
| The Hub, Inc | 46298 | 26 | 1201 |
| Thieman, Mrs. Leo | 65041 | 30 | 562 |
| Thrall, Edna May | 52449<br>55546 | 31<br>32 | 994<br>1176 |
| 353 Lexington Avenue Corporation | 65089 | 27 | 762 |
| Tide Water Oil Co | 39936 | 29 | 1208 |
| Tillotson Manufacturing Co | 44167 | 27 | 913 |
| Title & Trust Co | 73785 | 33 | 25 |
| Titus, C. Dickson | 20705 | 24 | 36 |
| Titus, Inc., C. W | 42268 | 33 | 928 |
| Todd, Willis | 37536 | 24 | 405 |
| Tolerton & Warfield Co.[2] | 45320 | 23 | 892 |
| Torrens, James H.[3] | 53778 | 31 | 787 |
| Towers & Sullivan Manufacturing Co | 40508 | 25 | 922 |
| Townsend, A. J | 73186 | 32 | 940 |
| Townsend, W. S | 74541 | 32 | 940 |
| Transatlantic Shipping Co., Inc | 61932 | 31 | 938 |
| Travelers Bank & Trust Co | 62834<br>71349 | 31 | 507 |
| Travelers Fire Insurance Co | 62833<br>71348 | 31 | 507 |
| Travelers Indemnity Co | 57916<br>62832<br>71347 | 31 | 507 |
| Trojan Oil Co | 33757 | 26 | 659 |
| Turney, W. W | 65258 | 31 | 308 |
| Turney, Mrs. W. W | 65257 | 31 | 308 |
| Tuthill, Jr., Horace S | 52448 | 31<br>32 | 994<br>1176 |
| Tuttle, Carl B | 70558 | 31 | 782 |
| Twin Bell Oil Syndicate | 45052 | 26 | 172 |
| Tyler et al., Sidney F., trustees | 56449 | 28 | 367 |
| **U.** | | | |
| Uihlein, Joseph E | 51234 | 30 | 399 |
| Ullmann, Emanuel Solomon | 56470 | 30 | 764 |
| Ullmann, Jr., Joseph | 56471 | 30 | 764 |

[1] Nonacquiescence relates to affiliation issue.

[2] Nonacquiescence relates to issue regarding deduction of loss sustained by two affiliated companies during fiscal year ended January 31, 1924, and the taxable period February 1 to April 25, 1924, in computing the consolidated net income for taxable period April 26 to December 31, 1924, and the year 1925.

[3] Nonacquiescence relates to the trust and dividend issues.

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| Ullmann, Samuel, estate of | 56472 | 30 | 764 |
| Ullmann et al., Theresa, executors | 56472 | 30 | 764 |
| Union Guardian Trust Co., administrator [1] | 75516 | 32 | 996 |
| Union Guardian Trust Co., executor [1] | 44735 | 26 | 1321 |
| Union Pacific R. R. Co.[2] | 51530<br>70183<br>70219 | 32 | 383 |
| Union Pacific R. R. Co. et al.[3] | 35639–35649<br>35684<br>35685<br>40060<br>40061<br>40062 | 26 | 1401 |
| Union Trust Co., trustee | 42917 | 24 | 84 |
| United National Corporation | 67949 | 33 | 790 |
| United Oil Co | 38082<br>42922<br>51622 | 25 | 101 |
| V. | | | |
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| Volunteer State Life Insurance Co | 54176 | 27 | 1149 |
| Von Gunten, Christian W | 61278 | 28 | 702 |
| Vonnegut Hardware Co | 44940 | 28 | 784 |
| W. | | | |
| Waggoner, Ella | 33517 | 24 | 657 |
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| Walker, Talbot C | 20407 | 27 | 829 |
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| Walters, John W | 70010<br>71597 | 29 | 1255 |
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[1] Estate tax decision.
[2] Nonacquiescence relates to the issues regarding cost of intercompany transportation of material used in construction of capital assets; sale in 1926 of block 394, Seattle Tide Lands; sale of land to Kansas City Terminal Railway Co.; adjustment for depreciation sustained prior to January 1, 1909, of equipment retired in 1924.
[3] Nonacquiescence relates to issue regarding rental interest and issue concerning net loss of Los Angeles & Salt Lake R. R. Co. for period January 1 to April 30, 1921.
[4] Estate tax decision; acquiescence published in Cumulative Bulletin X-2 recalled.
[5] Acquiescence published in Cumulative Bulletin X-1 withdrawn.
[6] Nonacquiescence relates to issue whether gains on sale of stock of the Waterbury Chemical Co. were taxable to petitioner or to trusts created by them.

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[1] Nonacquiescence relates to issue whether gains on sale of stock of the Waterbury Chemical Co. were taxable to petitioner or to trusts created by them.
[2] Gift tax decision.
[3] Nonacquiescence relates to statute of limitations issue.
[4] Nonacquiescence relates to the trust and dividend issues.
[5] Nonacquiescence relates to issue 5 of decision.
[6] Nonacquiescence relates to question whether distribution of stock had the effect of distribution of a taxable dividend.
[7] Acquiescence published in Cumulative Bulletin X-2 withdrawn.

# INCOME TAX RULINGS.—PART I.

## REVENUE ACTS OF 1936, 1935, AND 1934.

### A. REVENUE ACT OF 1936.

## SUBTITLE C.—SUPPLEMENTAL PROVISIONS.

### SECTION 143.—WITHHOLDING OF TAX AT SOURCE.

(Also Section 144.) XV-26-8148
T. D. 4649

Withholding of income tax under sections 143 and 144 of the Revenue Act of 1936.

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

*Collectors of Internal Revenue and Others Concerned:*

PARAGRAPH A. The Revenue Act of 1936 (Public, No. 740, Seventy-fourth Congress, second session, H. R. 12395), was approved by the President, June 22, 1936, 9 p. m., eastern standard time.

PARAGRAPH B. Section 143 (Title I—Income Tax) of the Act, relating to withholding of tax at the source, provides:

SEC. 143. WITHHOLDING OF TAX AT SOURCE.

(a) TAX-FREE COVENANT BONDS.—

(1) *Requirement of withholding.*—In any case where bonds, mortgages, or deeds of trust, or other similar obligations of a corporation, issued before January 1, 1934, contain a contract or provision by which the obligor agrees to pay any portion of the tax imposed by this title upon the obligee, or to reimburse the obligee for any portion of the tax, or to pay the interest without deduction for any tax which the obligor may be required or permitted to pay thereon, or to retain therefrom under any law of the United States, the obligor shall deduct and withhold a tax equal to 2 per centum of the interest upon such bonds, mortgages, deeds of trust, or other obligations, whether such interest is payable annually or at shorter or longer periods, if payable to an individual, a partnership, or a foreign corporation not engaged in trade or business within the United States and not having any office or place of business therein: *Provided,* That if the liability assumed by the obligor does not exceed 2 per centum of the interest, then the deduction and withholding shall be at the following rates: (A) 10 per centum in the case of a nonresident alien individual (except that such rate shall be reduced, in the case of a resident of a contiguous country, to such rate, not less than 5 per centum, as may be provided by treaty with such country), or of any partnership not engaged in trade or business within the United States and not having any office or place of business therein and composed in whole or in part of nonresident aliens, (B) in the case of such a foreign corporation, 15 per centum, and (C) 2 per centum in the case of other individuals and partnerships: *Provided further,* That if the owners of such obligations are not known to the withholding agent the Commissioner may

authorize such deduction and withholding to be at the rate of 2 per centum, or, if the liability assumed by the obligor does not exceed 2 per centum of the interest, then at the rate of 10 per centum.

(2) *Benefit of credits against net income.*—Such deduction and withholding shall not be required in the case of a citizen or resident entitled to receive such interest, if he files with the withholding agent on or before February 1 a signed notice in writing claiming the benefit of the credits provided in section 25(b); nor in the case of a nonresident alien individual if so provided for in regulations prescribed by the Commissioner under section 215.

(3) *Income of obligor and obligee.*—The obligor shall not be allowed a deduction for the payment of the tax imposed by this title, or any other tax paid pursuant to the tax-free covenant clause, nor shall such tax be included in the gross income of the obligee.

(b) NONRESIDENT ALIENS.—All persons, in whatever capacity acting, including lessees or mortgagors of real or personal property, fiduciaries, employers, and all officers and employees of the United States, having the control, receipt, custody, disposal, or payment of interest (except interest on deposits with persons carrying on the banking business paid to persons not engaged in business in the United States and not having an office or place of business therein), dividends, rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable annual or periodical gains, profits, and income (but only to the extent that any of the above items constitutes gross income from sources within the United States), of any nonresident alien individual, or of any partnership not engaged in trade or business within the United States and not having any office or place of business therein and composed in whole or in part of nonresident aliens, shall (except in the cases provided for in subsection (a) of this section and except as otherwise provided in regulations prescribed by the Commissioner under section 215) deduct and withhold from such annual or periodical gains, profits, and income a tax equal to 10 per centum thereof, except that such rate shall be reduced, in the case of a nonresident alien individual a resident of a contiguous country, to such rate (not less than 5 per centum) as may be provided by treaty with such country: *Provided*, That no such deduction or withholding shall be required in the case of dividends paid by a foreign corporation unless (1) such corporation is engaged in trade or business within the United States or has an office or place of business therein, and (2) more than 85 per centum of the gross income of such corporation for the 3-year period ending with the close of its taxable year preceding the declaration of such dividends (or for such part of such period as the corporation has been in existence) was derived from sources within the United States as determined under the provisions of section 119: *Provided further*, That the Commissioner may authorize such tax to be deducted and withheld from the interest upon any securities the owners of which are not known to the withholding agent. Under regulations prescribed by the Commissioner, with the approval of the Secretary, there may be exempted from such deduction and withholding the compensation for personal services of nonresident alien individuals who enter and leave the United States at frequent intervals.

(c) RETURN AND PAYMENT.—Every person required to deduct and withhold any tax under this section shall make return thereof on or before March 15 of each year and shall on or before June 15, in lieu of the time prescribed in section 56, pay the tax to the official of the United States Government authorized to receive it. Every such person is hereby made liable for such tax and is hereby indemnified against the claims and demands of any person for the amount of any payments made in accordance with the provisions of this section.

(d) INCOME OF RECIPIENT.—Income upon which any tax is required to be withheld at the source under this section shall be included in the return of the recipient of such income, but any amount of tax so withheld shall be credited against the amount of income tax as computed in such return.

(e) TAX PAID BY RECIPIENT.—If any tax required under this section to be deducted and withheld is paid by the recipient of the income, it shall not be re-collected from the withholding agent; nor in cases in which the tax is so paid shall any penalty be imposed upon or collected from the recipient of the income or the withholding agent for failure to return or pay the same, unless such failure was fraudulent and for the purpose of evading payment.

(f) REFUNDS AND CREDITS.—Where there has been an overpayment of tax under this section any refund or credit made under the provisions of section

322 shall be made to the withholding agent unless the amount of such tax was actually withheld by the withholding agent.

(g) WITHHOLDING BEFORE ENACTMENT OF ACT.—Notwithstanding the provisions of subsections (a) and (b), the deduction and withholding for any period prior to the tenth day after the date of the enactment of this Act shall be upon the items of income and at the rates prescribed in section 143 (a) and (b) of the Revenue Act of 1934, as amended, in lieu of the items and rates prescribed in such subsections.

PARAGRAPH C. Section 144 (Title I—Income Tax) of the Act, relating to payment of corporation income tax at the source, provides:

SEC. 144. PAYMENT OF CORPORATION INCOME TAX AT SOURCE.

(a) *General rule.*—In the case of foreign corporations subject to taxation under this title not engaged in trade or business within the United States and not having any office or place of business therein, there shall be deducted and withheld at the source in the same manner and upon the same items of income as is provided in section 143 a tax equal to 15 per centum thereof, except that in the case of dividends the rate shall be 10 per centum, and except that in the case of corporations organized under the laws of a contiguous country such rate of 10 per centum with respect to dividends shall be reduced to such rate (not less than 5 per centum) as may be provided by treaty with such country; and such tax shall be returned and paid in the same manner and subject to the same conditions as provided in that section: *Provided*, That in the case of interest described in subsection (a) of that section (relating to tax-free covenant bonds) the deduction and withholding shall be at the rate specified in such subsection.

(b) *Withholding before enactment of Act.*—Notwithstanding the provisions of subsection (a), the deduction and withholding for any period prior to the tenth day after the date of the enactment of this Act shall be upon the items of income and at the rates prescribed in section 144 of the Revenue Act of 1934, as amended, in lieu of the items and rates prescribed in such subsection.

PARAGRAPH D. Section 147(b) (Title I—Income Tax) of the Act, relating to returns of information at the source, provides:

SEC. 147. INFORMATION AT SOURCE.

* * * * * * *

(b) *Returns regardless of amount of payment.*—Such returns may be required, regardless of amounts, (1) in the case of payments of interest upon bonds, mortgages, deeds of trust, or other similar obligations of corporations, and (2) in the case of collections of items (not payable in the United States) of interest upon the bonds of foreign countries and interest upon the bonds of and dividends from foreign corporations by persons undertaking as a matter of business or for profit the collection of foreign payments of such interest or dividends by means of coupons, checks, or bills of exchange.

PARAGRAPH E. Section 62 (Title I—Income Tax) of the Act, relating to rules and regulations, provides:

SEC. 62. RULES AND REGULATIONS.

The Commissioner, with the approval of the Secretary, shall prescribe and publish all needful rules and regulations for the enforcement of this title.

PARAGRAPH F. Pursuant to the above-quoted provisions of the Act the following regulations are hereby prescribed with respect to withholding of tax at the source:

ARTICLE 1. *Domestic, foreign, resident, and nonresident persons.*—For the purpose of these regulations, a domestic corporation is one organized or created in the United States, including only the States, the Territories of Alaska and Hawaii, and the District of Columbia, or under the law of the United States or of any State or Territory, and a foreign corporation is one which is not domestic. A foreign corporation engaged in trade or business within the United States or having an office or place of business therein is referred to in these regulations as a resident foreign corporation, and a foreign corporation not engaged in trade or business within the United States and not having any office or place of business therein, as a nonresident foreign corporation. A partnership engaged in trade or business within the United States or having an office or place of business therein is referred to in these regulations as a resident partnership, and a partnership not engaged in trade or business within the United States and not having any office or place of business therein, as a nonresident partnership. As used in these regulations the term "nonresident alien" includes a nonresident alien individual and a nonresident alien fiduciary.

ART. 2. *Withholding tax at source.*—(*a*) *Withholding in general.*—Withholding of a tax of 10 per cent is required in the case of fixed or determinable annual or periodical income paid to a nonresident alien or to a nonresident partnership, composed in whole or in part of nonresident alien individuals, except (1) income from sources without the United States, including interest on deposits with persons carrying on the banking business paid to persons not engaged in business in the United States and not having any office or place of business therein, (2) interest upon bonds or other obligations of a corporation containing a tax-free covenant and issued before January 1, 1934, (3) dividends paid by a foreign corporation unless (*a*) such corporation is engaged in trade or business within the United States or has an office or place of business therein, and (*b*) more than 85 per cent of the gross income of such corporation for the 3-year period ending with the close of its taxable year preceding the declaration of such dividends (or for such part of such period as the corporation has been in existence) was derived from sources within the United States, as determined under the provisions of section 119, (4) dividends distributed by a corporation organized under the China Trade Act, 1922, to a resident of China, and (5) except that such rate of 10 per cent shall be reduced, in the case of a resident of a contiguous country, to such rate, not less than 5 per cent, as may be provided by treaty with such country.

A tax of 10 per cent must be withheld from interest on bonds or securities not containing a tax-free covenant, or containing a tax-free covenant and issued on or after January 1, 1934, if the owner is unknown to the withholding agent, except where such interest represents income from sources without the United States.

For withholding in the case of income paid to nonresident foreign corporations see article 11.

Resident or domestic fiduciaries are required to deduct the income tax at the source from all fixed or determinable annual or periodical gains, profits, and income paid to nonresident alien beneficiaries, to the extent that such items constitute gross income from sources within the United States. Income paid to a nonresident alien fiduciary which is otherwise subject to the withholding provisions of the Act is not exempt from withholding by reason of the fact that the beneficiaries of the income are citizens or residents of the United States.

A debtor corporation having an issue of bonds or other similar obligations which appoints a duly authorized agent to act in its behalf under the withholding provisions of the Act, is required to file notice of such appointment with the Commissioner of Internal Revenue, Sorting Section, Washington, D. C., giving the name and address of the agent.

If in connection with the sale of its property, payment of the bonds or other obligations of a corporation is assumed by the assignee, such assignee, whether an individual, partnership, or corporation, must deduct and withhold such taxes as would be required to be withheld by the assignor had no such sale or transfer been made.

For withholding in the case of dividends distributed by a corporation organized under the China Trade Act, 1922, see articles 4 and 12.

(*b*) *Tax-free covenant bonds issued before January 1, 1934.*—The withholding provisions of section 143(a)1 are applicable only to bonds, mortgages, or deeds of trust, or other similar obligations of a corporation which were issued before January 1, 1934, and which contain a tax-free covenant. For the purpose of section 143(a)1 bonds, mortgages or deeds of trust, or other similar obligations of a corporation are issued when delivered. If a broker or other person acts as selling agent of the obligor the obligation is issued when delivered by the agent to the purchaser. If a broker or other person purchases the obligation outright for the purpose of holding or reselling it, the obligation is issued when delivered to such broker or other person. In order that the date of issue of bonds, mortgages, or deeds of trust, or other similar obligations of corporations, containing a tax-free covenant may be readily determined by the owner, for the purpose of preparing the ownership certificates required under these regulations the "issuing" or debtor corporation shall indicate, by an appropriate notation, the date of issue or use the phrase, "Issued on or after January 1, 1934," on each such obligation or in a statement accompanying the delivery of such obligation.

In cases where on or after January 1, 1934, the maturity date of bonds or other obligations of a corporation is extended, the bonds shall be considered to have been issued on or after January 1, 1934. The interest on such obligations is not subject to the withholding provisions of section 143(a) but falls within the class of interest described in section 143(b).

In the case of interest upon bonds or other obligations of a corporation containing a tax-free covenant and issued before January 1, 1934, paid to an individual, fiduciary or a partnership, whether resident or nonresident, withholding of a tax of 2 per cent is required, except that if the liability assumed by the obligor in connection with such a covenant does not exceed 2 per cent of the interest, withholding is required at the rate of 10 per cent in the case of a nonresident alien, or a nonresident partnership composed in whole or in part of nonresident alien individuals, or if the owner is unknown to the withholding agent. The rates of withholding applicable to the interest on bonds or other obligations of a corporation containing a tax-free covenant, and issued before January 1, 1934, are applicable to interest on such obligations issued by a domestic corporation or a resident foreign corporation. However, withholding is not required in the case of interest payments on such bonds or obligations if such interest is not to be treated as income from sources within the United States under section 119(a)1(B) of the Act, and the payments are made to a nonresident alien or a partnership composed in whole of nonresident aliens. A nonresident foreign corporation having a fiscal or paying agent in the United States is required to withhold a tax of 2 per cent upon the interest on its tax-free covenant bonds issued before January 1, 1934, paid to a citizen or resident of the United States, individual or fiduciary, or a partnership any member of which is a citizen or resident.

For withholding in the case of interest upon bonds or other obligations of a corporation containing a tax-free covenant and issued before January 1, 1934, paid to nonresident foreign corporations see article 11.

Bonds issued under a trust deed containing a tax-free covenant are treated as if they contain such a covenant. If neither the bonds nor the trust deeds given by the obligor to secure them contain a tax-free covenant, supplemental agreements executed by the obligor corporation and the trustee containing a tax-free covenant which modify the original trust deeds to that extent are of the same effect from the date of their proper execution as if they had been part of the original deeds of trust, and the bonds from such date are subject to the provisions of section 143(a), provided appropriate authority exists for the modification of the trust deeds in this manner. The authority must be contained in the original trust deeds or actually secured from the bondholders.

In the case of corporate bonds or other obligations containing a tax-free covenant, issued before January 1, 1934, the corporation paying a Federal tax, or any part of it, for some one else pursuant to its agreement is not entitled to deduct such payment from gross income on any ground nor shall the tax so paid be included in the gross income of the bondholder. The amount of the tax may nevertheless be claimed by the bondholder as a credit against the total amount of income tax due in accordance with section 143(d). In the case, however, of corporate bonds or other obligations containing an appropriate tax-free covenant, the corporation paying for some one else, pursuant to its agreement, a State tax or any tax other than a Federal tax may deduct such payment as interest paid on indebtedness.

(c) *Withholding under Revenue Act of 1934, as amended.*—The withholding provisions of section 143 and section 144 of the Revenue Act of 1936 (which are merely administrative provisions providing for the collection at the source of the tax imposed under other sections of the Act) do not apply for any period prior to the tenth day after the date of the enactment of that Act, that is, for any period prior to July 2, 1936. For such prior period withholding shall be upon the items of income and at the rates provided by the Revenue Act of 1934, as amended.

ART. 3. *Fixed or determinable, annual or periodical income.*—Only fixed or determinable annual or periodical income is subject to withholding. The Act specifically includes in such income, interest, dividends, rent, salaries, wages, premiums, annuities, compensation, remunerations and emoluments. But other kinds of income are included, as, for instance, royalties.

Income is fixed when it is to be paid in amounts definitely predetermined. Income is determinable whenever there is a basis of calculation by which the amount to be paid may be ascertained. The income need not be paid annually if it is paid periodically; that is to say, from time to time, whether or not at regular intervals. That the length of time during which the payments are to be made may be increased or diminished in accordance with some one's will or with the happening of an event does not make the payments any the less determinable or periodical. A salesman working by the month for a commission on sales which is paid or credited monthly receives determinable periodical income. The distributable share of the income of an estate or trust from sources within the United States paid by a fiduciary to a nonresident alien beneficiary constitutes fixed or determinable annual or periodical income within the meaning of section 143(b). The income derived from the sale in the United States of property, whether real or personal, is not fixed or determinable annual or periodical income.

ART. 4. (*a*) *Exemption from withholding.*—Withholding from interest on corporate bonds or other obligations issued prior to January 1, 1934, containing a tax-free covenant shall not be required in the case of a citizen or resident if he files with the withholding agent when presenting interest coupons for payment, or not later than February 1 following the taxable year, an ownership certificate on Form 1000 stating that his net income does not exceed his personal exemption and credit for dependents. To avoid inconvenience a resident alien should file a certificate of residence on Form 1078 with withholding agents, who shall forward such certificates to the Commissioner of Internal Revenue, Sorting Section, Washington, D. C., with a letter of transmittal.

The income of domestic corporations and of resident foreign corporations is free from withholding.

No withholding from dividends paid by a corporation organized under the China Trade Act, 1922, is required unless the dividends are treated as income from sources within the United States under section 119 of the Act and are distributed to—

(1) A nonresident alien other than a resident of China at the time of such distribution;

(2) A nonresident partnership composed in whole or in part of nonresident aliens (other than a partnership resident in China); or

(3) A nonresident foreign corporation (other than a corporation resident in China).

The salary or other compensation for personal services of a nonresident alien individual who enters and leaves the United States at frequent intervals, shall not be subject to deduction and withholding of income tax at the source, provided he is a resident of Canada or Mexico. Such a nonresident alien shall file on Form 1040B, with the collector of internal revenue for the district in which he is employed, a true and accurate return of his total income from all sources within the United States, including the compensation for personal services rendered in the United States.

The following items of fixed or determinable annual or periodical income from sources within the United States received by a citizen of France residing in France, or a corporation organized under the laws of France, are not subject to the withholding provisions of the Revenue Act of 1936, since such income is exempt from Federal income tax under the provisions of the convention and protocol between the United States and France, signed April 27, 1932, and effective January 1, 1936 (C. B. XIV-2, 535):

(1) Amounts paid as consideration for the right to use patents, secret processes and formulas, trade marks and other analogous rights;

(2) Income received as copyright royalties; and

(3) Private pensions and life annuities.

The items of fixed and determinable income enumerated above paid to citizens of France residing in France and corporations organized under the laws of France are not subject to the withholding provisions of the Revenue Act of 1936. The person paying such income should be notified by letter from the French citizen or corporation, as the case may be, that the income is exempt from taxation under the provisions of the convention and protocol referred to above. Such letter from a citizen of France shall contain his address and a statement that he is a citizen of France residing in France. The letter from such corporation shall contain the address of its office or place of business and a statement that it is a corporation organized under the laws of the Republic of France, and shall be signed by an officer of the corporation giving his official title. The letter of notification or a copy thereof should be immediately forwarded by the recipient to the Commissioner of Internal Revenue, Sorting Section, Washington, D. C.

(*b*) *Discontinuance of exemption certificates.*—A nonresident alien individual not engaged in trade or business within the United States and not having an office or place of business therein is subject to the tax imposed by section 211(a) of the Act on gross income and is not entitled to any personal exemption or credit for dependents. Although a nonresident alien individual who is engaged in trade or business within the United States or has an office or place of business therein is entitled to the personal exemption of $1,000 (and a credit for dependents if he is a resident of Canada or Mexico), he is subject to the normal tax and the surtax imposed by sections 11 and 12 of the Act by reason of the provisions of section 211(b) and the benefit of the personal exemption and credit for dependents may not be received by filing a claim therefor with the withholding agent. Accordingly, the use of exemption certificates by nonresident alien individuals as provided for in prior regulations is hereby discontinued. For relief from withholding with respect to compensation for personal services in the case of nonresident aliens, residents of Canada or Mexico, who enter and leave the United States at frequent intervals, see article 4(*a*).

ART. 5. *Ownership certificates for bond interest.*—In accordance with the provisions of section 147(b), citizens and resident individuals and fiduciaries, resident partnerships and nonresident partnerships all of the members of which are citizens or residents, owning bonds, mortgages, or deeds of trust, or other similar obligations issued by a domestic corporation, a resident foreign corporation, or a nonresident foreign corporation having a fiscal agent or a paying agent in the United States, when presenting interest coupons for payment shall file ownership certificates for each issue of such obligations regardless of the amount of the coupons.

In the case of interest payments on overdue coupon bonds, the interest coupons of which have been exhausted, ownership certificates are required to be filed when collecting the interest in the same manner as if interest coupons were presented for collection.

In all cases where the owner of bonds, mortgages, or deeds of trust, or other similar obligations of a corporation is a nonresident alien, a nonresident partnership composed in whole or in part of nonresident aliens, a nonresident foreign corporation, or where the owner is unknown, an ownership certificate for each issue of such obligations shall be filed when interest coupons for any amount are presented for payment. The ownership certificate is required whether or not the obligation contains a tax-free covenant. However, ownership certificates need not be filed by a nonresident alien, a partnership composed in whole of nonresident aliens, or a nonresident foreign corporation in connection with interest payments on such bonds, mortgages, or deeds of trust or other similar obligations of a domestic or resident foreign corporation qualifying under section 119(a)1(B) of the Revenue Act of 1936, or of a nonresident foreign corporation.

The ownership certificate shall show the name and address of the debtor corporation, the name and address of the owner of the obligations, a description of the obligations, the amount of interest and its due date, the rate at which tax is to be withheld, and the date upon which the interest coupons were presented for payment.

Ownership certificates need not be filed in the case of interest payments on obligations of a State, Territory, or any political subdivision thereof, or the District of Columbia; or obligations of a corporation organized under Act of Congress, if such corporation is an instrumentality of the United States; or the obligations of the United States or its possessions. (See section 22(b)4 of the Act.) Ownership certificates are not required to be filed in connection with interest payments on bonds, mortgages, or deeds of trust, or other similar obligations issued by an individual or a partnership. Ownership certificates are not required where the owner is a domestic corporation, a resident foreign corporation, or a foreign government.

When interest coupons detached from corporate bonds are received unaccompanied by ownership certificates, unless the owner of the bonds is known to the first bank to which the coupons are presented for payment, and the bank is satisfied that the owner is a person who is not required to file an ownership certificate, the bank shall require of the payee a statement showing the name and address of the person from whom the coupons were received by the payee, and alleging that the owner of the bonds is unknown to the payee. Such statement shall be forwarded to the Commissioner with the monthly return on Form 1012. The bank shall also require the payee to prepare a certificate on Form 1001, crossing out "owner" and inserting "payee" and entering the amount of the interest on line 3, and shall stamp or write across the face of the certificate "Statement furnished," adding the name of the bank.

Ownership certificates are required in connection with interest payments on registered bonds as in the case of coupon bonds, except that if ownership certificates are not furnished by the owner of such bonds, ownership certificates must be prepared by the withholding agent.

ART. 6. *Form of certificate for citizens or residents.*—For the purpose of article 5, Form 1000 shall be used in preparing ownership certificates of citizens or residents of the United States (individual or fiduciary), resident partnerships, and nonresident partnerships all of the members of which are citizens or residents. If the obligations are issued by a nonresident foreign corporation having a fiscal or paying agent in the United States, Form 1000 should be modified to show the name and address of the fiscal agent or the paying agent in addition to the name and address of the debtor corporation.

ART. 7. *Form of certificate for nonresident aliens, nonresident foreign corporations, and unknown owners.*—For the purpose of article 5, Form 1001 shall be used in preparing ownership certificates (*a*) of nonresident aliens, (*b*) of nonresident partnerships composed in whole or in part of nonresident aliens, (*c*) of nonresident foreign corporations, and (*d*) where the owner is unknown.

For the purpose of this article and articles 5, 6, and 9, existing ownership certificate forms, properly modified, may be used pending the issuance of revised forms.

ART. 8. *Return and payment of tax withheld.*—Every withholding agent shall make on or before March 15 an annual return on Form 1013 of the tax withheld from interest on corporate bonds or other obligations. This return should be filed with the collector for the district in which the withholding agent is located. The withholding agent shall also make a monthly return on Form 1012 on or before the 20th day of the month following that for which the return is made. The ownership certificates, Forms 1000 and 1001, must be forwarded to the Commissioner with the monthly return. Such of the forms as report interest from which the tax is to be withheld should be listed on the monthly return. While the forms reporting interest from which no tax is to be withheld need not be listed on the return, the number of such forms submitted should be entered in the space provided. If Form 1000 is modified to show the name and address of a fiscal or paying agent in the United States (see article 6), Forms 1012 and 1013 should be likewise modified.

Every person required to deduct and withhold any tax from income other than such bond interest shall make an annual return thereof to the collector on or before March 15 on Form 1042, showing the amount of tax required to be withheld for each nonresident alien, nonresident partnership composed in whole or in part of nonresident aliens, or nonresident foreign corporation to which income other than bond interest was paid during the previous taxable year. Form 1042 should be filed with the collector for the district in which the withholding agent is located. In every case of both classes the tax withheld must be paid on or before June 15 of each year to the collector. For penalties and additions to the tax attaching upon failure to make such returns or such payment, see sections 145 and 291 of the Act.

If a debtor corporation has designated a bank to act for it as withholding agent, and the bank has not collected any tax from the bondholders nor received any funds from the debtor corporation to pay the tax which the debtor corporation assumed in connection with its tax-free covenant bonds, the bank can not be held liable for the tax merely by reason of its appointment as withholding agent. If a duly authorized withholding agent has become insolvent or for any other reason fails to make payment to the collector of internal revenue of money deposited with it by the debtor corporation to pay taxes, or money withheld from bondholders, the debtor corporation is not discharged of its liability under section 143(a)1, since the withholding agent is merely the agent of the debtor corporation.

ART. 9. *Ownership certificates in the case of fiduciaries and joint owners.*—If fiduciaries have the control and custody of more than one estate or trust, and such estates and trusts have as assets bonds of corporations and other securities, a certificate of ownership shall be executed for each estate or trust, regardless of the fact that the bonds are of the same issue. The ownership certificate should show the name of the estate or trust, in addition to the name and address of the fiduciary. If bonds are owned jointly by two or more persons, a separate ownership certificate must be executed in behalf of each of the owners.

ART. 10. *Return of income from which tax was withheld.*—The entire amount of the income from which the tax was withheld shall be included in gross income in the return made by the recipient of the income without deduction for such payment of the tax. But any tax so withheld shall be credited against the total income tax as computed in the taxpayer's return. If the tax is paid by the recipient of the income or by the withholding agent it shall not be recollected from the other, regardless of the original liability therefor, and in such event no penalty will be asserted against either person for failure to return or pay the tax where no fraud or purpose to evade payment is involved.

ART. 11. *Withholding in the case of nonresident foreign corporations.*—A tax of 15 per cent is required to be withheld in the case of fixed or determinable annual or periodical income paid to a nonresident foreign corporation except (1) income from sources without the United States, including interest on deposits by persons carrying on the banking business paid to persons not engaged in business in the United States and not having any office or place of business therein, (2) interest upon bonds or other obligations of a corporation containing a tax-free covenant and issued before January 1, 1934, where the liability assumed by the obligor does not exceed 2 per cent of the interest, and (3) dividends.

Withholding of a tax at the rate of 2 per cent is required in the case of interest payments made to a nonresident foreign corporation, representing income from sources within the United States, paid upon corporate bonds or other obligations containing a tax-free covenant, issued before January 1, 1934, where the liability assumed by the obligor exceeds 2 per cent of the interest.

A tax of 10 per cent is required to be withheld from income from sources within the United States paid to a nonresident foreign corporation which consists of dividends (other than dividends distributed by a corporation organized under the China Trade Act, 1922, to a resident of China) except that such rate of 10 per cent shall be reduced, in the case of corporations organized under the laws of a contiguous country, to such rate (not less than 5 per cent) as may be provided by treaty with such country. Dividends paid by a foreign corporation are not, however, subject to withholding unless such corporation is engaged in trade or business within the United States or has an office or place of business therein and more than 85 per cent of the gross income of such foreign corporation for the 3-year period ending with the close of its taxable year preceding the declaration of such dividends (or for such part of such period as the corporation has been in existence) was derived from sources within the United States as determined under the provisions of section 119 of the Act.

For withholding in the case of dividends distributed by a corporation organized under the China Trade Act, 1922, see articles 4 and 12.

ART. 12. *Withholding by a China Trade Act corporation.*—Dividends distributed by a corporation organized under the China Trade Act, 1922, which are treated as income from sources within the United States under the provisions of section 119 of the Act are subject to withholding at the rate of 10 per cent when paid to persons (other than residents of China) who are (1) nonresident aliens, (2) nonresident partnerships composed in whole or in part of nonresident aliens, or (3) nonresident foreign corporations. The 10 per cent rate of withholding specified in this article with respect to dividends shall be reduced in the case of shareholders who are (*a*) nonresident aliens residents of a contiguous country or (*b*) nonresident foreign corporations organized under the laws of a contiguous country, to such rate (not less than 5 per cent), as may be provided by treaty with such country.

ART. 13. *Aids to withholding agents in determining liability for withholding of tax.*—Since no withholding of tax on bond interest or other income is required in the case of a resident foreign corporation, the person paying such income should be notified by a letter from such corporation that it is not subject to the withholding provisions of the Act. The letter from the corporation shall contain the address of its office or place of business in the United States and be signed by an officer of the corporation giving his official title. Such letter of notification, or copy thereof, should be immediately forwarded by the recipient to the Commissioner of Internal Revenue, Sorting Section, Washington, D. C.

Although the burden of withholding tax from dividends is placed upon the payor corporation, or any other person (including a nominee), having the control, receipt, custody, disposal, or payment of dividends, if such payor corporation or person has no other reason to believe that the dividends are subject to withholding, the following procedure in general may be adopted:

(1) As to those stockholders whose name and style indicate that they are nonresident aliens, foreign partnerships, or foreign corporations, the tax shall

be withheld in all cases if the address of any such stockholder is without the United States.

(2) If the address of such stockholders is in care of an individual, a partnership, or a corporation within the United States, the tax shall likewise be withheld, but as to any stockholder whose address is within the United States, the tax need not be withheld.

CHAS. T. RUSSELL,
*Acting Commissioner of Internal Revenue.*

Approved June 25, 1936.

HENRY MORGENTHAU, Jr.,
*Secretary of the Treasury.*

(Filed with the Division of the Federal Register June 26, 1936, 12.39 p. m.)

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## SECTION 144.—PAYMENT OF CORPORATION INCOME TAX AT SOURCE.

SECTION 144.

REVENUE ACT OF 1936.

Regulations with respect to withholding of tax at source. (See T. D. 4649, page 49.)

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### B. REVENUE ACT OF 1935.

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## TITLE I.—INCOME AND EXCESS-PROFITS TAXES.

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## SECTION 102.—INCOME TAXES ON CORPORATIONS.

SECTION 102. XV–4–7919
I. T. 2952

REVENUE ACT OF 1935.

Procedure to be followed by domestic corporations in complying with the provisions of section 144 of the Revenue Act of 1934, as amended by section 102 (f) and (i) of the Revenue Act of 1935, relating to the withholding of income tax at the source on dividends paid to foreign corporations.

Advice is requested relative to the procedure to be followed by domestic corporations in complying with the provisions of section 144 of the Revenue Act of 1934, as amended by section 102 (f) and (i) of the Revenue Act of 1935, relating to the withholding of income tax at the source on 10 per cent of the dividends paid to foreign corporations.

Under the provisions of section 23(p) of the Revenue Act of 1934, corporations are allowed as a deduction from gross income the amount received as dividends from a domestic corporation which is subject to income tax. The deduction is not allowed, however, in the case of dividends received from a corporation organized under the China Trade Act of 1922, or a corporation which under section 251 of the Revenue Act of 1934 is taxable only on its gross income from sources within the United States by reason of its receiving a large percentage of its gross income from sources within a possession of the United States.

Section 23(p) of the Revenue Act of 1934 was amended by section 102(h) of the Revenue Act of 1935 to allow as a deduction only 90 per cent of the amount of dividends received from a domestic corporation, leaving the balance (10 per cent) of the dividend taxable. Under the provisions of section 144 of the Revenue Act of 1934, as amended by section 102 (f) and (i) of the Revenue Act of 1935, income tax is required to be withheld at the source from 10 per cent of the dividends paid by a domestic corporation to "foreign corporations * * * not engaged in trade or business within the United States and not having any office or place of business therein * * *."

Under the above amendments to the Revenue Act of 1934, domestic corporations should deduct a tax of 15 per cent of the 10 per cent of dividends (not permitted as a deduction) on and after January 1, 1936, if paid by a domestic corporation subject to taxation under Title I (Income Tax) of the Revenue Act of 1935 to foreign corporations not engaged in trade or business in the United States and not having an office or place of business therein. The Bureau has been advised that many of the larger corporations are confronted with an administrative problem in complying with the foregoing provisions of law. In order to distinguish between domestic and foreign corporations for the purpose of withholding the tax on the 10 per cent of dividends not allowable as a deduction, the following procedure has been suggested by withholding agents for determining the foreign corporation stockholders from which the tax shall be deducted:

1. As to those stockholders of record whose name and style indicate that they are foreign corporations, the tax shall be deducted in all cases if the address of such stockholder is without the United States.

2. If the address of such corporate stockholder is in care of an individual or corporation within the United States, the tax shall likewise be deducted; but as to those foreign corporations whose address on the stock books is within the United States, the tax shall not be deducted.

It is further proposed that in cases where a tax has been withheld in paying a dividend to a stockholder who in writing states that the stockholder is not a foreign corporation or that, if a foreign corporation, it is engaged in trade or business within the United States or has an office or place of business therein, refunds will be made by the dividend disbursing corporation in reliance upon such representation, unless such tax has been reported to the Government.

Although the burden of withholding tax from dividends, which are paid to a foreign corporation not engaged in trade or business within the United States and not having any office or place of business therein, is placed upon the payor corporation, it is concluded that the procedure suggested, if the domestic corporation has no other reason to believe that the dividends are subject to withholding, will enable it to comply with the provisions of the Act. In so far as the Bureau is concerned, no reason is seen at the present time why the suggested procedure should not in general be adopted by domestic corporations for the purpose of ascertaining which dividends paid to foreign corporations are subject to withholding.

SECTION 102. XV-21-8096
G. C. M. 16521

REVENUE ACT OF 1935.

Where stock of a domestic corporation is registered in the names of Dutch Administration Offices, a tax at the rate of 15 per cent should be withheld from 10 per cent of the dividends paid by the domestic corporation (which are not allowable as a deduction under section 23(p) of the Revenue Act of 1934, as amended by section 102(h) of the Revenue Act of 1935), unless disclosure on Forms 1087 is made by the Dutch Administration Offices that the stock registered in their names is actually owned by nonresident alien individuals or other persons not subject to the withholding provisions relating to such dividends.

Advice is requested concerning the withholding of income tax by domestic corporations from dividends payable to Dutch Administration Offices, the latter being foreign corporations not engaged in trade or business within the United States and not having any office or place of business therein.

Under the provisions of section 144 of the Revenue Act of 1934, as amended by section 102 (f) and (i) of the Revenue Act of 1935, domestic corporations subject to taxation are required to deduct a tax of 15 per cent on 10 per cent of the dividends (not permitted as deductions) paid on and after January 1, 1936, to foreign corporations not engaged in trade or business in the United States and not having any office or place of business therein. A ruling on this subject was contained in I. T. 2952 [page 58, this Bulletin]. In that ruling it is stated in part as follows:

It is further proposed that in cases where a tax has been withheld in paying a dividend to a stockholder who in writing states that the stockholder is not a foreign corporation or that, if a foreign corporation, it is engaged in trade or business within the United States or has an office or place of business therein, refunds will be made by the dividend disbursing corporation in reliance upon such representation, unless such tax has been reported to the Government.

It is pointed out in that ruling that the burden of withholding of tax is placed upon the payor corporation and that no reason is seen why the procedure suggested should not in general be adopted by domestic corporations for the purpose of ascertaining which dividends paid to foreign corporations are subject to withholding. The specific case now referred to is that of the Dutch Administration Offices, which buy large blocks of stock issued by domestic corporations and in turn issue their own bearer certificates which are sold abroad. The Dutch Administration Offices propose to notify the domestic corporations to the effect that they have no knowledge of any foreign corporations owning any of their bearer certificates, and that if they learn of any foreign corporation owning the certificates at the time the coupons are payable they will deduct the income tax and forward it to the domestic corporation.

The question of withholding income tax at the source from dividends upon stock of domestic corporations registered in the name of Dutch Administration Offices is not new. Under section 13(f) of the Revenue Act of 1916, dividends upon stock of domestic corporations were subject to withholding. Under the provisions of Treasury Decision 2382, promulgated October 19, 1916, Form 1087 was drafted for use in disclosing the identity of ownership of stock where the stock was registered in a name other than that of the actual owner. Under the provisions of Treasury Decision 2386, promulgated on the same date, it was stated that Dutch Administration Offices bear the relationship of agent with respect to their bearer certificate holders. Provision was also made in that Treasury decision for the use of Form 1087 to disclose actual ownership. Treasury Decision 2669 (modifying Treasury Decision 2386) was promulgated under date of March 9, 1918, in which it was stated that the relationship of the Dutch Administration Offices to their various bearer certificate holders is that of fiduciary, and again a provision was made for the use of Form 1087 to disclose actual ownership of stock. Under the present regulations the use of Form 1087 is prescribed in article 147-8. In that article it is stated that dividends on stock are *prima facie* the income of the record owner of the stock and provision is made for disclosure of the name and address of the actual owner on Form 1087. It is further provided that unless such disclosure is made the record owner will be held liable for such tax based upon such dividends.

It is the opinion of this office that where stock of a domestic corporation is registered in the names of Dutch Administration Offices, a tax at the rate of 15 per cent should be withheld from 10 per cent of the dividends paid by the domestic corporation (which are not allowable as a deduction under the provisions of section 23(p) of the Revenue Act of 1934, as amended by section 102(h) of the Revenue Act of 1935), unless disclosure is made by the Dutch Administration Offices that the stock registered in their names is actually owned by nonresident alien individuals or other persons not subject to withholding provisions relating to such dividends.

As indicated above, the regulations provide that disclosure should be made on Form 1087, prescribed for use of the record owners of stock of domestic or resident corporations. Such forms are evidence which may be relied upon by the domestic corporation to justify its failure to withhold income tax from dividends paid to foreign corporations. Attention is invited, however, to the fact that the burden of withholding the tax from the dividends is placed upon the payor corporation. If it does not withhold the tax, Forms 1087 and any other evidence on which it relied should be forwarded with its withholding return, Form 1042, and will be considered in connection with the audit of its return. In other words, the evidence upon which the payor corporation relied will be subject to final approval by the Department.

HERMAN OLIPHANT,
*General Counsel for the Department of the Treasury.*

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XV-8-7970
T. D. 4626

INCOME TAX.

Regulations 86 amended to accord with the Revenue Act of 1935 and other Acts amending the income tax provisions of the Revenue Act of 1934.

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

*To Collectors of Internal Revenue and Others Concerned:*

PARAGRAPH A. The Revenue Act of 1935, approved August 30, 1935 (Public, No. 407, Seventy-fourth Congress, first session), in so far as it relates to Federal income tax for the purposes of this Treasury decision, provides:

SEC. 101. SURTAXES ON INDIVIDUALS.

Section 12(b) of the Revenue Act of 1934 is amended by striking out all after the bracket—

"$6,080 upon surtax net incomes of $44,000; and upon surtax net incomes in excess of $44,000 and not in excess of $50,000, 27 per centum in addition of such excess."

and inserting in lieu thereof the following:

"$7,700 upon surtax net incomes of $50,000; and upon surtax net incomes in excess of $50,000 and not in excess of $56,000, 31 per centum in addition of such excess.

"$9,560 upon surtax net incomes of $56,000; and upon surtax net incomes in excess of $56,000 and not in excess of $62,000, 35 per centum in addition of such excess.

"$11,660 upon surtax net incomes of $62,000; and upon surtax net incomes in excess of $62,000 and not in excess of $68,000, 39 per centum in addition of such excess.

"$14,000 upon surtax net incomes of $68,000; and upon surtax net incomes in excess of $68,000 and not in excess of $74,000, 43 per centum in addition of such excess.

"$16,580 upon surtax net incomes of $74,000; and upon surtax net incomes in excess of $74,000 and not in excess of $80,000, 47 per centum in addition of such excess.

"$19,400 upon surtax net incomes of $80,000; and upon surtax net incomes in excess of $80,000 and not in excess of $90,000, 51 per centum in addition of such excess.

"$24,500 upon surtax net incomes of $90,000; and upon surtax net incomes in excess of $90,000 and not in excess of $100,000, 55 per centum in addition of such excess.

"$30,000 upon surtax net incomes of $100,000; and upon surtax net incomes in excess of $100,000 and not in excess of $150,000, 58 per centum in addition of such excess.

"$59,000 upon surtax net incomes of $150,000; and upon surtax net incomes in excess of $150,000 and not in excess of $200,000, 60 per centum in addition of such excess.

"$89,000 upon surtax net incomes of $200,000; and upon surtax net incomes in excess of $200,000 and not in excess of $250,000, 62 per centum in addition of such excess.

"$120,000 upon surtax net incomes of $250,000; and upon surtax net incomes in excess of $250,000 and not in excess of $300,000, 64 per centum in addition of such excess.

"$152,000 upon surtax net incomes of $300,000; and upon surtax net incomes in excess of $300,000 and not in excess of $400,000, 66 per centum in addition of such excess.

"$218,000 upon surtax net incomes of $400,000; and upon surtax net incomes in excess of $400,000 and not in excess of $500,000, 68 per centum in addition of such excess.

"$286,000 upon surtax net incomes of $500,000; and upon surtax net incomes in excess of $500,000 and not in excess of $750,000, 70 per centum in addition of such excess.

"$461,000 upon surtax net incomes of $750,000; and upon surtax net incomes in excess of $750,000 and not in excess of $1,000,000, 72 per centum in addition of such excess.

"$641,000 upon surtax net incomes of $1,000,000; and upon surtax net incomes in excess of $1,000,000 and not in excess of $2,000,000, 73 per centum in addition of such excess.

"$1,371,000 upon surtax net incomes of $2,000,000; and upon surtax net incomes in excess of $2,000,000 and not in excess of $5,000,000, 74 per centum in addition of such excess.

"$3,591,000 upon surtax net incomes of $5,000,000; and upon surtax net incomes in excess of $5,000,000, 75 per centum in addition of such excess."

SEC. 102. INCOME TAXES ON CORPORATIONS.

(a) Section 13(a) of the Revenue Act of 1934 is amended to read as follows:

"(a) *Rate of tax.*—There shall be levied, collected, and paid for each taxable year upon the net income (in excess of the credit against net income provided in section 26) of every corporation, a tax as follows:

"Upon net incomes not in excess of $2,000, 12½ per centum.

"$250 upon net incomes of $2,000; and upon net incomes in excess of $2,000 and not in excess of $15,000, 13 per centum in addition of such excess.

"$1,940 upon net incomes of $15,000; and upon net incomes in excess of $15,000 and not in excess of $40,000, 14 per centum in addition of such excess.

"$5,440 upon net incomes of $40,000; and upon net incomes in excess of $40,000, 15 per centum in addition of such excess."

(b) Section 141(c) of the Revenue Act of 1934 is amended by striking out "except that there shall be added to the rate of tax prescribed by section 13(a) a rate of 2 per centum, but the tax at such increased rate shall be considered as imposed by section 13(a)" and by inserting in lieu thereof the following: "except that the rate of tax shall be 15¾ per centum, in lieu of the rates prescribed by section 13(a), but the tax at such rate of 15¾ per centum shall be considered as imposed by section 13(a)."

(c) Section 23 of the Revenue Act of 1934 (relating to deductions from gross income) is amended by adding at the end thereof a new subsection as follows:

"(r) *Charitable and other contributions by corporations.*—In the case of a corporation, contributions or gifts made within the taxable year to or for the use of a domestic corporation, or domestic trust, or domestic community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes or the prevention of cruelty to children (but in the case of contributions or gifts to a trust, chest, fund, or foundation, only if such contributions or gifts are to be used within the United States exclusively for such purposes), no part of the net earnings of which inures to the benefit of any private shareholder or individual, and no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation; to an amount which does not exceed 5 per centum of the taxpayer's net income as computed without the benefit of this subsection. Such contributions or gifts shall be allowable as deductions only if verified under rules and regulations prescribed by the Commissioner, with the approval of the Secretary."

(d) Section 204(c) of the Revenue Act of 1934 (relating to deductions from gross income by insurance companies other than life or mutual) is amended by adding at the end thereof a new paragraph as follows:

"(10) Charitable, and so forth, contributions, as provided in section 23(r)."

(e) Section 232 of the Revenue Act of 1934 (relating to deductions allowed foreign corporations) is amended by inserting "(a) *In general.*—" before the beginning of the section and by inserting at the end thereof the following new subsection:

"(b) *Charitable, and so forth, contributions.*—The so-called 'charitable contribution' deduction allowed by section 23(r) shall be allowed whether or not connected with income from sources within the United States."

(f) Section 144 of the Revenue Act of 1934 (relating to payment of corporation income tax at source) is amended by inserting after the words "a tax equal to 13¾ per centum" the following: "thereof with respect to all payments of income made before January 1, 1936, and equal to 15 per centum thereof with respect to all payments of income made after December 31, 1935."

(g) Section 143(a)(1) of the Revenue Act of 1934 (relating to withholding of interest on tax-free covenant bonds) is amended by striking out clause (B) thereof and inserting in lieu thereof the following:

"(B) in the case of such a foreign corporation, 13¾ per centum with respect to all payments of interest made before January 1, 1936, and 15 per centum with respect to all payments of interest made after December 31, 1935, and."

(h) Section 23(p) of the Revenue Act of 1934 (relating to the deduction of dividends received by corporations) is amended by striking out the words "the amount" and inserting in lieu thereof the following: "90 per centum of the amount."

(i) Section 144 of the Revenue Act of 1934 is amended by striking out the period at the end thereof and inserting a colon and the following: "*Provided further*, That in the case of the payment, after December 31, 1935, of dividends of the class with respect to which a deduction is allowed by section 23(p), the deduction and withholding provided for in this section shall also apply to 10 per centum of the amount of the payment: *Provided further*, That the Commissioner, under rules and regulations prescribed by him with the approval of the Secretary, may authorize withholding under this section and section 143(a)(1)(B), in cases where the taxpayer has a taxable year ending on any other date than December 31, at the rate of 13¾ per centum (and, in the case of payments of dividends with respect to which withholding is required, may authorize such payments to be made without withholding) until the beginning of the taxpayer's first taxable year which begins after December 31, 1935."

SEC. 103. INCOME TAX ON LIFE INSURANCE COMPANIES.

Sections 201(b) (1) and (2) of the Revenue Act of 1934 are amended by striking out "13¾ per centum of" and inserting in lieu thereof "a tax at the rates specified in section 13 upon."

SEC. 104. INCOME TAX ON INSURANCE COMPANIES OTHER THAN LIFE OR MUTUAL.

Sections 204(a) (1) and (2) of the Revenue Act of 1934 are amended by striking out "13¾ per centum of" and inserting in lieu thereof "a tax at the rates specified in section 13 upon."

* * * * * * *

SEC. 107. TAXABLE YEARS TO WHICH APPLICABLE.

The amendments made by sections 101, 102 (except subsections (f), (g), and (i) thereof), 103, and 104 shall apply only in the case of taxable years beginning after December 31, 1935.

SEC. 108. CREDIT ALLOWED CHINA TRADE ACT CORPORATIONS.

(a) Section 261(a) of the Revenue Act of 1934 is amended to read as follows:

"(a) *Allowance of credit.*—For the purpose only of the taxes imposed by section 13 of this Act and section 106 of the Revenue Act of 1935 there shall be allowed, in the case of a corporation organized under the China Trade Act, 1922, in addition to the credit provided in section 26, a credit against the net income of an amount equal to the proportion of the net income derived from sources within China (determined in a similar manner to that provided in section 119) which the par value of the shares of stock of the corporation owned on the last day of the taxable year by (1) persons resident in China, the United States, or possessions of the United States, and (2) individual citizens of the United States or China wherever resident, bears to the par value of the whole number of shares of stock of the corporation outstanding on such date: *Provided*, That in no case shall the diminution, by reason of such credit, of the tax imposed by such section 13 (computed without regard to this section) exceed the amount of the special dividend certified under subsection (b) of this section; and in no case shall the diminution, by reason of such credit, of the tax imposed by such section 106 (computed without regard to this section) exceed the amount by which such special dividend exceeds the diminution permitted by this section in the tax imposed by such section 13."

(b) The amendment made by subsection (a) shall apply, with respect to the tax imposed by section 13 of the Revenue Act of 1934, as amended, only in the case of taxable years beginning after December 31, 1935.

SEC. 109. PERSONAL HOLDING COMPANIES.

(a) Section 351(a) of the Revenue Act of 1934 is amended to read as follows:

"(a) *Imposition of tax.*—There shall be levied, collected, and paid, for each taxable year, upon the undistributed adjusted net income of every personal holding company a surtax equal to the sum of the following:

"(1) 20 per centum of the amount thereof not in excess of $2,000; plus

"(2) 30 per centum of the amount thereof in excess of $2,000 and not in excess of $100,000; plus

"(3) 40 per centum of the amount thereof in excess of $100,000 and not in excess of $500,000; plus

"(4) 50 per centum of the amount thereof in excess of $500,000 and not in excess of $1,000,000; plus

"(5) 60 per centum of the amount thereof in excess of $1,000,000."

(b) Section 351(b)(2)(C) of such Act is amended by striking out the period at the end thereof and inserting in lieu thereof a comma and the following: "and distributions (not in complete or partial liquidation and not a 'dividend' as defined in section 115) made during the taxable year out of earnings or profits of such year."

(c) The amendments made by this section shall apply only in the case of taxable years beginning after December 31, 1935.

SEC. 110. CORPORATE LIQUIDATIONS.

(a) Section 112(b) of the Revenue Act of 1934 is amended by adding after paragraph (5) a new paragraph reading as follows:

"(6) *Exchange in liquidation.*—No gain or loss shall be recognized upon the receipt by a corporation of property (other than money) distributed in complete liquidation of another corporation, if the corporation receiving such property on such exchange was on the date of the enactment of the Revenue Act of 1935 and has continued to be at all times until the exchange, in control of such other corporation. As used in this paragraph 'complete liquidation' includes any one of a series of distributions by a corporation in complete cancellation or redemption of all its stock in accordance with a plan of liquidation under which the transfer of the property under the liquidation is to be completed within a time specified in the plan, not exceeding five years from the close of the taxable year during which is made the first of the series of distributions under the plan. If such transfer of property is not completed within the taxable year the Commissioner may require of the taxpayer, as a condition to the nonrecognition of gain under this paragraph, such bond, or waiver of the statute of limitations on assessment and collection, or both, as he may deem necessary to insure the assessment and collection of the tax if the transfer of the property is not completed in accordance with the plan. This paragraph shall not apply to any liquidation if any distribution in pursuance thereof has been made before the date of the enactment of the Revenue Act of 1935."

(b) Section 112(c)(1) of the Revenue Act of 1934 is amended by striking out "or (5)" and inserting in lieu thereof "(5), or (6)."

(c) Section 112(e) of the Revenue Act of 1934 is amended by striking out "subsection (b)(1) to (5)" and inserting in lieu thereof "subsection (b)(1) to (6)."

(d) Section 112(i) of the Revenue Act of 1934 is amended by striking out "(4), or (5)" and inserting in lieu thereof "(4), (5), or (6)," and by striking out "(3) or (5)" and inserting in lieu thereof "(3), (5), or (6)."

(e) The amendments made by this section shall apply only in the case of taxable years beginning after December 31, 1935.

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SEC. 202. ESTATE TAX—VALUATION.

(a) Section 302 of the Revenue Act of 1926, as amended, is amended by adding a new subdivision as follows:

"(j) If the executor so elects upon his return (if filed within the time prescribed by law or prescribed by the Commissioner in pursuance of law), the value of the gross estate shall be determined by valuing all the property included therein on the date of the decedent's death as of the date one year after the decedent's death, except that (1) property included in the gross estate on the date of death and, within one year after the decedent's death, distributed by the executor (or, in the case of property included in the gross estate under subdivision (c), (d), or (f) of this section, distributed by the trustee under the instrument of transfer), or sold, exchanged, or otherwise disposed of, shall be included at its value as of the time of such distribution, sale, exchange, or other disposition, whichever first occurs, instead of its value as of the date one year after the decedent's death, and (2) any interest or estate which is affected by mere lapse of time shall be included at its value as of the time of death (instead of the later date) with adjustment for any difference in its value as of the later date not due to mere lapse of time. No deduction under this title of any item shall be allowed if allowance for such item is in effect given by the valuation under this subdivision. Wherever in any other subdivision or section of this title or in Title II of the Revenue Act of 1932, reference is made to the value of property at the time of the decedent's death, such reference shall be deemed to refer to the value of such property used in determining the value of the gross estate. In case of an election made by the executor under this subdivision, then for the purposes of the deduction under section 303(a)(3) or section 303(b)(3), any bequest, legacy, devise, or transfer enumerated therein shall be valued as of the date of decedent's death with adjustment for any difference in value (not due to mere lapse of time or the occurrence or nonoccurrence of a contingency) of the property as of the date one year after the decedent's death (substituting the date of sale or exchange in the case of property sold or exchanged during such one-year period)."

(b) The amendment made by this section shall be effective only with respect to transfers of estates of decedents dying after the date of the enactment of this Act.

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SEC. 404. INTEREST ON DELINQUENT TAXES.

Notwithstanding any provision of law to the contrary, interest accruing during any period of time after the date of the enactment of this Act upon any internal-revenue tax (including amounts assessed or collected as a part thereof) or customs duty, not paid when due, shall be at the rate of 6 per centum per annum.

* * * * * * *

SEC. 406. FAILURE TO FILE RETURNS.

In the case of a failure to make and file an internal-revenue tax return required by law, within the time prescribed by law or prescribed by the Commissioner in pursuance of law, if the last date so prescribed for filing the return is after the date of the enactment of this Act, if a 25 per centum addition to the tax is prescribed by existing law, then there shall be added to the tax, in lieu of such 25 per centum: 5 per centum if the failure is for not more than 30 days, with an additional 5 per centum for each additional 30 days or fraction thereof during which failure continues, not to exceed 25 per centum in the aggregate.

* * * * * * *

SEC. 503. EFFECTIVE DATE OF ACT.

Except as otherwise provided, this Act shall take effect upon its enactment.

PAR. B. The Act entitled "An Act to amend certain provisions relating to publicity of certain statements of income," approved April 19, 1935 (Public, No. 40, Seventy-fourth Congress, first session), provides:

That section 55(b) of the Revenue Act of 1934 relating to filing and making public certain income statements is amended to read as follows:

"(b) (1) All income returns filed under this title for any taxable year beginning after December 31, 1934 (or copies thereof, if so prescribed by regulations made under this subsection), shall be open to inspection by any official, body, or commission, lawfully charged with the administration of any State tax law, if the inspection is for the purpose of such administration or for the purpose of obtaining information to be furnished to local taxing authorities as provided in paragraph (2). The inspection shall be permitted only upon written request of the governor of such State, designating the representative of such official, body, or commission to make the inspection on behalf of such official, body, or commission. The inspection shall be made in such manner, and at such times and places, as shall be prescribed by regulations made by the Commissioner with the approval of the Secretary.

"(2) Any information thus secured by any official, body, or commission of any State may be used only for the administration of the tax laws of such State, except that upon written request of the governor of such State any such information may be furnished to any official, body, or commission of any political subdivision of such State, lawfully charged with the administration of the tax laws of such political subdivision, but may be furnished only for the purpose of, and may be used only for, the administration of such tax laws. Any officer, employee, or agent of any State or political subdivision, who divulges (except as authorized in this subsection, or when called upon to testify in any judicial or administrative proceeding to which the State or political subdivision, or such State or local official, body, or commission, as such, is a party) any information acquired by him through an inspection permitted him or another under this subsection shall be guilty of a misdemeanor and shall upon conviction be punished by a fine of not more than $1,000, or by imprisonment for not more than one year, or both."

PAR. C. The Act entitled "An Act to exempt from taxation official compensation of certain foreign representatives and to provide for the deductibility from income of certain dividends on preferred stock owned by the United States or instrumentalities thereof," approved August 27, 1935 (Public, No. 374, Seventy-fourth Congress, first session), provides:

That section 116 of the Revenue Act of 1934 relating to exclusions from gross income is amended by adding at the end thereof a new subsection reading as follows:

"(h) *Compensation of employees of foreign governments.*—Wages, fees, or salary of an employee of a foreign government (including a consular or other officer, or a nondiplomatic representative) received as compensation for official services to such government—

"(1) If such employee is not a citizen of the United States; and

"(2) If the services are of a character similar to those performed by employees of the Government of the United States in foreign countries; and

"(3) If the foreign government whose employee is claiming exemption grants an equivalent exemption to employees of the Government of the United States performing similar services in such foreign country.

"The Secretary of State shall certify to the Secretary of the Treasury the names of the foreign countries which grant an equivalent exemption to the employees of the Government of the United States performing services in such foreign countries, and the character of the services performed by employees of the Government of the United States in foreign countries."

SEC. 2. The provisions of section 1 shall be retroactively applied in computing income under the provisions of the Revenue Act of 1934 and prior Revenue Acts, or any of such Acts as amended, subject to the statutory period of limitations properly applicable to such Acts.

SEC. 3. Title I of the Revenue Act of 1934, relating to income tax, is amended by adding after section 120 a new section reading as follows:

"SEC. 121. *Deduction of dividends paid on certain preferred stock of certain corporations.*—In computing the net income, for any taxable year beginning after December 31, 1934, of any national banking association, or of any bank or trust company organized under the laws of any State, Territory, possession of the United States, or the Canal Zone, or of any other banking corporation engaged in the business of industrial banking and under the supervision of a State banking department or of the Comptroller of the Currency, or of any incorporated domestic insurance company, there shall be allowed as a deduction from gross income, in addition to deductions otherwise provided for in this title, any dividend (not including any distribution in liquidation) paid, within such taxable year, to the United States or to any instrumentality thereof exempt from Federal income taxes, on the preferred stock of the corporation owned by the United States or such instrumentality."

PAR. D. In order to accord with the above-mentioned Acts, Regulations 86 are amended as follows:

The first paragraph of article 1-1 is amended to read:

ARTICLE 1-1. *Scope of regulations.*—These regulations deal with the tax upon income imposed by Title I and Title I-A of the Revenue Act of 1934, and by such titles as amended by (*a*) the Revenue Act of 1935, approved August 30, 1935, (*b*) the Act entitled "An Act to amend certain provisions relating to publicity of certain statements of income," approved April 19, 1935, and (*c*) the Act entitled "An Act to exempt from taxation official compensation of certain foreign representatives and to provide for the deductibility from income of certain dividends on preferred stock owned by the United States or instrumentalities thereof," approved August 27, 1935.

Article 1–1 is further amended by adding at the end thereof a new paragraph reading:

The references in these regulations to the Revenue Act of 1934 and to titles, sections, subsections, or paragraphs thereof shall be considered, wherever consistent, as references also to such Act, titles, sections, subsections, or paragraphs thereof as amended by the Acts referred to in the first paragraph of this article.

The first sentence of article 11–1, relating to normal income tax on individuals, is amended to read:

Title I of the Revenue Act of 1934, and Title I of that Act, as amended, which in general apply to taxable years beginning after December 31, 1933 (see section 1), and taxable years beginning after December 31, 1935, respectively, impose an income tax on individuals, including a normal tax (section 11) and a surtax (section 12).

Article 12–2, relating to computation of surtax, is amended to read:

ART. 12–2. *Computation of surtax.*—The table designated below as Surtax Table No. 1 shows the surtax due for taxable years beginning after December 31, 1933, but not after December 31, 1935, upon certain specified amounts of surtax net income. The table designated below as Surtax Table No. 2 shows the surtax due for taxable years beginning after December 31, 1935, upon certain specified amounts of surtax net income. In each instance the first figure of the surtax net income in the surtax net-income column is to be excluded and the second figure included. The percentage given opposite applies to the excess of income over the first figure in the surtax net-income column. The last column gives the total surtax on a surtax net income equal to the second figure in the surtax net-income column.

SURTAX TABLE NO. 1.

(Taxable years beginning after December 31, 1933, but not after December 31, 1935.)

| Surtax net income. | Per cent. | Total surtax. |
|---|---|---|
| $0 to $4,000 | | |
| $4,000 to $6,000 | 4 | $80 |
| $6,000 to $8,000 | 5 | 180 |
| $8,000 to $10,000 | 6 | 300 |
| $10,000 to $12,000 | 7 | 440 |
| $12,000 to $14,000 | 8 | 600 |
| $14,000 to $16,000 | 9 | 780 |
| $16,000 to $18,000 | 11 | 1, 000 |
| $18,000 to $20,000 | 13 | 1, 260 |
| $20,000 to $22,000 | 15 | 1, 560 |
| $22,000 to $26,000 | 17 | 2, 240 |
| $26,000 to $32,000 | 19 | 3, 380 |
| $32,000 to $38,000 | 21 | 4, 640 |
| $38,000 to $44,000 | 24 | 6, 080 |
| $44,000 to $50,000 | 27 | 7, 700 |
| $50,000 to $56,000 | 30 | 9, 500 |
| $56,000 to $62,000 | 33 | 11, 480 |
| $62,000 to $68,000 | 36 | 13, 640 |
| $68,000 to $74,000 | 39 | 15, 980 |
| $74,000 to $80,000 | 42 | 18, 500 |
| $80,000 to $90,000 | 45 | 23, 000 |
| $90,000 to $100,000 | 50 | 28, 000 |
| $100,000 to $150,000 | 52 | 54, 000 |
| $150,000 to $200,000 | 53 | 80, 500 |
| $200,000 to $300,000 | 54 | 134, 500 |
| $300,000 to $400,000 | 55 | 189, 500 |
| $400,000 to $500,000 | 56 | 245, 500 |
| $500,000 to $750,000 | 57 | 388, 000 |
| $750,000 to $1,000,000 | 58 | 533, 000 |
| $1,000,000 up | 59 | |

SURTAX TABLE NO. 2.

(Taxable years beginning after December 31, 1935.)

| Surtax net income. | Per cent. | Total surtax. |
|---|---|---|
| $0 to $4,000 | | |
| $4,000 to $6,000 | 4 | $80 |
| $6,000 to $8,000 | 5 | 180 |
| $8,000 to $10,000 | 6 | 300 |
| $10,000 to $12,000 | 7 | 440 |
| $12,000 to $14,000 | 8 | 600 |
| $14,000 to $16,000 | 9 | 780 |
| $16,000 to $18,000 | 11 | 1, 000 |
| $18,000 to $20,000 | 13 | 1, 260 |
| $20,000 to $22,000 | 15 | 1, 560 |
| $22,000 to $26,000 | 17 | 2, 240 |
| $26,000 to $32,000 | 19 | 3, 380 |
| $32,000 to $38,000 | 21 | 4, 640 |
| $38,000 to $44,000 | 24 | 6, 080 |
| $44,000 to $50,000 | 27 | 7, 700 |
| $50,000 to $56,000 | 31 | 9, 560 |
| $56,000 to $62,000 | 35 | 11, 660 |
| $62,000 to $68,000 | 39 | 14, 000 |
| $68,000 to $74,000 | 43 | 16, 580 |
| $74,000 to $80,000 | 47 | 19, 400 |
| $80,000 to $90,000 | 51 | 24, 500 |
| $90,000 to $100,000 | 55 | 30, 000 |
| $100,000 to $150,000 | 58 | 59, 000 |
| $150,000 to $200,000 | 60 | 89, 000 |
| $200,000 to $250,000 | 62 | 120, 000 |
| $250,000 to $300,000 | 64 | 152, 000 |
| $300,000 to $400,000 | 66 | 218, 000 |
| $400,000 to $500,000 | 68 | 286, 000 |
| $500,000 to $750,000 | 70 | 461, 000 |
| $750,000 to $1,000,000 | 72 | 641, 000 |
| $1,000,000 to $2,000,000 | 73 | 1, 371, 000 |
| $2,000,000 to $5,000,000 | 74 | 3, 591, 000 |
| $5,000,000 up | 75 | |

The surtax for any amount of surtax net income not shown in the tables is computed by adding to the surtax for the largest amount shown which is less than the surtax net income, the surtax upon the excess over that amount at the rate indicated in the tables. Accordingly, the surtax due for taxable years beginning after December 31, 1933, but not after December 31, 1935, upon a surtax net income of $63,128 would be $11,886.08, computed as follows:

| | |
|---|---|
| Surtax on $62,000 from Table No. 1 | $11, 480. 00 |
| Surtax on $1,128 at 36 per cent | 406. 08 |
| Total | 11, 886. 08 |

The surtax due for taxable years beginning after December 31, 1935, upon a surtax net income of $63,128 would be $12,099.92, computed as follows:

| | |
|---|---|
| Surtax on $62,000 from Table No. 2 | $11, 660. 00 |
| Surtax on $1,128 at 39 per cent | 439. 92 |
| Total | 12, 099. 92 |

The following is substituted for the first sentence of article 13–1, as amended by Treasury Decision 4585, approved September 9, 1935 (C. B. XIV–2, 54), relating to tax on corporations, and the remainder of that article is made the second paragraph thereof:

In general, for taxable years beginning after December 31, 1933, but not after December 31, 1935, the Act imposes an income tax on all corporations not expressly exempt (see section 101) at the rate of 13¾ per cent of the net income subject to tax, and for taxable years beginning after December 31, 1935, an income tax at the rates specified in section 13(a) of the Revenue Act of 1934, as amended by section 102(a) of the Revenue Act of 1935. The following table shows the tax due from corporations in general for taxable years beginning after December 31, 1935, upon certain specified amounts of net income. In each instance the first figure of the net income in the net-income column is to be excluded and the second figure included. The percentage given opposite applies to the excess of income over the first figure in the net-income column. The last column gives the total tax on a net income equal to the second figure in the net-income column.

CORPORATION INCOME TAX TABLE.

(Taxable years beginning after December 31, 1935.)

| Net income. | Per cent. | Total tax. |
|---|---|---|
| $0 to $2,000 | 12½ | $250 |
| $2,000 to $15,000 | 13 | 1,940 |
| $15,000 to $40,000 | 14 | 5,440 |
| $40,000 up | 15 | ---------- |

The tax for any amount of net income not shown in the table is computed by adding to the tax for the largest amount shown which is less than the net income, the tax upon the excess over that amount at the rate indicated in the table. Accordingly, the tax due for taxable years beginning after December 31, 1935, upon a net income of $20,000 would be $2,640, computed as follows:

| | |
|---|---|
| Tax on $15,000 from table | $1,940.00 |
| Tax on $5,000 at 14 per cent | 700.00 |
| Total | 2,640.00 |

The following is substituted for the last sentence of the first paragraph of article 23(o)-1, as amended by Treasury Decision 4585, approved September 9, 1935 (C. B. XIV-2, 54), relating to contributions or gifts by individuals:

This article does not apply to gifts by estates and trusts (see section 162). For contributions or gifts by corporations see article 23(r)-1.

Article 23(o)-1 is further amended by adding at the end thereof a new paragraph reading as follows:

A donation made by an individual to an organization other than one referred to in section 23(o) which bears a direct relationship to his business and is made with a reasonable expectation of a financial return commensurate with the amount of the donation may constitute an allowable deduction as business expense.

Article 23(o)-2 is revoked.

A new article is added after article 23(q)-1, designated "Art. 23(r)-1," as follows:

ART. 23(r)-1. *Contributions or gifts by corporations.*—A corporation is entitled to deduct from gross income for a taxable year beginning after December 31, 1935, contributions or gifts to organizations referred to in section 23(r), whether or not such contributions or gifts constitute business expenses, but only to the extent provided in that section.

Corporations may deduct, for a taxable year beginning after December 31, 1935, to the extent provided by section 23(r), contributions or gifts to organizations referred to in that section, only for the taxable year in which they are actually paid, regardless of when pledged and regardless of whether the books and records of the corporation are kept on the cash receipts and disbursements basis or the accrual basis.

The provisions of the first paragraph of article 23(o)-1, as amended, relating to (1) the statement in returns of the name and address of each organization to which a contribution or gift was made and the approximate date and the amount of the contribution or gift, (2) the substantiation of the claims for deductions when required by the Commissioner, and (3) the basis for calculation of the amount of a contribution or gift which is other than money, are equally applicable to claims for deductions of contributions or gifts by corporations under section 23(r).

Donations to organizations other than those referred to in section 23(r) which bear a direct relationship to the corporation's business and are made with a reasonable expectation of a financial return commensurate with the amount of the donation may constitute allowable deductions as business expenses. For example, a street railway corporation may donate a sum of money to an organization (of a class not referred to in section 23(r)) intending to hold a convention in the city in which it operates, with the reasonable expectation that the holding of such convention will augment its income through a greater number of people using the cars. Sums of money expended for lobbying purposes, the promotion or defeat of legislation, the exploitation of propaganda, including advertising other than trade advertising, and contributions for campaign expenses, are not deductible from gross income.

The following is substituted for articles 55(b)-1 to 55(b)-5, inclusive, relating to publicity of returns:

ART. 55(b)-1. *Definitions.*—Any word or term used in this article and articles 55(b)-2 to 55(b)-4, inclusive, which is defined in the Revenue Act of 1934, or the Revenue Act of 1934 as amended, shall be given the respective definition contained in that Act.

ART. 55(b)-2. *Copies of income returns.*—Every person (except nonresident alien individuals) required to file an income return (including affiliation schedules) under the provisions of sections 51, 52, 141, 142 or 187 of Title I, section 351 of Title I-A, or section 702 of Title V of the Revenue Act of 1934, or any such section as amended, or under section 106 of the Revenue Act of 1935, for any taxable year beginning after December 31, 1934, shall file with the return a copy thereof on a duplicate form on colored paper which will be provided for that purpose. The copy on such duplicate form shall be a complete duplicate of the return as filed except that the affidavits on the duplicate form need not be filled in. There shall be attached to the copy on the duplicate form a copy of any schedule or statement attached to the original return except (1) Schedule C-1 in the case of a corporation return, (2) the copy of the will or trust instrument in the case of a fiduciary return, (3) the power of attorney on Form 935 or Form 936 in the case of a return made by an agent, and (4) the copy of the annual statement made to the insurance department of the State, Territory, or District of Columbia in the case of a return of an insurance company. In lieu of filling in the duplicate form on colored paper, a legible photostat or photograph of the return and related schedules as filed may be filed with the return provided such photostat or photograph is not of larger dimensions than the return and is securely fastened to the duplicate form.

ART. 55(b)-3. *Inspection of copies of returns.*—Within a reasonable time after the returns are filed the copies thereof (including photostats and photographs), under such procedure as may be prescribed by the Commissioner, shall be made available for inspection in the office of the collector of internal revenue in which the returns are filed, by any official, body, or commission, lawfully charged with the administration of any State tax law, or by the representatives of such official, body, or commission designated in writing by the governor of the State, for the purpose of such administration or for the purpose of obtaining information to be furnished to local taxing authorities as provided in section 55(b)(2) of the Revenue Act of 1934, as amended. The governors of the respective States shall be notified by the Commissioner of the date the copies of the returns are available for inspection and inspection thereof shall not be permitted after one year from such date.

ART. 55(b)-4. *Request for permission to inspect copies.*—Requests for permission to inspect the copies of returns must be in writing signed by the governor under the seal of his State, and must be addressed to the Commissioner of Internal Revenue, Washington, D. C., Records Division. The request must state (*a*) the kind of returns it is desired to inspect, (*b*) the taxable year or years covered by the copies of returns it is desired to inspect, (c) the name of the official, body, or commission by whom or which the inspection is to be made, (d) the name of the representative of such official, body, or commission, designated to make the inspection, (e) by specific references, the State tax law which such official, body, or commission is charged with administering and the law under which he, she, or it is so charged, (f) the purpose for which the inspection is to be made, and (g) if the inspection is for the purpose of obtaining information to be furnished to local taxing authorities, (1) the name of the official, body, or commission of any political subdivision of the State, lawfully charged with the administration of the tax laws of such political subdivision, if any, to whom or to which the information secured by the inspection is to be furnished, and (2) the purpose for which the information is to be used by such official, body, or commission.

As to inspection and furnishing copies of returns under other provisions of law see Treasury Decision 4504, approved December 29, 1934 (C. B. XIV-1, 86).

The following new articles are added after article 112(b)(5)-2:

ART. 112(b)(6)-1. *Exchange in liquidation of controlled corporation—Definition of terms.*—Under the general rule, upon the exchange of property, gain or loss must be recognized if the new property differs in a material particular, either in kind or in extent from the old property. See article 111-1. The purpose of the provisions of section 112(b)(6) is to except from the general rule certain exchanges incident to complete liquidation of a corporation which is controlled by another corporation. The nonrecognition of gain or loss is limited to the receipt by a corporation of property (other than money) distributed during a taxable year of the recipient beginning after December 31, 1935, in complete liquidation of another corporation, if the recipient corporation is in control of such other corporation. The Act expressly requires that the recipient corporation must have been on August 30, 1935 (the date of the enactment of the Revenue Act of 1935), and have continued to be at all times until the exchange, in control of the liquidating corporation. The Act also expressly provides that the provisions of section 112(b)(6) shall not apply to any liquidation if any distribution in pursuance thereof has been made before August 30, 1935. Section 112(i) places a limitation on the application of section 112(b)(6) to foreign corporations. See article 112(i)-1.

The application of the term "exchange in liquidation" is strictly limited to the specific transactions described in section 112(b)(6).

The term "complete liquidation" means the distribution of the properties of the controlled corporation in cancellation or redemption of all its stock in accordance with a plan of liquidation. The term also includes any one of a series of distributions of property of the controlled corporation in complete cancellation or redemption of all of its stock in accordance with a plan of liquidation.

The term "plan of liquidation" means a plan (evidenced by written memoranda) providing for a complete liquidation within one taxable year or within a specified time not exceeding the 5-year period allowed by section 112(b)(6).

The term "control" is defined, for the purpose of section 112(b)(6), in section 112(h). See article 112(h)-1.

ART. 112(b)(6)-2. *Exchanges in liquidation for property and money.*—If in an exchange in liquidation in pursuance of a plan of complete liquidation, there is received by the controlling corporation money (not permitted to be received without the recognition of gain) then

(1) As provided in section 112(c)(1), the gain, if any, to the controlling corporation will be recognized in an amount not in excess of the sum of money, but

(2) No loss from such an exchange will be recognized (see section 112(e)).

ART. 112(b)(6)-3. *Exchanges in liquidation as affecting minority interests.*—In an exchange in liquidation in pursuance of a plan of complete liquidation, the gain or loss of minority shareholders shall be determined without regard to section 112(b)(6), which is not applicable thereto, since that section does not apply to exchanges in liquidation made by minority shareholders.

ART. 112(b)(6)-4. *Filing of bonds or waivers of statute of limitations.*—Any bond required under section 112(b)(6) shall have such surety or sureties as the Commissioner may require. However, see section 1126 of the Revenue Act of 1926 (paragraph 31 of the Appendix to these regulations), providing that where a bond is required by law or regulations, in lieu of surety or sureties there may be deposited bonds or notes of the United States. Only surety companies holding certificates of authority from the Secretary of the Treasury as acceptable sureties on Federal bonds will be approved as sureties. The bonds shall be executed in triplicate so that the Commissioner, the taxpayer, and the surety or depositary may each have a copy.

Waivers under section 112(b) (6) of the statute of limitations on assessment or collection, or both, shall be executed on a form prescribed by the Commissioner.

ART. 112(b) (6)–5. *Records to be kept and information to be filed with returns.*—(*a*) Permanent records in substantial form shall be kept by every corporation which is a party to an exchange in liquidation under section 112(b) (6) showing the information required by this article to be submitted with the return of the corporation. The plan of liquidation must be adopted by each of the corporations parties thereto and the resolution of adoption shall appear as part of the official records of each such corporation.

(*b*) The controlling corporation shall file with its return for its taxable year in which the liquidation occurred, or, if the plan of liquidation provides for a series of distributions over a period of more than one taxable year, for each taxable year in which a distribution is made under the plan:

(1) A duly certified copy of the plan for complete liquidation.

(2) A statement showing the amount of money, if any, and all properties received as a distribution in liquidation, and the fair market values of such properties at the date of distribution.

(3) A statement as to its ownership of the voting stock and of the shares of all other classes of stock of the liquidating corporation (showing percentages) as of August 30, 1935 (the date of the enactment of the Revenue Act of 1935), and at all times since, to and including the date of the distribution in liquidation, and the cost or other basis of such stock.

(c) The liquidating corporation shall file with its return for the taxable year in which the liquidation occurred, or, if the plan of liquidation provides for a series of distributions over a period of more than one taxable year, for each taxable year in which a distribution is made under the plan, a list of all of its properties and money, showing the amount of money and the fair market values of its properties on the date of the exchange in liquidation or, if the plan of liquidation provides for a series of distributions over a period of more than one taxable year, the amount of money and the fair market values of all of its properties on the date on which each distribution was made, specifying the amount of money and the properties transferred in each such distribution.

Article 112(c)–1 is amended by adding at the end thereof a new paragraph reading:

As to receipt of money in an exchange in liquidation, see article 112(b) (6)–2.

The first paragraph of article 112(e)–1 is amended to read:

The Act provides that in no event shall a loss be recognized from a tax-free exchange of property under section 112(b) (1) to (6), inclusive, notwithstanding the fact that there is received in the exchange other property or money in addition to property permitted to be received without recognition of gain or loss.

The first sentence of article 112(h)–1 is amended to read:

Section 112(h) defines the term "control" in reference to the phrase "control of the corporation," as used in section 112(b) (5) and (6) and section 112(g) (1).

The first sentence of article 112(i)–1 is amended to read:

A foreign corporation will not be considered a corporation to which a tax-free transfer of property for stock or securities may be made, or a corporation a party to a reorganization with which a tax-free reorganization exchange may be made, or a corporation a party to an exchange in liquidation to which a tax-free liquidation distribution may be made, unless, prior to the transfer or exchange, it has been established to the satisfaction of the Commissioner that such transfer or exchange is not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income taxes.

Paragraph (*c*) of article 113(a)(5)-1, relating to basis of property acquired by bequest, devise, or inheritance, is amended to read:

(*c*) *Fair market value.*—For the purposes of this article, the value of property as of the date of the death of the decedent as appraised for the purpose of the Federal estate tax or if the property is not appraised as of the date of the death of the decedent for such purpose or if the estate is not subject to such tax, its value as appraised as of the date of the death of the decedent for the purpose of State inheritance or transmission taxes, shall be deemed to be its fair market value at the time of the death of the decedent.

Article 113(a)(6)-1 is amended by inserting after the fifth paragraph thereof a new paragraph reading as follows:

In the case of distributions to a controlling corporation under section 112(b)(6) the cost or other basis of the stock of the liquidating corporation assignable to the properties distributed (decreased in the amount of any money received and increased in the amount of gain recognized upon such exchange) shall be allocated among the several properties received in the proportion that the fair market value of each such property as of the date of distribution bears to the fair market value of all of such properties on that date.

The second sentence of the second paragraph of article 116-1, relating to income of foreign governments, ambassadors, and consuls, is amended to read:

Their income from all sources other than a business carried on by them in the United States is also exempt.

The third paragraph of article 116-1 is amended to read:

All employees of a foreign government (including consular or other officers, or nondiplomatic representatives) who are not citizens of the United States are exempt from Federal income tax with respect to wages, fees, or salaries received by them as compensation for official services rendered in the United States to such foreign government, provided (1) the services are of a character similar to those performed by employees of the Government of the United States in such foreign country and (2) the foreign government whose employee is claiming exemption grants an equivalent exemption to employees of the Government of the United States performing similar services in such foreign country. The Act entitled "An Act to exempt from taxation official compensation of certain foreign representatives and to provide for the deductibility from income of certain dividends on preferred stock owned by the United States or instrumentalities thereof," approved August 27, 1935 (Public, No. 374, Seventy-fourth Congress, first session), provides that the Secretary of State shall certify to the Secretary of the Treasury the names of the foreign countries which grant an equivalent exemption to the employees of the Government of the United States performing services in such foreign countries, and the character of the services performed by employees of the Government of the United States in foreign countries. The income received by employees of foreign governments (other than ambassadors, ministers and members of their households including secretaries, attachés and servants) from sources other than their salaries, fees, or wages, referred to above, is subject to Federal income tax.

The second paragraph of article 143-1, relating to withholding of tax at source, is amended to read:

A tax of 13¾ per cent is required to be withheld in the case of fixed or determinable annual or periodical income (with the exceptions stated in the first paragraph of this article) paid before January 1, 1936, to a nonresident foreign corporation (see article 801-8). In the case of payments of such income (including 10 per cent of payments of dividends of a class allowed as a credit by section 25(a)) made after December 31, 1935, a tax of 15 per cent is required to be withheld. See section 144 and article 144-1.

The first sentence of the ninth paragraph of article 143-1 is amended to read:

Withholding of a tax of 2 per cent is required in the case of interest paid to an individual or a partnership, whether resident or nonresident (see article 801–8), or to a nonresident foreign corporation upon bonds or other obligations of domestic corporations or resident foreign corporations (see article 801–8) containing a tax-free covenant and issued before January 1, 1934, except that if the liability assumed by the obligor in connection with such a covenant does not exceed 2 per cent of the interest, withholding is required at the rate of 4 per cent in the case of a nonresident alien or a nonresident partnership composed in whole or in part of nonresident alien individuals, at the rate of 13¾ per cent in the case of payments made to a nonresident foreign corporation before January 1, 1936, and at the rate of 15 per cent in the case of payments made to a nonresident foreign corporation after December 31, 1935.

The next to the last sentence of article 143–3, as amended by Treasury Decision 4535, approved March 16, 1935 (C. B. XIV–1, 118), relating to exemption from withholding, is amended to read:

In the case of (*c*) the rate of withholding applicable is 13¾ per cent in the case of distributions made prior to January 1, 1936, and 15 per cent in the case of distributions made after December 31, 1935.

The first paragraph of article 144–1, as amended by Treasury Decision 4535, approved March 16, 1935 (C. B. XIV–1, 118), is amended to read:

ART. 144–1. *Withholding in the case of nonresident foreign corporations.*—In general, with respect to payments to nonresident foreign corporations (see article 801–8) withholding is required of a tax of 2 per cent in the case of interest representing income from sources within the United States paid upon corporate bonds or other obligations containing a tax-free covenant, issued before January 1, 1934, except that if the liability assumed by the obligor in connection with such a covenant does not exceed 2 per cent of the interest, withholding is required at the rate of 13¾ per cent with respect to payments made before January 1, 1936, and at the rate of 15 per cent with respect to payments made after December 31, 1935. Withholding of a tax of 13¾ per cent is also required in the case of payments made before January 1, 1936, of other fixed or determinable annual or periodical income from sources within the United States to nonresident foreign corporations, except dividends paid by a domestic corporation subject to taxation under Title I other than dividends distributed by a corporation organized under the China Trade Act, 1922, to a nonresident foreign corporation which is not a resident of China. Withholding of a tax of 15 per cent is also required in the case of payments made after December 31, 1935, of other fixed or determinable annual or periodical income from sources within the United States to nonresident foreign corporations, except 90 per cent of the amount of dividends distributed by a domestic corporation subject to taxation under Title I other than dividends distributed by a corporation organized under the China Trade Act, 1922, to a nonresident foreign corporation which is not a resident of China. A tax of 15 per cent shall be withheld from 10 per cent of the amount of dividends distributed after December 31, 1935, by a domestic corporation subject to taxation under Title I to a nonresident foreign corporation including nonresident foreign corporations having a taxable year ending on any other date than December 31, except that no withholding is required from dividends distributed by a corporation organized under the China Trade Act, 1922, to a nonresident foreign corporation which is a resident of China. As to refunds of excess tax withheld at the source see sections 143(f) and 322 and articles 143–11, 322–1, 322–2, 322–3 as amended by Treasury Decision 4585, approved September 9, 1935 (C. B. XIV–2, 54), and 322–4 to 322–7, inclusive.

The second sentence of the first paragraph of article 201(b)–1, relating to rates of tax on life insurance companies, is amended to read:

The rate for 1934, and for subsequent years is 13¾ per cent, except that for taxable years beginning after December 31, 1935, the tax is imposed at the graduated rates specified in section 13(a) of the Revenue Act of 1934, as amended by section 102(a) of the Revenue Act of 1935, and the net income upon which the tax is imposed differs from the net income of other corporations.

Article 203(a)(3)-1, relating to the deduction of dividends by life insurance companies, is amended to read:

ART. 203(a)(3)-1. *Dividends.*—The deduction allowed by section 203(a)(3) for dividends received from other corporations is identical with the deduction allowed other corporations by section 23(p), and by that section, as amended, except that for taxable years beginning after December 31, 1935, life insurance companies are entitled to a deduction for the full amount received as dividends from a domestic corporation which is subject to taxation under Title I of the Revenue Act of 1934, as amended, other than a corporation entitled to the benefits of section 251, and other than a corporation organized under the China Trade Act, 1922.

The third sentence of article 204(a)-1, as amended by Treasury Decision 4585, approved September 9, 1935 (C. B. XIV-2, 54), relating to tax on insurance companies other than life or mutual, is amended to read:

The rate of tax imposed by section 204 is 13¾ per cent, except that for taxable years beginning after December 31, 1935, the tax is imposed at the graduated rates specified in section 13(a) of the Revenue Act of 1934, as amended by section 102(a) of the Revenue Act of 1935, and the net income upon which the tax is imposed, as defined in section 204, differs from the net income of other corporations.

The first sentence of article 232-1, relating to deductions allowed foreign corporations, is amended to read:

Foreign corporations are allowed the same deductions from their gross income arising from sources within the United States as are allowed to domestic corporations to the extent that such deductions are connected with such gross income except that for taxable years beginning after December 31, 1935, the so-called charitable contribution deduction allowed by section 23(r) is allowed whether or not connected with income from sources within the United States.

The following is substituted for the next to the last sentence of article 261-2, relating to credits allowed China Trade Act corporations:

In the case of taxable years beginning before January 1, 1936, the decrease in tax by reason of such credit must not exceed the amount of the special dividend referred to in section 261(b), and is not allowable unless the special dividend has been certified to the Commissioner by the Secretary of Commerce. In the case of taxable years beginning after December 31, 1935, the diminution, by reason of such credit, of the tax imposed by section 13 (computed without regard to section 261(a) of the Revenue Act of 1934, as amended by section 108 of the Revenue Act of 1935), shall not exceed the amount of the special dividend referred to in section 261(b), and is not allowable unless the special dividend has been certified to the Commissioner by the Secretary of Commerce.

The third sentence of article 261-4, relating to withholding by a China Trade Act corporation, is amended to read:

In the case of an individual shareholder or partnership, the rate of withholding is 4 per cent, and in the case of a corporation, 13¾ per cent with respect to payments made before January 1, 1936, and 15 per cent with respect to payments made after December 31, 1935.

The following sentence is added to the third paragraph of article 273-1, relating to jeopardy assessments:

In any case, however, interest accruing during any period of time after August 30, 1935, is at the rate of 6 per cent per annum.

The following is substituted for the first three paragraphs of article 291-1:

ART. 291-1. *Addition to the tax in case of failure to file return.*—In case of failure to make and file a return required by Title I within the prescribed time, a certain per cent of the amount of the tax is added to the tax unless the return is later filed and failure to file the return within the prescribed time is shown to the satisfaction of the Commissioner to be due to reasonable cause and not to willful neglect. If the last date prescribed by law or prescribed by the Commissioner in pursuance of law for filing the return is before August 31, 1935, the amount to be added to the tax for failure to make and file the return within the prescribed time is 25 per cent of the amount of the tax. If the last date so prescribed for filing the return is after August 30, 1935, the amount to be added to the tax in lieu of such 25 per cent is 5 per cent if the failure is for not more than 30 days, with an additional 5 per cent for each additional 30 days or fraction thereof during which failure continues, not to exceed 25 per cent in the aggregate. Two classes of delinquents are subject to this addition to the tax:

(*a*) Those who do not file returns and for whom returns are made by a collector or the Commissioner, and

(*b*) Those who file tardy returns and are unable to show reasonable cause for the delay.

A taxpayer who files a tardy return and wishes to avoid the addition to the tax for delinquency must make an affirmative showing of all facts alleged as a reasonable cause for failure to file the return on time in the form of an affidavit which should be attached to the return. If such an affidavit is furnished with the return or upon the collector's demand, the collector, unless otherwise directed by the Commissioner, will forward the affidavit with the return, and, if the Commissioner determines that the delinquency was due to a reasonable cause, and not to willful neglect, the addition to the tax will not be assessed. If the taxpayer exercised ordinary business care and prudence and was nevertheless unable to file the return within the prescribed time, then the delay is due to a reasonable cause.

If the addition to the tax for delinquency in filing the return has been added, the amount so added shall be collected in the same manner as the tax.

The next to the last paragraph of article 351-3, relating to the computation of undistributed adjusted net income of personal holding companies, is amended to read:

The "undistributed adjusted net income" is computed by subtracting from the "adjusted net income" described above, (*a*) an amount equal to 20 per cent of the excess of the adjusted net income over the amount of dividends received from personal holding companies which are allowable as a deduction for the purpose of the tax imposed by section 13 or 204, (*b*) reasonable amounts used or set aside to retire indebtedness incurred by the taxpayer prior to January 1, 1934 (see article 351-4), and (*c*) any dividends paid during the taxable year, and for taxable years beginning after December 31, 1935, distributions (not in complete or partial liquidation and not a "dividend" as defined in section 115, for example, as a result of an existing deficit) made during the taxable year out of earnings or profits of such year.

Article 351-5 is amended to read:

ART. 351-5. *Rates of surtax.*—For taxable years beginning before January 1, 1936, the surtax is to be computed at the rate of 30 per cent upon the amount of the undistributed adjusted net income not in excess of $100,000, and at the rate of 40 per cent upon the amount of the undistributed adjusted net income in excess of $100,000. For taxable years beginning after December 31, 1935, the surtax is to be computed at the rates specified in section 351(a) of the Revenue Act of 1934, as amended by section 109 of the Revenue Act of 1935. The following table shows the surtax due from personal holding companies for taxable years beginning after December 31, 1935, upon certain specified amounts of undistributed adjusted net income. In each instance the first figure of the undistributed adjusted net income in the undistributed adjusted net-income column is to be excluded and the second figure included. The percentage given opposite applies to the excess of income over the first figure in the undistributed adjusted net-income column. The last column gives the total surtax on an undistributed adjusted net income equal to the second figure in the undistributed adjusted net-income column.

PERSONAL HOLDING COMPANY SURTAX TABLE.

(Taxable years beginning after December 31, 1935.)

| Undistributed adjusted net income. | Per cent. | Total surtax. |
|---|---|---|
| $0 to $2,000 | 20 | $400 |
| $2,000 to $100,000 | 30 | 29,800 |
| $100,000 to $500,000 | 40 | 189,800 |
| $500,000 to $1,000,000 | 50 | 439,800 |
| $1,000,000 up | 60 | ---------- |

The surtax for any amount of undistributed adjusted net income not shown in the table is computed by adding to the surtax for the largest amount shown which is less than the undistributed adjusted net income, the surtax upon the excess over that amount at the rate indicated in the table. Accordingly, the surtax due for taxable years beginning after December 31, 1935, upon an undistributed adjusted net income of $150,000 would be $49,800, computed as follows:

| | |
|---|---|
| Tax on $100,000 from table | $29,800.00 |
| Tax on $50,000 at 40 per cent | 20,000.00 |
| Total | 49,800.00 |

GUY T. HELVERING,
*Commissioner of Internal Revenue.*

Approved February 18, 1936.

STEPHEN B. GIBBONS,
*Acting Secretary of the Treasury.*

C. REVENUE ACT OF 1934.

# SUBTITLE B.—GENERAL PROVISIONS.

## PART II.—COMPUTATION OF NET INCOME.

## SECTION 22(a).—GROSS INCOME: GENERAL DEFINITION.

ARTICLE 22(a)-1: What included in gross income. XV-6-7937
G. C. M. 16020

REVENUE ACT OF 1934 AND PRIOR REVENUE ACTS.

Taxability of income of restricted Indians of the Five Civilized Tribes.

An opinion is requested as to what changes, if any, are to be made in procedure with reference to the taxability of income of restricted Indians of the Five Civilized Tribes on account of the decision of the Supreme Court of the United States in *Superintendent of Five Civilized Tribes (on behalf of Sandy Fox)* v. *Commissioner* (295 U. S., 418, Ct. D. 974, C. B. XIV-1, 158).

That case involved the taxability of the income of a restricted Indian derived from the reinvestment of income from restricted allotted lands, the original income having been considered to be tax-exempt as from a tax-free source. It has been the consistent position of the Bureau that the reinvestment income is taxable. (See *Katie Snell et al.* v. *Commissioner*, 10 B. T. A., 1081, and G. C. M. 9621, C. B. X-2, 111.) The decision of the United States Supreme Court in *Superintendent, etc.*, v. *Commissioner*, supra, confirms that position.

In that case the Court stated that nontaxability and restriction upon alienation are distinct things, and that taxation of the trust property of its Indian wards by the Federal Government, under Federal Revenue Acts general in scope, is not so inconsistent with the relationship between the Government and its Indian wards that exemption is a necessary implication; and that if exemption exists it must derive plainly from agreements with the Indian Tribes or some Act of Congress dealing with their affairs.

With particular reference to the taxability of the restricted allotments of the Five Civilized Tribes, and of the income derived directly therefrom, the Attorney General in his opinion of March 15, 1924 (34 Ops. A. G., 275, T. D. 3570, C. B. III-1, 85), ruled that, in addition to the specific exemption for stated periods of the homestead allotments contained in the Acts of Congress, all of the restricted allotted lands continued to be exempt from taxation during the continuance of the restrictions " in accordance with the purpose and intent of section 19 of the Act of April 26, 1906 (34 Stat., 137, 144), and section 4 of the Act of May 27, 1908 (35 Stat., 312, 313)." Section 19 of the Act of 1906 clearly exempted the allotted lands during the continuance of the restrictions but not beyond the life of the original allottee. Section 4 of the Act of 1908 provided that all allotted lands from which restrictions are removed shall be subject to taxation and all other civil burdens, and that allotted lands shall not be subject to any personal claim or demand arising prior to the removal of restriction. Exemption from taxation by necessary implication of allotted lands solely because of the existence of restrictions seems to be required by the language of Congress in said section 4, even if tested by the standard of construction raised by the Supreme Court in *Superintendent, etc.*, v. *Commissioner*, supra. At any rate, Congress in the Act of May 10, 1928 (45 Stat., 495), seems to have proceeded on that understanding of the matter. In section 3 of the latter Act it is provided that all minerals, including oil and gas, produced on or after April 26, 1931, from restricted allotted lands of the Five Civilized Tribes in Oklahoma shall be subject to taxation.

By section 4 of that Act it is provided also that on and after said date allotted, inherited, or devised restricted lands of each Indian in excess of 160 acres shall be subject to taxation; that the restricted owner shall select from his restricted lands tracts not exceeding 160 acres which shall remain exempt from taxation (except as to the minerals *produced* therefrom as above indicated), such selection to be evidenced by a certificate filed with the Superintendent of the Five Civilized Tribes and recorded in the proper county; and that such certificated restricted lands shall remain exempt (except as to minerals produced) while the title remains in the Indian designated in the certificate or any full-blood heir or devisee of the land. By section 1 of the Act of January 27, 1933 (47 Stat., 777), the exemption of the certificated restricted lands was broadened by making them exempt (except as to minerals produced) in the hands of any restricted Indian heir, devisee, or donee (and not only as to a full-blood Indian heir or devisee), or in the hands of any restricted Indian for whom such lands are purchased with restricted funds.

This office is of the opinion, therefore, that no change in the procedure followed by the Bureau for the period up to April 26, 1931, in respect of the taxability of the restricted allotted lands of the members of the Five Civilized Tribes, and of the income derived directly therefrom, is required on account of the decision of the Supreme Court in *Superintendent, etc.*, v. *Commissioner*, supra. The procedure to be adhered to beginning with April 26, 1931, is indicated by the above review of the express legislation of Congress in the Acts of May 10, 1928, and January 27, 1933.

With reference to the taxability of reinvestment income, it has been indicated above that the Bureau's position has consistently been that such income is taxable, and that the decision in *Superintendent, etc.*, v. *Commissioner*, supra, is but an affirmation of a long standing position of the Bureau.

ROBERT H. JACKSON,
*Assistant General Counsel for the Bureau of Internal Revenue.*

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ARTICLE 22(a)-1: What included in gross income. XV-8-7961
G. C. M. 16100

REVENUE ACT OF 1934 AND PRIOR REVENUE ACTS.

Taxability of income of restricted members of the Osage Indian Tribe.

Advice is requested relative to the taxability of income of the restricted members of the Osage Indian Tribe.

The case of *Superintendent of Five Civilized Tribes (on behalf of Sandy Fox)* v. *Commissioner* (295 U. S., 418, Ct. D. 974, C. B. XIV-1, 158), which has given rise to this review of the matter, dealt primarily with the taxability of income from the reinvestment of income from the restricted allotted lands of members of the Five Civilized Tribes. The Court held that such reinvestment income is and has been subject to tax. In answer to the contention that restrictions and nontaxability should go hand in hand, "and that it is not lightly to be assumed that Congress intended to tax the ward for the benefit of the guardian," the Court said that the general terms of the taxing Act include the income under consideration and if exemption exists it must derive plainly from agreements with the Indians or some Act of Congress dealing with their affairs. The Court specifically stated that the decision in *Blackbird* v. *Commissioner* (38 Fed. (2d), 976), which is to the contrary, does not harmonize with its opinion in *Choteau* v. *Burnet* (283 U. S., 691), and concluded with the following language:

> Nor can we conclude that taxation of income from trust funds of an Indian ward is so inconsistent with that relationship that exemption is a necessary implication. Nontaxability and restriction upon alienation are distinct things. (*Choate* v. *Trapp*, 224 U. S., 665, 673.) The taxpayer here is a citizen of the United States, and wardship with limited power over his property does not, without more, render him immune from the common burden.

*Shaw* v. *Gibson-Zahniser Oil Corporation*, supra, held that restricted land purchased for a full-blood Creek—ward of the United States—with trust funds was not free from State taxation, and declared that such exemption could not be implied merely because of the restrictions upon the Indian's power to alienate.

The Osage Allotment Act of 1906 (34 Stat., 539) is silent as to any tax exemption of the Osage mineral rights or of the income therefrom, nor is there any language in any of the subsequent Acts of Congress dealing with the Osage Tribe which exempts such rights or income from Federal taxation. (See *Mary Blackbird* v. *Commissioner*, 14 B. T. A., 1247, for a similar conclusion by the Board of Tax Appeals.) Accordingly, in view of the decision of the United States Supreme Court in *Superintendent, etc.*, v. *Commissioner*, supra, it is held that the income of the restricted members of the Osage Tribe from rents, royalties, and bonuses derived from the mineral leases of the Tribe is subject to Federal income tax.

The homestead allotments of the members of the Osage Tribe were made inalienable and nontaxable by section 2, paragraph 4, of the Allotment Act of 1906 "until otherwise provided by Act of Congress," subject to the provision in paragraph 7 of section 2 that if a member were issued a certificate of competency by the Secretary of the Interior, his homestead should remain inalienable and nontaxable for 25 years or during his life. By section 3 of the Act of March 3, 1921 (41 Stat., 1249), it was provided that the homestead allotments of *all the members* of the Osage Tribe should not be subject to taxation, if held by the original allottee, prior to April 8, 1931. (See I. T. 1834, C. B. II-2, 62.) By section 1 of the Act of March 2, 1929 (45 Stat., 1478), the rule now in effect is that the homestead allotments of those Osages of one-half or more Indian blood who do not have certificates of competency are exempt in the hands of the original allottee or in the hands of his unallotted heirs or devisees of one-half or more Osage Indian blood until January 1, 1959, provided that the tax-exempt land of any such Indian allottee, heir, or devisee shall not at any time exceed 160 acres. The income from such homestead allotments remains exempt from Federal income tax. It should be borne in mind that the exemption mentioned in this paragraph has no relation to the minerals contained in such allotments, the mineral rights under all the allotted lands having been reserved as tribal property without provisions for tax exemption as heretofore pointed out. (See I. T. 1834, supra.) The homestead exemption is to be confined within the limits last above indicated.

The former position of the Bureau that the income of the restricted members of the Osage Tribe from the mineral leases of the tribe should not be subjected to Federal income tax was adopted after the decision of the United States Supreme Court in *Choteau* v. *Burnet*, supra. Inasmuch as certiorari had not been applied for in *Blackbird* v. *Commissioner*, supra, and inasmuch as the ruling of the circuit court of appeals in that case to the effect that a restricted Indian is not subject to the tax because of his relationship with the Federal Government arising out of the existence of restrictions was in harmony with the ruling of the Attorney General to the same effect in reference to the restricted allotments of the Quapaw Indians (34 Ops. A. G., 439, T. D. 3754, C. B. IV-2, 37), it was decided that the Government should continue to abide by that position. Accordingly, the mineral income of such restricted Indians has been considered to be tax exempt up to the present time. In view of the fact that the exclusion of such income from the returns of the restricted members of the Osage Tribe has been based upon official action thus taken and not upon any act or failure of the Indians, a reversal of procedure for prior years would entail a hardship upon such Indians. Because of this situation, this office is of the opinion that the conclusion that such mineral income is taxable to such restricted Indians should not be applied retroactively prior to May 20, 1935, the date of the decision of the United States Supreme Court in *Superintendent, etc.*, v. *Commissioner*, supra.

With respect to the taxability of the income of restricted Indians from the reinvestment of income derived from sources heretofore considered to be tax exempt, it has been the consistent position of the Bureau that such reinvestment income is taxable. This position was approved by the Board of Tax Appeals in *Katie Snell et al.* v. *Commissioner* (10 B. T. A., 1081), decided February 29, 1928. In G. C. M. 9621 (June, 1931, C. B. X-2, 111), this office restated its position that such income is taxable. The matter was finally concluded by the decision of the United States Supreme Court (May 20, 1935) in *Superintendent, etc.*, v. *Commissioner*, supra. The situation in this respect does not present any change of position of the Bureau as a result of that decision.

ROBERT H. JACKSON,
*Assistant General Counsel for the Bureau of Internal Revenue.*

Approved.
GUY T. HELVERING, *Commissioner.*
T. J. COOLIDGE, *Acting Secretary.*

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ARTICLE 22(a)-1: What included in gross income. XV-19-8075
G. C. M. 16572

ALL REVENUE ACTS.

The proceeds of an embezzlement constitute taxable income in the hands of the embezzler for Federal income tax purposes.

An opinion is requested whether embezzled funds constitute taxable income to the embezzler.

Section II B of the Revenue Act of 1913 provides in part that net income shall include among other things " gains, profits, and income derived from * * * the transaction of any lawful business carried on for gain or profit * * *." In the Revenue Act of 1916 (section 2(a)) the definition of net income was amended and among other changes the word " lawful " was deleted therefrom. Thereafter, in *Rau* v. *United States* (260 Fed., 131), decided by the Circuit Court of Appeals for the Second Circuit, it was for the first time judicially stated that funds acquired by taxpayers through embezzlement should not be treated as income for Federal income tax purposes. The statement in that case was merely dictum and the court gave neither reasons nor citations of authority in support of it.

The Rau case was followed by *United States* v. *Frank Auditors*, an unreported case decided by the United States district court in the same circuit in which the Rau case was decided. In granting a motion for dismissal of the indictment charging perjury and fraud in connection with taxpayer's willful failure to return as income property which he had stolen or embezzled, the court, again merely by way of dictum, observed that stolen property could not be regarded as taxable income under the Revenue Acts. No authority was cited in support of that conclusion but the court gave as a reason the fact that a thief and an embezzler do not acquire legal title to the proceeds of such crimes, and it was intimated that nothing could be regarded as taxable income other than property the legal ownership of which may be regarded as residing in the taxpayer.

In *Steinberg* v. *United States* (14 Fed. (2d), 564), also from the same circuit as the preceding cases, the court stated that upon the authority of the Rau case a distinction might be drawn between the proceeds of an embezzlement, a robbery, or a burglary and those of sales of liquor, or plumes from birds of paradise, the legal title to which resides in the offender and is therefore taxable income in his hands. That statement was also dictum and is considerably weakened by the succeeding paragraphs in the court's opinion which indicate that the court was merely making an argumentative statement with respect to the taxable status of embezzled property.

Contrasted with the dicta above mentioned, there is the broad and unqualified definition of gross income contained in the Revenue Acts from 1916 to the present time which specifically includes "gains or profits and income derived from any source whatever." It would be difficult to find more appropriate language for the expression of a legislative intent to include as taxable income all gains inuring to a taxpayer whether or not obtained by lawful means. There is nothing in the definition to suggest that Congress intended to draw a distinction between gains enjoyed by the taxpayer to which he had legal title and those possessed by him and inuring to his benefit but to which he does not have legal title. Moreover, such a distinction can scarcely be said to harmonize with the rules of the Bureau as to what constitutes taxable income in other cases. For example, apart from the specific requirements of section 167 of the Revenue Act of 1934 and the corresponding provisions of prior Revenue Acts, it is now established by decisions of the United States Supreme Court that the grantor of an irrevocable trust is taxable on that portion of the income of the trust which is used for the purpose of discharging his own obligations. (See *Douglas* v. *Willcuts*, 296 U. S., 1, Ct. D. 1041, C. B. XIV-2, 250; *Helvering* v. *Schweitzer*, 296 U. S., 551; *Helvering* v. *Blumenthal*, 296 U. S., 552.) In those cases the grantors of the trust had no interest in the trust income which could be described as a definite legal or equitable estate. The taxation of such income to them was sustained by the court in each case upon the theory that the income was, nevertheless, actually applied for their benefit.

The United States Supreme Court has also defined income as "gain derived from capital, from labor, or from both combined, provided it be understood to include profit gained through a sale or conversion of capital assets." (*Eisner* v. *Macomber*, 252 U. S., 189, T. D. 3010, C. B. 3, 25.) This definition of income is likewise sufficiently all-inclusive to comprehend embezzled property. The proceeds of an embezzlement may surely be regarded as a *gain*, and if the court's requirement that gain must be derived from labor may be taken to mean that the gain must result from some expenditure of human energy, then it would seem that the proceeds of an embezzlement are derived from labor.

Although there are no decisions holding directly that the proceeds of an embezzlement constitute taxable income, yet, in view of the foregoing, it may properly be said that there is no controlling authority to the contrary. Furthermore, the definitions of taxable income and all analogies indicate that such proceeds were not excepted by Congress from those gains which do constitute taxable income. (See generally the reasoning of the court in *United States* v. *Wampler*, 5 Fed. Supp., 796, Ct. D. 791, C. B. XIII-1, 101.)

Accordingly, it is the opinion of this office that the proceeds of an embezzlement constitute taxable income in the hands of the embezzler.

HERMAN OLIPHANT,
*General Counsel for the Department of the Treasury.*

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ARTICLE 22(a)-3: Compensation paid other than in cash.

XV-10-7982
G. C. M. 16069

REVENUE ACT OF 1934.

Premiums paid by an employer on the ordinary type of life insurance policies on the lives of its employees represent additional income to the employees. Premiums paid by an employer on group life insurance policies for its employees do not constitute additional income and are not required to be included in the Federal income tax returns of the employees.

Advice is requested relative to the treatment for Federal income tax purposes of premiums paid on both ordinary and group life insurance policies by the M Company for the benefit of its employees.

It was held in I. T. 2891 (C. B. XIV-1, 50) that amounts paid by an employer toward the purchase of retirement annuity contracts for the benefit of employees are not constructively received by the employees in the year or years in which such payments are made and are not, therefore, required to be included in the Federal income tax returns of the employees. It is suggested that the ruling in question is inconsistent with the statements in G. C. M. 8432 (C. B. IX-2, 114), wherein it was pointed out (citing cases) that premiums paid by a corporation for insurance policies on the lives of its officers represent additional compensation to the officers. Advice is, therefore, requested whether the conclusion reached in G. C. M. 8432, supra, is to be applied to the premiums paid on the ordinary life insurance policies taken out for the employees of the M Company or whether I. T. 2891 is applicable. Advice is also requested as to the effect, for income tax purposes, of the right of the insured to designate the beneficiary.

The statements made in G. C. M. 8432, that generally the premiums paid by corporations on individual life insurance policies taken out by or on behalf of their officers and covering their lives constitute additional income to the officers which should be included in their returns for the year or years in which paid, find support in the decisions of the Board of Tax Appeals in *George Matthew Adams* v. *Commissioner* (18 B. T. A., 381), *N. Loring Danforth* v. *Commissioner* (18 B. T. A., 1221), and in the more recent decisions of the Board of Tax Appeals and the United States Circuit Court of Appeals for the Third Circuit in *Frank D. Yuengling* v. *Commissioner* (27 B. T. A., 782, affirmed 69 Fed. (2d), 971). The position of this office in this particular also finds support in the statement made by the United States Supreme Court in *Burnet* v. *Wells* (289 U. S., 670, Ct. D. 688, C. B. XII-1, 261), viz:

> Insurance for dependents is to-day in the thought of many a pressing social duty. Even if not a duty, it is a common item in the family budget, kept up very often at the cost of painful sacrifice, and abandoned only under dire compulsion. It will be a vain effort at persuasion to argue to the average man that a trust created by a father to pay premiums on life policies for the use of sons and daughters is not a benefit to the one who will have to pay the premiums if the policies are not to lapse. Only by closing our minds to common modes of thought, to everyday realities, shall we find it in our power to form another judgment. * * *

The ruling published as I. T. 2891 is not to be construed as modifying G. C. M. 8432, supra. The latter should be followed in cases involving the question of the treatment for Federal income tax purposes of premiums paid by an employer on life insurance policies other than group life insurance policies. The position of the Bureau on the question of premiums paid by an employer on group life insurance policies is indicated by article 22(a)-3 of Regulations 86, as well as the corresponding articles of prior regulations, reading in part as follows:

> * * * Premiums paid by an employer on policies of group life insurance covering the lives of his employees, the beneficiaries of which are designated by the employees, are not income to the employees. * * *

No distinction should be made between the premiums paid by an employer on an individual policy of life insurance covering the life of an employee where the employee is entitled to designate the beneficiary and premiums paid on a policy of life insurance the proceeds of which inure directly to the benefit of the employee's wife or other dependents or his estate, notwithstanding the insured employee may not be permitted to designate the beneficiary.

ROBERT H. JACKSON,
*Assistant General Counsel for the Bureau of Internal Revenue.*

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## SECTION 22(b).—GROSS INCOME: EXCLUSIONS FROM GROSS INCOME.

ARTICLE 22(b)-1: Exemptions—Exclusions from gross income. XV-13-8016
I. T. 2963

REVENUE ACT OF 1934.

> The retirement pay received by an officer retired from active service in the Regular Army, Navy, or Marine Corps is not exempt from Federal income tax under the provisions of the Act of August 12, 1935 (Public, No. 262, Seventy-fourth Congress, 49 Stat., 607).

Inquiry is made whether the retirement pay received by a retired Army officer is exempt from Federal income tax under the provisions of the Act of August 12, 1935, relating to "veterans."

The taxpayer entered the military service of the United States in 1892 as a commissioned officer and served continuously until 1919 when he was retired from active service for disability in line of duty. He is a veteran of the Spanish-American War, Philippine Insurrection, and the World War. The Veterans Administration determined that he was entitled to total disability rating from the date of retirement.

Section 3 of the Act of August 12, 1935 (Public, No. 262, Seventy-fourth Congress, 49 Stat., 607, C. B. XIV-2, 538), provides in part as follows:

SEC. 3. Payments of benefits * * * made to, or on account of, a beneficiary under any of the laws relating to veterans shall be exempt from taxation * * *.

Section 1251 of the Revised Statutes provides:

* * * When a retiring board finds that an officer is incapacitated for active service, and that his incapacity is the result of an incident of service, and such decision is approved by the President, said officer shall be retired from active service and placed on the list of retired officers. (Title 10, section 933, U. S. C.)

The term " veteran " relates to one long exercised in the service of war or, more popularly, one who has seen service as distinguished from a recruit or a soldier in his first enlistment. The taxpayer's service undeniably entitled him to be called a " veteran," but the question of exemption from Federal income tax of the pay received by officers retired from active service in the Regular Army, Navy, or Marine Corps does not rest upon the use of that term alone.

The Act of August 12, 1935, is entitled "An Act to safeguard the estates of veterans derived from payments of pension, compensation, emergency officers' retirement pay and insurance, and for other purposes." Section 5 states that the Act shall be effective from and after its passage but that its provisions "shall apply to payments made heretofore under any of the Acts mentioned herein." Under section 2, mention is made of the War Risk Insurance Act, as amended, the World War Veterans' Act, 1924, as amended, the Emergency Officers' Retirement Act, as amended, the World War Adjusted Compensation Act, as amended, the pension laws in effect prior to March 20, 1933, Public Law Numbered 2, Seventy-third Congress, as amended, Public Law Numbered 484, Seventy-third Congress, or any Act or Acts amendatory of such Acts. The Act of August 12, 1935, does not mention the statute under which the taxpayer receives retirement pay, nor is any reference made therein to any of the general statutes under which retirement pay is provided for officers or enlisted men of the Regular Army, Navy, or Marine Corps.

Retirement allowances paid to officers retired from active service in the Regular Army, Navy, or Marine Corps are regarded as compensation for services previously rendered and for awaiting orders to active service whenever the contingency may arise. An officer who is retired from active service is still in the military service of the United States.

It is held, therefore, that the provisions of the Act of August 12, 1935, supra, are not such as to exempt from Federal income tax the retirement pay received by an officer retired from active service in the Regular Army, Navy, or Marine Corps.

ARTICLE 22(b)(2)-2: Annuities.

XV-26-8140
I. T. 2984

REVENUE ACT OF 1934.

Taxation of annuities paid to retired civil service employees.

Advice is requested whether Treasury Decision 3112 (C. B. 4, 76), promulgated January 10, 1921, relating to the taxability of annuities granted under the Civil Service Retirement Act, is applicable to such annuities received in the taxable year 1935. In the event that Treasury decision is not applicable, the Bureau is requested to rule as to the proper treatment, for Federal income tax purposes, of an annuity received under the following statement of facts:

The annuitant in question was separated from the service on June 30, 1935, and granted an annuity of $1,200 per annum, effective July 1, 1935, payable in 12 equal monthly installments. During his service there was deducted from his salary for the retirement fund the sum of $2,281.91. Of this amount $60 was credited to the so-called "tontine account" representing $1 per month from July 1, 1930, as provided in the Retirement Act of May 29, 1930, which remains in the retirement fund. The balance of his deductions $2,221.91 plus interest of $698.08 was credited to his individual account, and this sum, $2,919.99, purchased for him $263.56 of his $1,200 annuity.

It was held in Treasury Decision 3112, supra, that an annuity paid to a retired civil service employee is subject to tax to the extent that the aggregate amount of the annuity payments exceeds the amounts withheld from the compensation of the employee. Prior to the enactment of the Revenue Act of 1934, annuity payments in an amount equal to the consideration paid by the annuitant were returnable to him tax free for Federal income tax purposes. Although the amount ultimately returned to the annuitant tax free under the provisions of section 22(b)2 of the Revenue Act of 1934 is unchanged, it is distributed over a different period. Each year the excess of the amount received over 3 per cent of the consideration paid by the annuitant is tax free until the aggregate of the sums excluded from gross income under the Revenue Act of 1934 and prior Revenue Acts exceeds the consideration paid. When the aggregate of the amounts received and excluded from gross income equals the consideration paid by the annuitant, the entire amount received thereafter in each taxable year must be included in gross income. No change has been made, therefore, in Treasury Decision 3112, but the provisions of the Revenue Act of 1934, with respect to annuities in general, operate so as to cause a change in the method of its application to cases in 1934 and subsequent years.

Relative to the ruling requested, article 22(b)(2)-2 of Regulations 86, relating to the Revenue Act of 1934, provides in part as follows:

* * * If an annuity is payable in two or more installments over each 12-month period, such portion of each installment shall be taxable as is equal to 3 per cent of the aggregate premiums or consideration paid for such annuity, * * * divided by the number of installments payable during such years, * * *.

The consideration paid by the annuitant in the present case is held to include the amount credited to the tontine account and to exclude the interest credited to his individual account. Applying the law and regulations to the facts presented, $5.70 ($2,281.91 × .03 = $68.4573 ÷ 12) is the portion of the annuity payment of $100 each month which is subject to Federal income tax. For the six months of 1935 the annuitant received $600. Of this sum, $34.20 ($5.70×6) is the part which should be included in the annuitant's gross income for that year and the remainder, $565.80, should not be returned as income.

Assuming that like provisions (section 22(b)2 of the Revenue Act of 1934) will be in effect for the years 1936 and 1937, $68.45 (3 per cent of $2,281.91) of the annuity for 1936 will be taxable and $1,131.55 will not be taxable. The total amount to be excluded from gross income for 1935 and 1936 is, therefore, $1,697.35. This leaves $584.56 ($2,281.91 minus $1,697.35) to be excluded from gross income for 1937. Consequently, of the annuity of $1,200 to be received in that year, $615.44, or the difference between the annuity and the excluded sum of $584.56, is the amount which will be includible as taxable income in the annuitant's return for that year.

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ARTICLE 22(b)(3)-1: Gifts and bequests. XV-11-7993
I. T. 2959

REVENUE ACT OF 1934.

Where, under the provisions of the Civil Service Retirement Act of May 29, 1930, as amended by the Act of June 22, 1934 (48 Stat., 1201), a beneficiary, distributee, or next of kin receives any part of the amount standing to the credit of a decedent, whether an employee or annuitant at the date of death, such sum is exempt from Federal income tax under the provisions of section 22(b)3 of the Revenue Act of 1934.

Advice is requested whether the amount to the credit of a decedent under the Civil Service Retirement Act of May 29, 1930, as amended, when paid to a beneficiary, distributee, or next of kin is subject to Federal income tax in the hands of the recipient.

Section 12(c) of the Civil Service Retirement Act, as amended by the Act of June 22, 1934 (48 Stat., 1201), reads as follows:

(c) In case an annuitant shall die without having received in annuities purchased by the employee's contributions as provided in (2) of section 4 of this Act an amount equal to the total amount to his credit at time of retirement, the amount remaining to his credit and any accrued annuity shall be paid, upon the establishment of a valid claim therefor, in the following order of precedence:

First, to the beneficiary or beneficiaries designated in writing by such annuitant and recorded on his individual account;

Second, if there be no such beneficiary, to the duly appointed executor or administrator of the estate of such annuitant;

Third, if there be no such beneficiary, or executor or administrator, payment may be made, after the expiration of 30 days from the date of the death of the annuitant, to such person or persons as may appear in the judgment of the Civil Service Commission to be legally entitled thereto, and such payment shall be a bar to recovery by any other person.

In the case of an annuitant who has elected to receive an increased annuity as provided in section 4 of this Act, the amount to be paid under the provisions of this subsection shall be only the accrued annuity.

Section 12(d) of the Civil Service Retirement Act, as amended, provides for payment in the same order of precedence of the amount in the retirement fund to the credit of an employee who dies without having attained eligibility for retirement or without having established a valid claim for annuity.

Section 22(b)3 of the Revenue Act of 1934 provides for the exclusion from gross income and the exemption from taxation of—

(3) *Gifts, bequests, and devises.*—The value of property acquired by gift, bequest, devise, or inheritance * * *.

It is held, therefore, that where under the provisions of the Civil Service Retirement Act of May 29, 1930, as amended by the Act of June 22, 1934 (48 Stat., 1201), a beneficiary, distributee, or next of kin receives any part of the amount standing to the credit of a decedent, whether an employee or annuitant at the date of death, such sum is exempt from Federal income tax under the provisions of section 22(b)3 of the Revenue Act of 1934.

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## SECTION 23(a).—DEDUCTIONS FROM GROSS INCOME: EXPENSES.

ARTICLE 23(a)-1: Business expenses.

REVENUE ACT OF 1934.

Attorney's fees paid in connection with litigation involving Louisiana taxes on merchandise. (See I. T. 2972, page 108.)

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ARTICLE 23(a)-1: Business expenses.

XV-20-8084
I. T. 2973

REVENUE ACT OF 1934.

Where a substitute teacher is employed in lieu of a regular teacher in the public schools of the District of Columbia and the latter pays the substitute on a per diem basis, the amount paid by the regular teacher constitutes a proper deduction as an ordinary and necessary business expense.

Advice is requested whether the amount paid to a substitute teacher in the public schools of the District of Columbia by a regular teacher in such schools for services rendered by the former in the absence of the latter is deductible as an ordinary and necessary business expense under section 23(a) of the Revenue Act of 1934.

It is stated that there are two classes of substitutes, one known as an annual substitute and one as a per diem substitute. The annual substitutes (provided for in the District of Columbia Code) receive a basic salary and when they are not substituting for regular teachers they are employed in regular work. When one of the annual substitutes is used in lieu of a regular teacher, the compensation of the latter is reduced, such reduction being based upon a schedule employed in the schools. If, however, a per diem substitute is called by the principal of the school to substitute for a regular teacher, then the regular teacher, instead of having a reduction in the amount of compensation, as in the case where an annual substitute is employed, receives full compensation and is required to pay the per diem teacher a certain amount. The latter is the class concerning which the inquiry is made.

Upon consideration of the question presented, it is held that where a substitute is employed in lieu of a regular teacher and the latter pays the substitute on a per diem basis, the amount so paid by the regular teacher constitutes a proper deduction as an ordinary and necessary business expense. Support for this view is found in *Lillian M. Goldsmith* v. *Commissioner* (7 B. T. A., 151, acquiescence, C. B. VII-1, 12). In that case the petitioner was vice president and owned 50 per cent of the capital stock of a corporation engaged in business in Chicago, Ill. She received a fixed salary of $5,000 a year. Due to her absence from Chicago and her inability satisfactorily to protect her interest in the corporation, she personally employed a substitute and paid him a salary of $20 a week (a total of $1,040 in the year involved) to look after her interests in the corporation and to keep her fully advised in the premises. That amount was allowed by the Board as an ordinary and necessary business expense.

There is no doubt, of course, in the other situation, that is, where an annual substitute is employed and the regular teacher's salary is reduced accordingly, that the latter should return, for Federal income tax purposes, only the net amount of compensation received.

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## SECTION 23(c).—DEDUCTIONS FROM GROSS INCOME: TAXES GENERALLY.

ARTICLE 23(c)-1: Taxes. XV-1-7886
G. C. M. 15894

REVENUE ACT OF 1934.

In the State of Mississippi the ownership of personal or real property on January 1 of each year is the event which determines the liability for taxes thereon and taxpayers whose books of account are kept on the accrual basis should accrue their property taxes as of that date.

Advice is requested relative to the proper accrual date for property taxes in the State of Mississippi.

The provisions of law applicable to the question submitted are contained in chapter 61 of the Mississippi Code, 1930, Annotated, volume 1, reading as follows:

3120. *Taxes, a lien, from what date.*—Taxes, both State and county, assessed upon lands or personal property, shall bind the same, and be entitled to preference over all judgments, executions, encumbrances, or liens, whensoever created; and all taxes assessed shall be a lien upon and bind the property assessed, from the 1st day of January of the year in which the assessment shall be made; and no property shall be exempt from distress and sale for taxes. And it shall not be necessary to the validity of an assessment, or of a sale of land for taxes, that it shall be assessed to its true owner; but the taxes shall be a charge on the land or personal property taxed, and the sale shall be a proceeding against the thing sold, and shall vest title in the purchaser, without regard to who may own the land or other property when assessed or when sold, or whether wrongfully assessed, either to a person, or to the State, or any county, city, town, or village, or subdivision of either.

3121. *What date fixes liability to taxation.*—All taxable property brought into the State or acquired or held by any person before the 1st day of January shall be assessed, and taxes thereon paid for the ensuing year, provided, however, that when a municipality is created or the corporate limits thereof extended after the 1st day of January of any year, it shall have, prior to July 1 of said year, the full right and power to assess said property and collect taxes for the current year to the same extent as if it had been created or limits extended prior to the 1st day of January of that year. But nothing in this section shall be construed to limit the power of the State to define and declare the situs of particular species of property having no fixed situs at some place in this State.

The Bureau has consistently held that ownership of property on the date as of which the assessment is made is the "event" which determines the liability for taxes, and if the taxpayer's books of account are kept on the accrual basis, he should accrue property taxes as of that date. (See G. C. M. 15305, C. B. XIV-2, 80, and decisions cited therein.) The rulings of the Bureau have followed the principle laid down by the Supreme Court of the United States in *United States* v. *Anderson* (269 U. S., 422, T. D. 3839, C. B. V-1, 179), wherein it was stated that in advance of the assessment of a tax all the events may occur which fix the amount of the tax and determine the liability of the taxpayer to pay it.

With respect to personal property, there appears to be no doubt from the wording of section 3121 of the Mississippi Code, 1930, that ownership of the property on January 1 fixes the liability for taxes assessed for the ensuing year. (The day as of which personal property should be assessed was formerly February 1.) In *Adams* v. *Lamb-Fish Lumber Co.* (114 Miss., 534, 75 So., 378), the Supreme Court of Mississippi pointed out that the liability for taxes on personal property attaches as of the date of assessment. The liability attaches to all personal property owned on that date regardless of the fact that actual levy is made at a later date.

As to real property no specific date is stated in the statute as of which assessment should be made, but the State court decisions indicate that the date is the same as in the case of personal property, that is, January 1. Although the exact amount of the liability for property taxes is not ascertained until later in the year, the liability relates back to the date as of which the lien for taxes attaches. (*Vicksburg Waterworks Co.* v. *Vicksburg Water Supply Co.*, 80 Miss., 68, 31 So., 535; *Wildberger* v. *Shaw*, 84 Miss., 442, 36 So., 539; *Swinney* v. *Cockrell*, 86 Miss., 318, 38 So., 353; *McHenry Baptist Church* v. *McNeal*, 86 Miss., 22, 38 So., 195.) The lien date prescribed by statute at the time those cases were decided was February 1. That date has since been changed to January 1. (See section 3120 of the Mississippi Code, 1930.)

In view of the foregoing, it is held that in Mississippi ownership of personal or real property on January 1 of each year is the event which determines the liability for taxes thereon, and taxpayers whose books of account are kept on the accrual basis should accrue their property taxes as of that date.

Although section 3120 of the Mississippi Code, 1930, was amended by chapter 199 of the session laws for 1934, the amendment does not in any way affect the conclusions stated herein.

ARTHUR H. KENT,
*Acting Assistant General Counsel for the Bureau of Internal Revenue.*

ARTICLE 23(c)-1: Taxes. XV-4-7920
I. T. 2953

REVENUE ACT OF 1934.

The general consumers' sales tax imposed by the West Virginia supplemental (emergency) revenue act of 1935, effective July 1, 1935, and terminating June 30, 1937, is deductible by the purchaser or consumer as a tax in his Federal income tax return.

A taxpayer inquires whether he may deduct, for Federal income tax purposes, the sales tax paid by him under the provisions of Article II of the West Virginia supplemental (emergency) revenue act of 1935.

Prior to the enactment of that act, a general consumers' sales tax had been imposed by Title II of the supplemental (emergency) revenue act of 1934, effective April 1, 1934, and terminating on June 30, 1935. The Bureau held that the tax so imposed was deductible as a tax only by the retailer or vendor. (I. T. 2812, C. B. XIII-2, 51.)

Article II of the supplemental (emergency) revenue act of 1935 is found in chapter 84 of the acts of the West Virginia Legislature, regular session, 1935. The law was passed March 9, 1935, became effective July 1, 1935, and will terminate on June 30, 1937. The provisions bearing on the question involved read as follows:

SEC. 3. * * * For the privilege of engaging in the business of selling tangible personal property at retail, and of dispensing certain selected services defined in section 6 of this article, a retail dealer shall collect from a purchaser a tax of 2 per cent of the gross proceeds of each separate transaction, and shall pay the amount collected to the tax commissioner in accordance with the provisions of this article.

A purchaser shall pay the amount of the tax to the retail dealer. The retail dealer shall keep the tax paid by the purchaser separate and apart from the proceeds of sale and shall account to the State for all the tax paid by the purchaser. There shall be no tax on sales where the monetary consideration is 5 cents or less. On each sale where the monetary consideration is from 6 cents to 50 cents, both inclusive, the tax payable by the purchaser shall be 1 cent; on each sale where the monetary consideration is from 51 cents to $1, both inclusive, the tax payable by the purchaser shall be 2 cents, and on each 50 cents of such monetary consideration, or fractional part thereof, in excess of $1, the tax payable by the purchaser shall be 1 cent.

No profit shall accrue to any person by virtue of the provisions of this section, as a result of the collection of the tax herein levied upon purchasers, notwithstanding that the total amount of such taxes collected may be in excess of the amount for which such person would be liable by the application of the levy of 2 per cent to the gross proceeds of his sales, and the total of all taxes collected by any such person shall be returned and remitted to the tax commissioner as hereinafter provided.

* * * * * * *

SEC. 6. * * * The provisions of this title shall apply not only to selling tangible personal property, but also to the furnishing of all services, except professional and personal services, and except those services furnished by corporations subject to the control of the public service commission and the State road commission.

* * * * * * *

SEC. 8. * * * It is the intent of this article that the tax levied hereunder shall be passed on to and be paid by the consumer. The amount of the tax shall be added to the sales price, and shall constitute a part of that price and be collectible as such.

SEC. 9. * * * A person engaged in any business taxable hereunder shall not advertise or hold out to the public, in any manner, directly or indirectly, that he will absorb all or any part of the tax, or that the tax imposed by this article is not to be considered an element in the price to the consumer. * * *

Section 23(c) of the Revenue Act of 1934 provides that in computing net income there shall be allowed as deductions taxes paid or accrued within the taxable year, with certain exceptions not here material. Article 23(c)-1 of Regulations 86, relating to the Revenue Act of 1934, provides that in general taxes are deductible only by the person upon whom they are imposed. From the provisions of the State law quoted above, it is clear that the legislative intent was to impose the tax under the West Virginia supplemental (emergency) revenue act of 1935 upon the purchaser or consumer and to make the retail dealer the collector of the tax for and on behalf of the State. Since the tax is imposed upon the purchaser or consumer, he may deduct the amount paid by him as a tax in his Federal income tax return. If, however, the tax is added to or made a part of his business expenses, or is otherwise used to reduce his net income, it may not be deducted separately as a tax.

The foregoing ruling is applicable only to the general consumers' sales tax imposed under the West Virginia supplemental (emergency) revenue act of 1935, and in no way alters the conclusion reached in I. T. 2812, supra, under the consumers' sales tax law enacted in 1933.

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ARTICLE 23(c)-1: Taxes. XV-5-7927
I. T. 2954

REVENUE ACT OF 1934.

For Federal income tax purposes, the cigarette stamp tax, effective July 1, 1935, imposed by the State of Connecticut is an allowable deduction as a tax in the return of the distributor or dealer purchasing and affixing the stamps. To the purchaser or consumer of the cigarettes, the cost of the stamps is merely additional cost of the article purchased.

Advice is requested as to who may take a deduction, for Federal income tax purposes, of the cigarette stamp tax imposed by the State of Connecticut in 1935.

The law under which the tax is imposed is contained in chapter 75a of the Cumulative Supplement to the Connecticut General Statutes, January Sessions, 1931, 1933, 1935. The law applies only to cigarettes sold by distributors, or held by dealers for resale, between July 1, 1935, and June 30, 1939, inclusive. Provisions of the law pertinent to the issue read as follows:

SEC. 464c. *Definitions.*—Whenever used in this chapter, unless the context shall otherwise require, * * * the word "distributor" shall mean any person engaged in this State in the business of producing or manufacturing cigarettes or importing into the State cigarettes at least 75 per cent of which are purchased directly from the manufacturers thereof; * * * the word "dealer" shall mean any person other than a distributor, as defined herein, who is engaged in this State in the business of selling cigarettes; * * * the word "sale" or "sell" shall include or apply to gifts, exchanges and barter.

SEC. 465c. *Dealers and distributors to be licensed.*—Each person engaging in the business of selling cigarettes in this State, including any distributor or dealer, shall secure a license from the tax commissioner before engaging in such business, or continuing to engage therein after July 1, 1935. * * *

* * * * * * *

SEC. 468c. *One mill tax imposed.*—A tax is imposed on all cigarettes held in this State by any person for sale, said tax to be at the rate of 1 mill for each cigarette, and the payment thereof to be evidenced by the affixing of stamps to the packages containing the cigarettes, as hereinafter provided. Any cigarette on which a tax has been paid, such payment being evidenced by the affixing of such stamp, shall not be subject to a further tax under this chapter. Nothing contained in this chapter shall be construed to impose a tax on any transaction the taxation of which by this State is prohibited by the Constitution of the United States.

* * * * * * *

SEC. 473c. *Distributors to affix stamps.*—Each distributor shall affix, or cause to be affixed, * * * to each individual package of cigarettes sold or distributed by him, stamps of the proper denomination, as required by section 468c. Such stamps may be affixed by a distributor at any time before the cigarettes are transferred out of his possession.

SEC. 474c. *Dealers to affix stamps.*—Each dealer shall, within 24 hours after July 1, 1935, and within 24 hours after coming into possession of any cigarettes not bearing proper stamps evidencing payment of the tax imposed by this chapter, and before selling such cigarettes, affix or cause to be affixed, in such manner as the commissioner may specify in regulations issued pursuant to this chapter, to each individual package of cigarettes, stamps of the proper denomination, as required by section 468c.

Pertinent provisions of the regulations published in June, 1935, by the tax commissioner of the State of Connecticut, relating to the statutes imposing a tax on the sale of cigarettes, read as follows:

3. *Affixing of stamps.*—* * * Distributors selling cigarettes to licensed dealers and licensed dealers selling cigarettes not purchased from a distributor in this State, are required to affix to each package of cigarettes a stamp equal in value to 1 mill for each cigarette contained therein * * *.

From the foregoing it appears that any person in the State of Connecticut who is engaged in the business of selling cigarettes must secure a license. With the exception of certain nonresidents engaged in the business of selling and shipping cigarettes into the State, stamps are sold only to licensed distributors and licensed dealers. It is clear under the State law and regulations that the tax is imposed upon the distributors or dealers who, in purchasing and affixing the stamps, pay the tax.

Section 23(c) of the Revenue Act of 1934 provides that in computing net income there shall be allowed as deductions taxes paid or accrued within the taxable year, with certain exceptions not here material. Article 23(c)-1 of Regulations 86, relating to the Revenue Act of 1934, states that in general taxes are deductible only by the person upon whom they are imposed.

For Federal income tax purposes, the cost of the stamps, which are required by the laws of Connecticut to be purchased and affixed to packages of cigarettes, is an allowable deduction as a tax in the return of the distributor or dealer purchasing and affixing the stamps. The cost of the stamps, however, may not be deducted separately as a tax if it is included as a part of the business expense of the distributor or dealer or is otherwise used to reduce his net income. To the purchaser or consumer of the cigarettes, the cost of the stamps is merely additional cost of the article purchased.

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ARTICLE 23(c)-1: Taxes. XV-5-7928
I. T. 2955

REVENUE ACT OF 1934.

The retail sales tax imposed by the State of Washington, effective May 1, 1935, is deductible by the purchaser or consumer as a tax in his Federal income tax return.

Advice is requested whether the sales tax imposed by the State of Washington is deductible in the Federal income tax return of the consumer.

The tax on retail sales, effective May 1, 1935, is imposed under title 3 of the State revenue act of 1935, chapter 180, Laws of Washington, 1935. Provisions of the law pertinent to the question read as follows:

SEC. 16. * * * From and after the 1st day of May, 1935, there is hereby levied and there shall be collected a tax on each retail sale in this State equal to 2 per cent of the selling price.

SEC. 17. * * * For the purposes of this title, unless otherwise required by the context:

* * * * * * *

(b) The term "seller" means every person engaged in the business of making sales at retail or retail sales, whether as agent, broker, or principal;

* * * * * * *

SEC. 21. * * * The tax hereby imposed shall be paid by the buyer to the seller, and it shall be the duty of each seller to collect from the buyer the full amount of the tax payable in respect to each taxable sale. The amount of tax shall be paid by the buyer in cash, or by token or in scrip having the face value of either the purchase price or that portion of the purchase price for which the tax has not been paid in cash. In case any seller fails to collect the tax herein imposed he shall be personally liable to the State for the amount of such taxes as he fails to collect. The amount of tax, until paid to the seller, shall constitute a debt from the buyer to the seller and all amounts collected by the seller shall be deemed held in trust for the State.

SEC. 22. * * *

The commission shall have power * * * to require that persons making retail sales shall purchase and keep on hand scrip or tokens for the purpose of supplying buyers therewith.

SEC. 23. * * * Each seller, on or before the 15th day of the month succeeding the end of each bimonthly period, shall make out a return for the preceding bimonthly period * * * setting forth the amount of all sales, nontaxable sales, all taxable sales, the amount of tax thereon and such other information as the tax commission may require, sign and transmit the same to the tax commission. * * * The tax collected by a seller or accrued under the provisions of this title shall be paid by the seller to the tax commission * * *: *Provided, however*, That the commission shall have full power to provide, by regulation, methods by which scrip or tokens shall be redeemed, accepted, transmitted or canceled in satisfaction of tax imposed under the provisions of this title.

SEC. 24. * * * The commission may authorize a seller to prepay the tax levied under this title upon sales made through vending machines or similar devices, and waive the collection of the tax from the customer. No such authority shall be granted except upon application to the commission and unless the commission, after hearing, shall find that the conditions of the applicant's business are such as to render impracticable the collection of the tax in the manner otherwise provided under this title. * * *

* * * * * * *

SEC. 27. * * * Whoever, excepting as expressly authorized pursuant to this act, refunds, remits or rebates to a buyer, either directly or indirectly and by whatsoever means, all or any part of the tax levied by this title, or makes in any form of advertising, verbal or otherwise, any statements which might infer that he is absorbing the tax or paying the tax for the buyer by an adjustment of prices, or at a price including the tax, or in any other manner whatsoever shall be guilty of a misdemeanor.

Section 23(c) of the Revenue Act of 1934 provides that in computing net income there shall be allowed as deductions taxes paid or accrued within the taxable year, with certain exceptions not here material. Article 23(c)-1 of Regulations 86, relating to the Revenue Act of 1934, provides that in general taxes are deductible only by the persons upon whom they are imposed.

From the State law quoted above, it is clear that the legislative intent was to impose the tax on retail sales upon the buyer and to make the seller the collector of the tax for and on behalf of the State. Since the tax is imposed upon the buyer or consumer, he may deduct the amount paid by him as a tax in his Federal income tax return. If the tax is added to or made a part of his business expense, or is otherwise used to reduce his net income, it may not be deducted separately as a tax.

Inasmuch as under section 24 of title 3 of the State law authority may be granted to a seller to prepay the tax on sales made through vending machines or similar devices and to waive the collection of the tax from the customer, in such cases the seller is entitled to deduct the amount of tax so paid as a tax in his Federal income tax return.

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ARTICLE 23(c)-1: Taxes. XV-8-7962
I. T. 2957

REVENUE ACT OF 1934.

The sales tax imposed under the sales tax act of New Jersey (chapter 268, laws of 1935) is an excise tax imposed for the privilege of selling tangible personal property at retail and is deductible by the retailer as a tax under section 23(c) of the Revenue Act of 1934 in determining his net income subject to Federal income tax.

Advice is requested whether the New Jersey sales tax is an allowable deduction in the Federal income tax return of the consumer or retailer.

The tax in question is imposed under the sales tax act of New Jersey, chapter 268, laws of 1935. The chapter is entitled "An act imposing taxes for the privilege of selling tangible personal property at retail, providing for the disposition of the proceeds therefrom, and prescribing the method of collection." By the terms of the law the tax was effective from July 1, 1935, to June 30, 1938, but the law was repealed by chapter 1 of the first special session, laws of 1935, effective at midnight October 25, 1935. Provisions of the act pertaining to the question are as follows:

301. *Definitions.*

* * * * * * *

i. "Retail sales" or "sales at retail" means any sale of tangible personal property, in the ordinary course of business, for consumption or use or for any purpose other than for resale in the form of tangible personal property. * * * The term "retail sale" or "sale at retail" does not include an isolated transaction * * * not being made in the ordinary course of repeated and successive transactions of a like character * * *;

* * * * * * *

n. "Taxpayer" means any person subject to a tax imposed by the provisions of this act.

* * * * * * *

401. *Tax rate.*

For the privilege of selling tangible personal property at retail, in this State, during the period commencing July 1, 1935, and ending June 30, 1938, every person shall pay a tax of 2 per centum upon the total gross selling price thereof, except as in this act provided. This tax shall be in addition to all other taxes.

402. *Adding tax to sales price.*

Every retailer shall add the tax imposed by this act, or the average equivalent of said tax, to his sales prices, except as hereinafter provided. and when added the tax shall constitute a part of the price, shall be a debt of the purchaser to the retailer until paid and shall be recoverable at law in the same manner as the purchase price. * * *

* * * * * * *

405. *Cancellation of sale; tax credit.*

Where a sale has been rescinded or canceled and the goods if delivered have been returned and the full sale price and tax thereon have been refunded or credited, the retailer shall be entitled to a credit for the amount of the tax which would have accrued had the sale not been rescinded or canceled. If the tax has already been paid to the commissioner the credit shall be applied against any present or future liability of the retailer, under this act, and if there be no such liability the retailer shall be entitled to a refund of the tax so paid.

* * * * * * *

504. *Tax a debt; proceedings to recover; preference.*

The taxes, fees, interest and penalties imposed by this act, from the time the same shall be due, shall be a personal debt of the retailer to the State of New Jersey, recoverable in any court of competent jurisdiction in an action at law in the name of the State of New Jersey. * * *

* * * * * * *

508. *Refunds and credits.*

a. Any retailer, at any time within two years after the payment of any original or additional tax assessed against him, may file with the commissioner a claim under oath for refund, * * *.

b. If * * * it shall be determined by the commissioner that there has been an overpayment of tax, the amount of such overpayment shall be credited against any liability of the retailer under this act and if there be no such liability the retailer shall be entitled to a refund of the tax so overpaid. * * *

The following excerpts from the rules and regulations promulgated by the State tax commission indicate the administrative concept as to who shall be regarded as the taxpayer:

202. *Nature of the tax.*—The sales tax is a tax imposed upon every person in the State of New Jersey engaged, more or less regularly, in making sales of tangible personal property at retail. It is a tax for the privilege of selling tangible personal property at retail and is measured by the total gross sales of such property. * * *

* * * * * * *

302. *Class of property involved in a "sale at retail."*— * * * It is for the privilege of making retail sales of this kind of property—tangible personal property—that the tax is imposed.

If a person is engaged in the business of rendering services in which the use of supplies and materials is incidental, he is not liable to the State for the payment of the sales tax on the supplies and materials used; he is the consumer and the tax must be included in the prices he pays for his supplies and materials. The retailer who sells to him is liable to the State for the tax.

* * * * * * *

601. *Tax must be passed on to purchasers.*—While the tax is imposed upon, and must be paid by, retailers, it must be passed on by the retailers to the purchasers. * * *

602. *Schedule for passing on the tax.*—It is the intent that the average equivalent of the tax imposed upon, and payable by, each retailer shall be passed on to consumers. * * *

603. *Tax liability not determined by the amount of tax passed on.*— * * * The State as the tax-collecting agency looks only to the retailers for the payment of the tax at the rate of 2 per cent of their total gross sales of tangible personal property, regardless of the amount passed on to consumers.

Section 23(c) of the Revenue Act of 1934 provides that in computing net income there shall be allowed as deductions taxes paid or accrued within the taxable year, with certain exceptions not here material. Article 23(c)-1 of Regulations 86, relating to the Revenue Act of 1934, provides that in general taxes are deductible only by the person upon whom they are imposed.

The pertinent provisions of the New Jersey sales tax law are not entirely harmonious with respect to the identity of the taxpayer. Some provisions indicate that the tax was intended to be a privilege tax levied upon the retailer and measured by the volume of gross sales, while others appear more consistent with the view that the consumer was the intended taxpayer with the retailer merely a collecting agency for the State. However, in view of the title of the act, which states that it is "An act imposing taxes for the privilege of selling tangible personal property at retail," the provisions of the act imposing the tax (section 401 of the New Jersey sales tax act), and the regulations of the State tax commission, it is the opinion of the Bureau that the tax in question is an excise tax imposed upon the retailer for the privilege of selling tangible personal property at retail, although he is required to pass the amount of the tax on to the purchaser as part of the selling price. The retailer, therefore, is entitled to deduct the amount as a tax under section 23(c) of the Revenue Act of 1934 in determining his net income subject to Federal income tax. The tax may not be deducted, however, unless the amount thereof collected by the retailer has been included in his gross income, nor is the tax deductible if it has been refunded to him. Furthermore, the amount may not be deducted separately as a tax if it is added to or made a part of the business expense of the retailer, or is otherwise used to reduce his net income. The purchaser or consumer may not deduct the amount as a tax notwithstanding it is passed on to him by the retailer.

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ARTICLE 23(c)-1: Taxes. XV-11-7994
I. T. 2960

REVENUE ACT OF 1934.

The excise tax imposed upon an employer under section 901 of the Social Security Act is deductible for Federal income tax purposes.

For Federal income tax purposes an employer may deduct the excise tax imposed under section 901 of the Social Security Act for the year in which such tax is paid or accrued, depending upon the method of accounting employed.

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ARTICLE 23(c)-1: Taxes. XV-12-8006
I. T. 2961

REVENUE ACT OF 1934.

The retail occupational sales tax imposed by the State of South Dakota, effective July 1, 1935, is deductible by the consumer as a tax in his Federal income tax return.

Advice is requested whether the retail occupational sales tax imposed by the State of South Dakota is deductible by the retailer or consumer for Federal income tax purposes.

The law under which the retail occupational sales tax of South Dakota is levied is set forth in Division III (sections 33 to 38) of chapter 205, Laws of South Dakota, 1935. That chapter is entitled "An act * * * imposing and providing for the collection, enforcement and administration of a net income tax, and a tax upon the exercise of the privilege of engaging or continuing to engage in the business or occupation of selling at retail as defined herein * * *." The act was approved March 14, 1935, and became effective July 1, 1935.

Section 34(a) of chapter 205 provides:

> * * * There is hereby imposed as a tax upon the privilege of engaging in business as a retailer, a tax of two per cent (2%) upon the gross receipts from all sales of tangible personal property, consisting of goods, wares, or merchandise, except as otherwise provided in this division, sold at retail in the State of South Dakota to consumers or users. There is hereby imposed a like rate of tax upon the gross receipts from the sales, furnishing or service of gas, electricity, water and communication service, including the gross receipts from such sales by any municipal corporation furnishing gas, electricity and communication service to the public in its proprietary capacity, except as otherwise provided in this division, when sold at retail in the State of South Dakota to consumers or users; and a like rate of tax upon the gross receipts from all sales of tickets or admissions to places of amusement and athletic events, except as otherwise provided in this division.
>
> The tax herein levied shall be computed and collected as hereinafter provided.

Under the provisions of the law, discounts taken on sales and the sale price of property returned by purchasers when the full sale price (including tax) is refunded to the purchasers are excepted from the computation of "gross receipts." Sales to certain purchasers, such as the United States, the State of South Dakota, public or municipal corporations, and relief agencies, and sales of certain commodities already taxed by the State, such as gasoline, beer, cigarettes, etc., are exempt. The retailer is required to add the amount of the tax to the sales price and collect it from the purchaser, unless the director of taxation shall determine that the use of tokens or coupons is the most expeditious method of collection, in which event the purchaser may be required to buy such tokens or coupons and the retailer will collect the tax from the purchaser at the time of the sale by collecting the necessary amount of tokens or other evidence of tax payment. Refunds are to be made to the retailer on account of property returned to him by the purchaser only where the retailer has actually refunded the amount of the tax to the purchaser. The act contains provisions establishing the manner in which the retailer shall return and account for the amounts collected from the purchaser as a tax, and penalties are provided for failure properly to collect and return such amounts.

The director of taxation has issued rules and regulations with respect to the retail occupational sales tax of South Dakota. Articles 2 and 5 provide in part as follows:

> ART. 2. *Nature of the tax.*—In accordance with the intention of the legislature, as expressed in the act, the two per cent (2%) sales tax is hereby declared to be a consumer's tax. * * *
>
> * * * * * * *
>
> ART. 5. *Monthly returns and payment of tax.*— * * *
>
> Since the two per cent (2%) sales tax will be paid by consumers and the merchants or dealers will act merely as tax collectors on behalf of the State, the monthly returns and remittances must be filed within the time prescribed by the act. * * *

Section 23(c) of the Revenue Act of 1934 provides that in computing net income there shall be allowed as deductions taxes paid or accrued within the taxable year, with certain exceptions not here material. Article 23(c)-1 of Regulations 86, relating to the Revenue

Act of 1934, provides that in general taxes are deductible only by the person upon whom they are imposed.

In order to ascertain who is entitled to the deduction for Federal income tax purposes of the retail occupational sales tax imposed by the State of South Dakota, it is necessary to determine the legislative intent, that is, whether it was intended to impose the tax upon the retailer or consumer. Features of the act imposing the tax which indicate that the consumer is the intended taxpayer are those which emphasize the imposition of the tax upon each sale as a separate transaction (which is not consistent with the principle of a privilege or license tax), provide for the exemption of certain commodities already taxed, require the retailer to add the amount of the tax to the sale price and collect it from the purchaser at the time of the sale, and allow refunds to the retailer only when he has refunded the tax to the consumer. In addition, the director of taxation for the State of South Dakota has held that the tax is imposed upon the consumer, that the consumer is the taxpayer, and that the retailer is merely the collector of the tax for the State.

The State law and the regulations thereunder thus indicate that it was the legislative intent to impose the South Dakota retail occupational sales tax upon the consumer. The tax being imposed upon the consumer, he may deduct the amount paid by him as a tax in his Federal income tax return. In the event the tax is added to or made a part of his business expenses, or is otherwise used to reduce his net income, it may not be deducted separately as a tax.

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ARTICLE 23(c)-1: Taxes. XV-12-8007
I. T. 2962

REVENUE ACT OF 1934.

The sales tax imposed under the Wyoming emergency sales tax act of 1935 is, with one exception (single unit purchases of 13 cents or under), imposed upon the consumer, who may deduct the amount paid by him as a tax in his Federal income tax return.

Advice is requested whether the sales tax of 2 per cent imposed by the State of Wyoming is deductible by the consumer.

The tax in question is levied under the emergency sales tax act of 1935, chapter 74, Laws of Wyoming, 1935, effective on and after April 1, 1935, and will expire on March 31, 1937. Provisions of the act pertinent to the question are as follows:

SEC. 4. From and after the effective date of this act, within the limitation herein set out, there is hereby levied and there shall be collected and paid:

(a) A tax upon every retail sale of tangible personal property made within the State of Wyoming equivalent to two (2%) per cent of the purchase price paid or charged, or in the case of retail sales involving the exchange of property, equivalent to two (2%) per cent of the consideration paid or charged, including the fair market value of the property exchanged at the time and place of the exchange, except that, those commodities now bearing a State excise tax in excess of five (5%) per cent shall not be taxable under the provisions of this act.

(b) A tax equivalent to two per cent (2%) of the amount paid: (1) to carriers, or telephone or telegraph corporations defined by the constitution of the State of Wyoming and also as defined by law, whether such corporations are municipally or privately owned, for all transportation, telephone service, or telegraph service; provided, that said tax shall not apply to interstate movements of freight, passengers and express; (2) to public utilities, gas, electric, and heat corporations as defined by chapter ninety-four (94), Wyoming Revised

Statutes, 1931, whether such corporations are municipally or privately owned for gas, electricity, or heat, furnished for domestic or commercial consumption.

(c) A tax equivalent to two per cent (2%) of the amount paid for all meals furnished at any restaurant, eating house, hotel, drug store or other place at which meals are regularly served to the public;

(d) A tax equivalent to two per cent (2%) of the amount paid for admission to any place of amusement, entertainment or recreation;

(e) The State board of equalization shall provide uniform methods and schedules for adding the tax or the average equivalent thereof to the selling price, and it shall be the duty of said board to formulate and promulgate appropriate rules and regulations to effectuate the purpose of this act; provided, that the purchaser, consumer or user shall not in any single unit purchase of thirteen cents (13¢) or under, be required to pay the tax as provided herein, and in all such cases the retailer shall assume and pay said tax.

SEC. 5. Every person receiving any payment or consideration upon a sale of property or service subject to the tax under the provisions of this act, or to whom such payment or consideration is payable (hereinafter called the vendor) shall be responsible for the collection of the amount of the tax imposed on said sales and shall, on or before the 15th day of each month, make a return, under oath or affirmation, to the State board of equalization for the preceding month and shall remit the taxes so collected to the State board of equalization. The vendor shall, in so far as the same can be done practicably, collect the tax from the vendee, * * *.

* * * * * * *

* * * If any vendor shall * * * collect as a tax an amount in excess of 2 per cent of his total taxable sales, he shall remit to the board the full amount of the tax herein imposed, and also such excess; and if any vendor under the pretense or representation of collecting the tax * * * shall collect * * * an amount in excess of 2 per cent of his total taxable sales, the retention of such excess or any part thereof, or the intentional failure to remit punctually * * * the full amount * * * is declared to be unlawful and shall be punishable by a fine of not exceeding one thousand dollars ($1,000) or by imprisonment for not to exceed six months, or by both such fine and imprisonment.

* * * * * * *

SEC. 11. A tax due and unpaid under this act shall constitute a debt due the State from the vendor and may be collected, together with interest, penalty and costs, by appropriate judicial proceedings, which remedy shall be in addition to all other existing remedies.

* * * * * * *

SEC. 16. It shall be unlawful and a misdemeanor for any retailer to advertise or hold out, or state to the public, or to any consumer, directly or indirectly, that the tax or any part thereof imposed by this act will be assumed or absorbed by the retailer, or that it will not be considered as an element in the price to the consumer, or if added, that it, or any part thereof, will be refunded.

Rules and regulations were promulgated by the State board of equalization on March 22, 1935. Article 4 provides in part that:

* * * It is the obligatory and binding duty of the retailer and of the vendor of tangible personal property, of meals, of admissions and of service, subject to said tax * * * to charge to and collect from the purchaser * * * said tax and to remit the same to the board as hereinafter provided; and he will be held liable and responsible to the State for the entire amount of said taxes in a sum of not less than two per cent (2%) upon his gross taxable sales, * * *.

Rule 2 of the special rules promulgated by the board relates to refunds to consumers and provides that when a retailer allows a refund or credit to a customer and the refund or credit is deductible from the retailer's gross receipts, "the retailer must return to, or credit the customer with, the amount of 'tax' passed on to the customer on the amount of deductible gross receipts. * * *" Rule

46 states that the burden of proof is upon the seller to determine whether the buyer is exempt from payment of the tax. The law and regulations indicate that it was the legislative intent to impose the tax, with one minor exception, on the buyer or ultimate consumer, and to make the retailer or vendor the collector of the tax for and on behalf of the State.

Section 23(c) of the Revenue Act of 1934 provides that in computing net income there shall be allowed as deductions taxes paid or accrued within the taxable year, with certain exceptions not here material. Article 23(c)-1 of Regulations 86, relating to the Revenue Act of 1934, provides that in general taxes are deductible only by the person upon whom they are imposed.

Inasmuch as the tax under the Wyoming emergency sales tax act of 1935 is, with one exception, imposed upon the consumer, he may deduct the amount paid by him as a tax in his Federal income tax return. If, however, the tax is added to or made a part of his business expense, or is otherwise used to reduce his net income, it may not be deducted separately as a tax. The exception referred to is the single unit purchases of 13 cents or under. (See subdivision (e) of section 4 of the act.) The vendor is specifically required to assume and pay the tax on such purchases. There is nothing in the law or regulations to indicate that the tax on such purchases is determined by the vendor as a separate item or treated as other than a component part of the 2 per cent of the gross taxable sales in computing the amount for which he is liable to the State. Unless the tax on the single unit purchases of 13 cents or under is accounted for separately as a tax by the vendor, it is not deductible by him as a tax for Federal income tax purposes.

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ARTICLE 23(c)-1: Taxes. XV-14-8025
I. T. 2965

REVENUE ACT OF 1934.

The tax imposed by the Missouri emergency revenue act of 1935 is deductible by the consumer for Federal income tax purposes.

Advice is requested whether the sales tax imposed by the Missouri emergency revenue act of 1935 is deductible by the consumer or retailer.

The act in question repeals a prior act, under which a tax was imposed for the privilege of engaging in the business of making sales at retail, and is effective from August 27, 1935, to December 31, 1937. (See Laws of Missouri, 1935, page 411 et seq.) The title of the act states that it is an act to repeal the existing sales tax law and to enact in lieu thereof a new law to provide for the raising of additional revenue by imposing and levying a tax of 1 per cent of the purchase price on sales at retail of tangible personal property and a tax of 1 per cent on the amount paid or charged for certain services. Provision is made for the collection of the tax by the vendor at the time of the sale or rendering of service. The act makes it unlawful for the seller to advertise that the tax will be assumed or absorbed by him or that it will not be added to the selling price or charge for service rendered, or, if added, that it will be refunded. Pertinent provisions of the law read as follows:

SEC. 2. *Tax imposed on retail sale of tangible personal property, sale of service, etc.—Amount of tax.*—From and after the effective date of this act and up to and including December 31, 1937, there shall be and is hereby levied and imposed and there shall be collected and paid:

(a) Upon every retail sale in this State of tangible personal property a tax equivalent to one (1) per cent, of the purchase price paid or charged, or in case such sale involves the exchange of property, a tax equivalent to one (1) per cent of the consideration paid or charged, including the fair market value of the property exchanged at the time and place of the exchange.

(b) A tax equivalent to one (1) per cent of the amount paid, for admission and seating accommodations to any place of amusement, entertainment or recreation, games and athletic events.

(c) A tax equivalent to one (1) per cent of amounts paid or charged on all sales of electricity or electrical current, water and gas (natural or artificial), to domestic, commercial or industrial consumers.

(d) A tax equivalent to one (1) per cent on amounts paid or charged on all sales of service to telephone subscribers and to others through equipment of telephone subscribers for the transmission of messages and conversations, both local and long distance, and upon the sale, rental or leasing of all equipment or services pertaining or incidental thereto.

(e) A tax equivalent to one (1) per cent of amounts paid or charged for all sales of services for transmission of messages by telegraph companies.

(f) A tax equivalent to one (1) per cent of the amounts paid or charged for advertising of whatever kind or character to be published in newspapers or magazines or to be displayed on billboards or other kind of indoor or outdoor advertising devices or to be broadcast over radio stations or to be displayed by any stereopticon or motion picture.

(g) A tax equivalent to one (1) per cent of the amount paid or charged for the making or rendering of any sale, service or transaction by any commercial laundry, or for cleaning, pressing or dyeing.

(h) A tax equivalent to one (1) per cent of the amount paid or charged for tickets, fares and services by every person operating a railroad, sleeping car, dining car, express car, and such buses and trucks as are licensed by the Public Service Commission of Missouri, engaged in the transportation of persons or freight for hire.

(i) A tax equivalent to one (1) per cent on the amount of sales or charges for all rooms, meals and drinks furnished at any hotel, tavern, inn, restaurant, eating house, drug store, dining car, tourist cabin, tourist camp or other place in which rooms, meals or drinks are regularly served to the public.

* * * * * * *

SEC. 5. *Person making sale responsible for tax—Tax is upon sale—Penalty for failure to pass on tax.*—Every person receiving any payment or consideration upon the sale of property or rendering of service subject to the tax imposed by the provisions of this act, or required to make collection of the tax imposed by the provisions of this act, shall be responsible not only for the collection of the amount of the tax imposed on said sale or service but shall, on or before the 15th day of each month, make a return to the State auditor of all taxes collected for the preceding month or required to be collected for the preceding month, and shall remit the taxes so collected or required to be collected to the State auditor. The seller of any property or person rendering any service, subject to the tax imposed by this act is directed to collect the tax from the purchaser of such property or the recipient of the service as the case may be.

The State auditor has issued rules and regulations under the Missouri emergency revenue act of 1935. Articles 1, 2, and 15 provide in part as follows:

ARTICLE 1. * * * The act imposes a tax upon the transaction or sale of tangible personal property at retail and/or certain services from August 27, 1935, to December 31, 1937.

* * * * * * *

ART. 2. * * *

This tax is upon the sale, service or transaction and shall be collected by the person making the sale of tangible personal property or rendering the services embraced in the act. * * *

* * * * * * *

ART. 15. * * *

(b) * * *

* * * But in any event the merchant is required to collect the equivalent of 1 per cent in tax and at the end of the month must file his report and remit the tax on a 1 per cent basis.

In the opinion of this office, the title of the act, its provisions, and the regulations thereunder clearly show that the excise tax in question is imposed upon the purchaser or ultimate consumer and that the seller is the collector of the tax for and on behalf of the State.

Section 23(c) of the Revenue Act of 1934 provides that in computing net income there shall be allowed as deductions taxes paid or accrued within the taxable year, with certain exceptions not here material. Article 23(c)-1 of Regulations 86, relating to the Revenue Act of 1934, provides that in general taxes are deductible only by the person upon whom they are imposed. Inasmuch as under the Missouri emergency revenue act of 1935 the sales tax is imposed upon the consumer, he may deduct the amount paid by him as a tax in his Federal income tax return. In the event the tax is added to or made a part of his business expenses, or is otherwise used to reduce his net income, it may not be deducted separately as a tax.

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ARTICLE 23(c)-1: Taxes. XV-16-8048
I. T. 2968

REVENUE ACTS OF 1928, 1932, AND 1934.

The excise tax imposed by the State of Ohio on the use, distribution, or sale of motor vehicle fuel is deductible for the taxable year 1935 and subsequent taxable years in the Federal income tax return of the consumer who pays it and to whom it is not refunded

The excise tax imposed on the use, distribution, or sale of liquid fuel is deductible by the dealer for Federal income tax purposes.

I. T. 2472 (C. B. VIII-1, 74) revoked.

Advice is requested whether the motor vehicle fuel tax and the liquid fuel tax imposed by the State of Ohio are deductible by the purchaser or the dealer in his Federal income tax return.

In I. T. 2472 (C. B. VIII-1, 74) the Bureau held that the dealer was entitled to a deduction of the gasoline tax imposed by the State of Ohio. Subsequent to that ruling numerous changes have been made in the State law. The statutory provisions under which the tax is levied are found in the Permanent Supplement, 1926-1935, to Page's Annotated Ohio General Code, chapter 9, sections 5522 to 5542-18c. The law has since been amended by 116 Ohio laws (page 422), 1935, effective September 2, 1935, without effecting any substantial change in the sections quoted herein. The pertinent sections read as follows:

SEC. 5527. *Excise tax of 1½ cents per gallon on motor vehicle fuel; purpose; exemptions.*—For the purpose of providing revenue for maintaining the State highway system of this State in passable condition for travel, for repairing the damage caused to such highway system by motor vehicles used on the same, for widening existing surfaces on such highways where such widening is rendered necessary by the volume of motor vehicle traffic thereon, for resurfacing such highways where existing surfaces have become worn or rutted, for enabling the several counties of the State to properly maintain and repair their roads and for enabling the several municipal corporations of the State properly to maintain, repair, construct and repave their streets, and supplementing revenue already available for such purposes and arising from direct taxation and from registration fees of motor vehicles, and for distributing equitably upon those persons using the privilege of driving such motor vehicles upon such highways and streets a fair share of the cost of maintaining and repairing the same, an excise tax is hereby imposed on all dealers in motor vehicle fuel upon the use, distribution or sale within this State by them of motor vehicle fuel at the rate of one and one-half cents (1½¢) per gallon so used, distributed or sold, to be computed in the manner hereinafter set forth; * * *.

* * * * * * *

SEC. 5534. *Refund of tax; application for refund; right to receive refund not transferable; exception.*—Any person who shall use any motor vehicle fuel on which the tax herein imposed has been paid, for the purpose of operating or propelling stationary gas engines, road rollers, power shovels, tractors not used on public highways, unlicensed motor vehicles used exclusively in intraplant operations, motor boats or aircraft, or who shall use any such fuel upon which the tax herein provided for has been paid, for cleaning or dyeing, or any other purpose than the propulsion of motor vehicles upon the highways of this State shall be reimbursed to the extent of the amount of the tax so paid on such motor vehicle fuel in the following manner: *Provided, however,* That such applications for refunds must be filed with the tax commission of Ohio within 90 days from the date of purchase or invoice.

* * * * * * *

The right to receive any refund under the provisions of this section shall not be assignable, except to the duly licensed dealer who shall have sold to the user the motor-vehicle fuel upon which the claim for refund is based. * * *

* * * * * * *

SEC. 5541. *Additional excise tax of 1½ cents per gallon on motor vehicle fuel; purpose.*—For the purpose of providing revenue * * * an excise tax is hereby imposed on all dealers in motor vehicle fuel, upon the use, distribution, or sale within the State by them of motor vehicle fuel, at the rate of one and one-half cents (1½¢) per gallon so used, distributed or sold, subject to the specific exemptions therein set forth, to be reported, computed, paid, collected, administered, enforced and refunded, and the failure properly and correctly to report and pay same penalized in exactly the same manner as is provided in sections 5527 to 5536-1, both inclusive, of the general code and all of the provisions contained in said sections 5527 to 5536-1, both inclusive, of the general code, relating to motor vehicle fuel excise taxes shall be, and the same hereby are reenacted and incorporated as if specifically set forth herein; which tax shall be in addition to the tax imposed under said sections 5527 to 5536-1 of the general code.

Section 23(c) of the Revenue Act of 1934 and the corresponding provisions of prior Revenue Acts provide that in computing net income there shall be allowed as deductions taxes paid or accrued within the taxable year, with certain exceptions not here material. Article 23(c)-1 of Regulations 86, relating to the Revenue Act of 1934, and corresponding provisions of regulations promulgated under prior Revenue Acts provide that in general taxes are deductible only by the persons upon whom they are imposed. While some of the language of the Ohio statutes under which the tax on motor vehicle fuel is imposed may indicate that the dealer is the one upon whom the tax is imposed, that view is not consistent with section 5527, wherein it is stated that the purpose is "for distributing equitably upon those persons using the privilege of driving such motor vehicles upon such highways and streets a fair share of the cost of maintaining and repairing the same." Furthermore, section 5534, with respect to reimbursements, provides that the person who uses motor vehicle fuel for purposes other than the propulsion of motor vehicles is entitled to a refund of the amount of tax paid.

That it was the legislative intent to impose the tax upon the consumer and to charge the dealer with its collection is borne out by the language of the decisions of the Ohio courts in *State* v. *Canfield Oil Co.* (34 Ohio App., 267, 171 N. E., 111), *Cincinnati Oil Works Co.* v. *City of Cincinnati* (40 Ohio App., 8, 177 N. E., 768), and *State* v. *Brown* (112 Ohio St., 590, 148 N. E., 95).

It is held, therefore, that the excise tax imposed by the State of Ohio on the use, distribution, or sale of motor vehicle fuel is deductible as a tax in the Federal income tax return of the consumer who pays it and to whom it is not refunded. If, however, such tax is added to or made a part of the business expense of the consumer, it may not be deducted by him separately as a tax. Under the authority granted by section 1108(a) of the Revenue Act of 1926, as amended by section 605 of the Revenue Act of 1928 and section 506 of the Revenue Act of 1934, this ruling will be applied to income tax returns for 1935 and subsequent taxable years only. Since I. T. 2472, supra, is inconsistent with this ruling, it is hereby revoked.

Provision is made in an act approved July 1, 1933 (115 Ohio Laws, 1933, 631), for the levy and collection of a tax on the use, distribution, or sale of liquid fuel within the State of Ohio. "Liquid fuel" is defined under section 5542–1 to include "any volatile or inflammable liquid by whatever name such liquid may be known or sold, which is used or usable, either alone or when mixed or compounded, for the purposes of generating light, heat or power, or for any purpose whatsoever; and without prejudice to the generality of said description, includes gasoline, kerosene and all other like substances, but does not include tar or petroleum residue oils from which gasoline and kerosene have been extracted."

The tax is imposed in the following terms:

SEC. 5542–2. *Purpose of tax; rate.*—For the purpose of affording the advantages of a free education to the youth of the State and to defray the expenses of administering this act, an excise tax is hereby imposed on all dealers in liquid fuel upon the use, distribution or sale within this State by them of liquid fuel on and after the day of passage of this act, and to and including the 31st day of December, 1935, at the rate of one cent (1¢) per gallon so used, distributed or sold, to be computed in the manner hereinafter set forth; * * *.

The only refunds provided in the case of liquid fuel (sections 5542–12 and 5542–14) are to the dealer for the tax paid on liquid fuel lost or destroyed or on excess gallonage reported sold over the amount received.

It is held that the tax of 1 cent per gallon imposed by the State of Ohio on the use, distribution, or sale of liquid fuel is imposed on the dealer and is deductible by him as a tax for Federal income tax purposes. The tax, however, may not be deducted separately as a tax if it has been included as a part of the business expenses of the dealer or is otherwise used to reduce his net income. Any part of the tax which has been refunded to the dealer may not be deducted; and, if the tax has been passed on to the consumer, the amount collected must be included in gross income.

GUY T. HELVERING,
*Commissioner of Internal Revenue.*

Approved.

WAYNE C. TAYLOR,
*Acting Secretary of the Treasury.*

ARTICLE 23(c)-1: Taxes.

XV-18-8066
I. T. 2971

REVENUE ACT OF 1934.

The California franchise tax accrues on the first day of a taxpayer's taxable year. A taxpayer keeping its books on the accrual basis is entitled to deduct in its return for the fiscal year ended July 31, 1935, the amount of its California franchise tax which accrued on August 1, 1934, the tax being measured by the taxpayer's net income for the fiscal year ended July 31, 1934.

Advice is requested relative to the proper accrual date for Federal income tax purposes of the California franchise tax under the law now in effect.

On July 31, 1935, the M Corporation had accrued a State franchise tax liability based upon its net income from August 1, 1934, to July 31, 1935. It contends that such tax is deductible in its Federal income tax return filed for the same period. In support of that view the taxpayer relies upon the decision of the United States Supreme Court in *United States* v. *Anderson et al.* (269 U. S., 422, T. D. 3839, C. B. V-1, 179).

The Bureau held that a corporation filing its return on the accrual basis for the calendar year 1931 was entitled to deduct for that year the amount of the California franchise tax imposed by the act of March 1, 1929 (as amended by chapters 64 and 65, California Statutes, 1931), which tax accrued on January 1, 1931, and was measured by the net income for the calendar year 1930. (I. T. 2770, C. B. XIII-1, 111.) The statute of 1929, however, has been further amended by chapters 275 and 353, California Statutes, 1935, effective June 6 and June 25, 1935, respectively. Pertinent provisions of the law, sections 4, 11, 12, and 23, as amended by chapters 275 and 353, read as follows:

SEC. 4. (1) * * *

(3) * * * every corporation * * * shall annually pay to the State, for the privilege of exercising its corporate franchises within this State, a tax according to or measured by its net income, to be computed, in the manner hereinafter provided, at the rate of 4 per centum upon the basis of its net income for the next preceding fiscal or calendar year. * * *

* * * * * * *

(7) Taxes under this section * * * shall accrue on the first day of the "taxable year," as defined in section 11 hereof. * * *

* * * * * * *

(8) The provisions of this subdivision, and of all other amendments to this act enacted during the year 1935, shall apply to taxable years beginning after December 31, 1934. Provided, however, that the tax for taxable years beginning prior to January 1, 1935, and ending during the calendar year 1935, shall be adjusted * * *.

* * * * * * *

SEC. 11. (a) The term "income year," as herein used, means the calendar year, or the fiscal year ending during such calendar year, upon the basis of which the net income is computed herein. * * *

(b) The term "taxable year," as herein used, means the calendar year, or the fiscal year ending during such calendar year, for which the tax is payable. * * *

* * * * * * *

SEC. 12. The net income shall be computed upon the basis of the taxpayer's annual accounting period, fiscal year or calendar year as the case may be, in accordance with the method of accounting regularly employed in keeping the books of such taxpayer * * *.

* * * * * * *

SEC. 23. * * *

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In the case of corporations of the classes referred to in subdivision (3) of section 4 of this act, one-half the amount of tax disclosed by the return, shall be due and payable as a first installment of the tax on such corporations, on or before the 15th day of the third month following the close of the income year, as defined in section 11 hereof. The balance of the tax shall be due and payable as a second installment, on or before the 15th day of the ninth month following the close of the income year. A tax imposed by this act or any installment thereof may be paid at the election of the taxpayer, prior to the date prescribed for its payment.

The instant case is not parallel with *United States* v. *Anderson*, supra. In that case it was held that where a taxpayer kept its books on the accrual basis and set up a reserve during the year 1916 for the munitions manufacturer's tax imposed by the Revenue Act of 1916, the munitions tax should be taken as a deduction in the income tax return for the year 1916, as accrued, and not in the return for the year 1917 when the tax was paid. In the instant case the tax for the fiscal year ended July 31, 1935, accrued, as provided by the California law, on the 1st day of the taxable year. That is, the tax for the fiscal year ended July 31, 1935, accrued on August 1, 1934, in the case of a corporation exercising its franchise on that date. The tax is for the fiscal year ended July 31, 1935, not the fiscal year ended July 31, 1934, though measured by the net income for the fiscal year ended July 31, 1934. Accordingly, a taxpayer on the accrual basis, filing its Federal income tax return for the fiscal year ended July 31, 1935, is entitled to deduct in the return for that year the amount of the franchise tax accrued on August 1, 1934, which tax is measured by the taxpayer's net income for the fiscal year ended July 31, 1934. (See also *Petaluma & Santa Rosa Railroad Co.* v. *Commissioner*, 11 B. T. A., 541, in which it was held that the California State franchise tax, based upon the gross receipts for 1920, was an expense of the business for 1921 and could not be deducted in the prior year as an accrued liability.)

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ARTICLE 23(c)-1: Taxes. XV-19-8076
(Also Section 23(a), Article 23(a)-1.) I. T. 2972

REVENUE ACT OF 1934.

Where a taxpayer uses the accrual method of accounting, additional taxes assessed by the State of Louisiana on merchandise in the taxpayer's warehouse on the last day of the years 1931, 1932, and 1933, and which were paid in 1935, are allowable deductions for the year in which the original taxes on the merchandise accrued.

Attorney's fees paid in 1935 in connection with litigation concluded in that year with respect to the taxes are an allowable deduction in the return for that year.

Advice is requested relative to the deductibility of certain taxes and attorney's fees.

The State of Louisiana Taxing Commission increased the assessment on consigned merchandise held in the taxpayer's warehouse on the last day of the years 1931, 1932, and 1933, resulting in taxes payable in 1932 of $10.53x$ dollars, in 1933 of $4.21x$ dollars, and in 1934 of $5.26x$ dollars. In the year 1935 the taxpayer paid the total amount of additional taxes ($20x$ dollars) and attorney's fees of $6x$ dollars in connection therewith. During the years under consideration the taxpayer used the accrual method of accounting and filed its returns on the calendar year basis.

Under section 23(c) of the Revenue Acts of 1928, 1932, and 1934, provision is made for the deduction of taxes from gross income for the year in which they are paid or accrued. The Bureau has held that personal property taxes in Louisiana accrue, for Federal income tax purposes, on January 1 of each year. The tax is for the period of the calendar year and is assessed as of the 1st day of January of the year in which the assessment is made. (I. T. 2643, C. B. XI-2, 81.) In the assessment of merchandise or stock in trade on hand during the year preceding the calendar year in which the assessment is made, the inventory value, as prescribed by Louisiana statutes, furnishes the basis for the assessment. (Section 8328, volume 3, Louisiana General Statutes, Dart, Annotated, 1932.)

To a taxpayer whose books are kept on the accrual basis, taxes are deductible from gross income for the taxable year in which such taxes accrue and not for the year in which they are paid. (*United States* v. *Anderson*, 269 U. S., 422.) It appears that the additional taxes of $10.53x$ dollars, based on December 31, 1931, figures, were assessable as of January 1, 1932, accrued on that date, and constitute taxes for the calendar year 1932; that, similarly, the additional taxes of $4.21x$ dollars accrued as of January 1, 1933, and constitute taxes for the calendar year 1933; and that the taxes of $5.26x$ dollars accrued as of January 1, 1934, and constitute taxes for 1934.

Inasmuch as the additional taxes were levied by reason of a valuation placed on the property by the taxing authorities in excess of that originally reported for the years in question, the taxpayer is not entitled to the deduction of the total additional taxes in the return for 1935. Such deficiencies in tax accrue as of the date the original tax accrued. (A. R. R. 1153, C. B. I-2, 92; I. T. 1953, C. B. III-1, 139; I. T. 1984, C. B. III-1, 140; I. T. 2500, C. B. VIII-2, 103.) The additional tax of $10.53x$ dollars is, therefore, an allowable deduction for 1932, the additional tax of $4.21x$ dollars is deductible for 1933, and the additional tax of $5.26x$ dollars is deductible for 1934.

Since the litigation concerning the payment of the additional taxes was concluded in 1935, the attorney's fees paid in that year are an allowable deduction as an ordinary and necessary business expense in the return for 1935.

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ARTICLE 23(c)-1: Taxes. XV-22-8101
G. C. M. 16491

REVENUE ACTS OF 1932 AND 1934.

The license tax on chain stores imposed by section 2, chapter 469, Laws of Wisconsin, 1933 (approved July 25, 1933), is not deductible for Federal income tax purposes even though accrued on the taxpayer's books in 1933 and 1934, inasmuch as the tax never became operative.

Advice is requested as to the proper accrual date of the license tax imposed upon chain stores by section 2, chapter 469 of the Laws of Wisconsin, 1933.

The act, designated as chapter 469, and entitled "An act to create section 76.75 and subsection (5) of section 20.09 of the statutes, relating to an emergency occupational tax on chain stores, providing penalties, and making an appropriation," was approved July 25, 1933 (published July 28, 1933), and was to terminate December 31, 1935. Section 1 of the act imposed an occupational tax on chain stores measured by gross income at graduated rates. Section 2 of the act reads in part as follows:

SEC. 2. If it is finally determined that the occupational tax on chain stores imposed in section 1 of this act is invalid, either in its entirety or in its application to any particular person or group, then such person shall immediately be required to secure a license and pay a license fee as hereinafter provided, effective as of July 1, 1933.

The fees for licenses to engage in the chain store business ranged from $10 to $100 for each store, depending upon the number of stores operated in the State.

Section 3 of the act reads as follows:

SEC. 3. It is the intent of the legislature that in the event that the provisions of section 1 of this act are finally declared invalid as to any person or group, such person or group shall be required to pay the license fees prescribed in section 2 the same as if said section took effect on July 1, 1933, except for such period for which such person shall have paid a license fee under chapter 29, laws of the special session of 1931–32. It is also the intent of the legislature that in the event that section 2 of this act takes effect by reason of section 1 being declared invalid, the emergency board shall provide such funds for the department of agriculture and markets as may be necessary to carry out its functions under section 2 of this act.

Under date of June 4, 1935, the Supreme Court of Wisconsin in *Ed Schuster & Co., Inc.*, v. *Henry* (218 Wis., 506, 261 N. W., 20) held that the Wisconsin statute in imposing a graduated occupational tax on gross incomes of chain stores was void as arbitrary and discriminatory under the equal protection clause of the fourteenth amendment to the Constitution of the United States. That case was consolidated with *Wadhams Oil Co.* v. *Henry*. Petition for writ of certiorari to the United States Supreme Court was filed in the latter case but the petition was denied under date of October 21, 1935 (296 U. S., 625). (Cf. *Stewart Dry Goods Co.* v. *Lewis*, 294 U. S., 550, relating to a similar tax imposed by the State of Kentucky.) Before the petition for writ of certiorari was denied, however, the Wisconsin Legislature enacted a law which was approved October 2, 1935 (published October 4, 1935), chapter 545, Laws of Wisconsin, 1935, repealing section 76.75 and subsection (7) of section 20.09 of the Wisconsin Statutes and section 2 of chapter 469, Laws of Wisconsin, 1933. That act, effective upon publication on October 4, 1935, imposed a graduated occupational tax upon chain stores ranging from $25 to $250 per store and depending upon the number of stores operated. In view of the fact that the occupational tax on chain stores was declared invalid by the Supreme Court of the State of Wisconsin and petition for writ of certiorari was denied by the United States Supreme Court, inquiry has been made relative to the proper accrual date for Federal income tax purposes of the license tax imposed by section 2 of chapter 469 of the Laws of Wisconsin, 1933, quoted above.

In *United States* v. *Anderson* (269 U. S., 422, T. D. 3839, C. B. V-1, 179), it was stated that in advance of the assessment of a tax "all the events may occur which fix the amount of the tax and determine the liability of the taxpayer to pay it." Although that case related to the accrual of munitions taxes, the general principle laid down has been cited as a precedent in many cases dealing with the question as to the proper accrual date of taxes. Under the provisions of section 2 of chapter 469, Laws of Wisconsin, 1933, the license tax imposed by that section did not become effective unless the occupational tax on chain stores (section 1) measured by gross income should be finally declared invalid. The question whether the occupational chain store tax was invalid was not finally determined until petition for writ of certiorari was denied by the United States Supreme Court on October 21, 1935. The denial of the petition for writ of certiorari on that date might well have been considered the "event" which determined the liability of chain stores for the license tax imposed by section 2 of the Wisconsin law, but before litigation of the question of the constitutionality of the occupational chain stores tax, measured by gross income, was terminated by denial of the petition for writ of certiorari on October 21, 1935, the legislature on October 2, 1935, repealed the law imposing the tax. It follows that section 2, chapter 469, Laws of Wisconsin, 1933, never became operative because the license tax (based on the number of stores conducted) was not, by the express provision of that section, to become effective unless and until the provisions of section 1, chapter 469, Laws of Wisconsin, 1933 (which imposed an occupational tax on chain stores), were finally declared to be invalid.

Inasmuch as the license tax referred to in section 2 of chapter 469, Laws of Wisconsin, 1933, never became operative, having been repealed before section 1, imposing an occupational tax on chain stores, was finally determined invalid, a taxpayer in that State may not, for Federal income tax purposes, take a deduction for any amount of such tax which he may have accrued on his books for the years 1933 and 1934. (With respect to the allowance of deductions for taxes declared to be unconstitutional, see I. T. 2578, C. B. X-1, 119.)

Herman Oliphant,
*General Counsel for the Department of the Treasury.*

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Article 23(c)-1: Taxes. XV-23-8113
I. T. 2977

REVENUE ACT OF 1934.

The emergency gross receipts tax imposed by the State of Maryland (effective from April 1, 1935, to March 31, 1936) is deductible as a tax by the vendor for Federal income tax purposes.

Advice is requested whether the vendor or the consumer is entitled to a deduction for Federal income tax purposes of the emergency gross receipts tax imposed by the State of Maryland.

The law under which the tax was imposed is set forth in chapters 188 and 539 of the Laws of Maryland, 1935. It was effective from April 1, 1935, to March 31, 1936. Chapter 188 is entitled "An act to add a new subtitle and 17 new sections to article 56 of the Annotated Code of Maryland, 1929 Supplement, title 'Licenses,' said new subtitle to be known as 'Emergency Gross Receipts Tax,' and said new sections to be known as sections 72–A * * * and 72–Q, to follow immediately after section 72 of said article, providing for the levy and collection of a tax for the privilege of engaging in the business of selling tangible personal property at retail at the rate of 1 per cent of the gross receipts from such sales; * * * providing the method and manner of collecting said tax; and imposing penalties for violations of the provision of this act."

Provisions of the act pertinent to the question involved read as follows:

72–A. Definitions. * * *

* * * * * * *

(d) The word "vendor" means any person who engages in the business of selling at retail tangible personal property subject to the tax imposed by this act, whether such person is a manufacturer, producer, wholesaler, jobber or retailer.

* * * * * * *

(g) The word "consumer" means the purchaser at final sale or the user of any tangible personal property subject to the tax imposed by this act.

* * * * * * *

72–B. For the privilege of engaging in the business of selling tangible personal property at retail, there is hereby imposed upon every person engaging in such business a license fee or tax, in addition to all other fees or taxes imposed by law, at the rate of 1 per centum of the gross receipts of any such person, on or after April 1, 1935, to and including March 31, 1936, from the sale of all tangible personal property at retail in this State.

72–C. On or before the 10th day of May, 1935, and on the 10th day of each calendar month thereafter, every vendor who has made any sales at retail subject to the tax hereby imposed during the preceding calendar month, shall make a return to the comptroller, * * * and shall pay the comptroller the amount of the tax herein imposed. * * *

* * * * * * *

72–E. (a) As soon as practicable after the return is filed, the comptroller shall examine it and compute the tax. If the amount paid exceeds the amount which should have been paid, the excess shall be refunded by the comptroller or credited on account of future taxes accruing from the same taxpayer or his sucessor or assigns.

* * * * * * *

72–J. Every tax imposed by this act and all increases, interest and penalties thereon shall become, from the time due and payable, a personal debt from the person liable to pay the same to the State of Maryland * * *.

Chapter 539, Laws of Maryland, 1935, adds section 72CC and 72CCC "for the purpose of increasing the fee for registering the title to motor vehicles and authorizing registered motor vehicle dealers to deduct from their gross sales, before the payment of the 1 per cent, gross receipts tax, the amount of gross sales on motor vehicles."

Section 23(c) of the Revenue Act of 1934 provides that in computing net income there shall be allowed as deductions taxes paid or accrued within the taxable year, with certain exceptions not here material. Article 23(c)1 of Regulations 86, relating to the Revenue Act of 1934, provides that in general taxes are deductible only by the person upon whom they are imposed.

In order to ascertain who is entitled to the deduction of the emergency gross receipts tax imposed by the State of Maryland, it is necessary to determine the legislative intent as to whether the tax was imposed upon the vendor or upon the consumer. The title of the act, which states that it is "An act * * * providing for the levy and collection of a tax for the privilege of engaging in the business of selling tangible personal property at retail," the literal terms under which the tax is imposed (72-B), and all other provisions of the act indicate that the tax was intended to be a privilege tax levied upon the vendor and measured by the volume of gross sales.

It is held, therefore, that the emergency gross receipts tax imposed by the State of Maryland is an excise tax upon the vendor for the privilege of selling tangible personal property at retail and is deductible by the vendor as a tax under section 23(c) of the Revenue Act of 1934 in determining his net income subject to Federal income tax. The tax may not be deducted separately as a tax if it is added to or made a part of the vendor's business expense, or is otherwise used to reduce his net income.

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ARTICLE 23(c)-1: Taxes. XV-23-8114
I. T. 2978

REVENUE ACT OF 1934.

The motor fuel tax imposed under chapter 58, Laws of Washington, 1933, as amended by chapter 109, Laws of Washington, 1935, is deductible as a tax in the Federal income tax return of the owner or operator of the motor vehicle by whom it is paid and to whom it is not refunded.

The fuel oil tax imposed under Title XI, chapter 180, Laws of Washington, 1935, is deductible by the distributor.

A ruling is requested whether, for Federal income tax purposes, the distributor or purchaser may deduct the tax imposed by the State of Washington (1) on motor fuel and (2) on fuel oil. It is stated that the law in effect when the Bureau held that the motor fuel tax was deductible by the purchaser (G. C. M. 7071, C. B. VIII-2, 106) has been repealed; that the tax is now imposed under chapter 58, Laws of Washington, 1933, as amended by chapter 109, Laws of Washington, 1935; and that the fuel oil tax is imposed under Title XI, chapter 180, Laws of Washington, 1935.

The pertinent provisions of the statute imposing the motor fuel tax, as amended in 1935, read as follows:

An act imposing an excise tax on gasoline and other inflammable liquids, and providing for the payment, collection and lien of the tax, * * *.

* * * * * * *

SEC. 5. Every distributor shall pay, in addition to any other taxes provided by law, an excise tax to the treasurer of this State of five (5) cents for each gallon of motor vehicle fuel sold, distributed or used by it in the State of Washington. The tax herein imposed shall be collected and paid to the State of Washington but once in respect to any motor vehicle fuel. Bills shall be rendered by distributors to all purchasers of inflammable petroleum products of fifty (50) gallons or more, and upon request to all purchasers of smaller lots. In the case of sales of motor vehicle fuels as herein defined, such bills shall contain a statement that the distributor has assumed the tax thereon; and in other cases the bills shall contain a statement that the purchaser is responsible for the tax, if the product shall be used for the purpose of operating a motor vehicle.

SEC. 6. Every person who shall use any inflammable petroleum products other than motor vehicle fuel, to operate a motor vehicle, as herein defined, shall pay a tax of five (5) cents for each gallon thereof so used. Every such person shall report to the director and pay the tax in the manner provided for distributors * * *.

* * * * * * *

SEC. 18. * * *

Any person who shall use any motor vehicle fuel as herein defined for the purpose of operating any internal combustion engine not used on nor in conjunction with any motor vehicle capable of being operated upon a public highway, and as the motor power thereof, upon which motor vehicle fuel excise tax provided for in this chapter has been paid, shall be entitled to and shall receive a refund of five (5) cents for each gallon of motor vehicle fuel so used. Every person who shall purchase and use any motor vehicle fuel as herein defined as an ingredient for manufacturing or for cleaning or dyeing or for some other similar purpose and upon which the motor vehicle fuel excise tax provided for in this chapter has been paid shall be entitled to and shall receive a refund of five (5) cents for each gallon of motor fuel so used. Every person who shall export any motor vehicle fuel as herein defined for use outside of this State and who shall have paid the excise tax upon such motor vehicle fuel as required by this chapter, either directly to the vendor from whom it was purchased or indirectly by adding the amount of such excise tax to the price of such fuel, shall be entitled to and receive a refund of five (5) cents for each gallon of motor vehicle fuel so exported: *Provided*, * * *.

Any person claiming refund from motor vehicle fuel used other than in motor vehicles as herein provided may be required by the director of licenses to also furnish information by affidavit regarding the amount of motor vehicle fuel purchased from other sources or for other purposes during the period reported upon which no refund is claimed.

Section 23(c) of the Revenue Act of 1934 provides that in computing net income there shall be allowed as deductions taxes paid or accrued within the taxable year, with certain exceptions not here material. Article 23(c)–1 of Regulations 86, relating to the Revenue Act of 1934, states that in general taxes are deductible only by the person upon whom they are imposed.

While it is true that by the terms of the Washington law the distributor is required to pay the tax to the State, his position with respect to the tax is that of collector only. The provisions of the motor fuel tax law, when considered in their entirety, indicate that it was the intention of the legislature to impose a tax upon the use of motor vehicle fuel, including all inflammable petroleum products, in the propulsion of motor vehicles upon the highways of the State and not upon the sale of such fuel by the distributor. (See generally *Cunningham* v. *Potts*, 9 Fed. (2d), 469, discussing the statute here in question.) The refund provisions of the statute which authorize a refund of the tax to purchasers of motor vehicle fuel who use it for purposes other than the operation of motor vehicles is particularly significant in this connection.

Since the distributor is merely the collector of the motor vehicle fuel tax, it is evident that the purchaser or consumer is the taxpayer within the meaning of section 23(c) of the Revenue Act of 1934. Accordingly, the tax is deductible as a tax in the Federal income tax return of the owner or operator of the motor vehicle by whom the tax is paid and to whom it is not refunded. If the tax is added to or made a part of the business expense of the taxpayer, or is otherwise used to reduce his net income, it can not be deducted by him separately as a tax.

Relative to the tax on fuel oil imposed by Title XI, chapter 180, Laws of Washington, 1935, pertinent provisions of the law read as follows:

SEC. 78. From and after the 1st day of May, 1935, there is hereby levied and there shall be collected, in addition to any other taxes provided by law, an excise tax upon every distributor at the rate of one-quarter (¼) cent for each gallon of fuel oil and/or diesel oil sold, distributed, withdrawn or used by him in the State of Washington. The tax herein imposed shall be collected by the director of licenses of this State and shall be paid by every distributor but once in respect to any fuel oil and/or diesel oil, sold, distributed, withdrawn or used by him.

Bills shall be rendered by distributors to all purchasers of fuel oil and/or diesel oil of fifty (50) gallons or more and to all purchasers of smaller quantities upon request containing a statement that the distributor has assumed the tax thereon.

SEC. 79. * * *

* * * * * * *

(c) The word "distributor" shall mean and include every person who refines, manufactures, produces or compounds fuel oil and/or diesel oil and sells, distributes, or in any manner uses the same in this State; also any person who imports any fuel oil and/or diesel oil into this State and stores, withdraws, sells, distributes, or in any manner uses the same in this State whether in the original package or container in which it is imported or otherwise; also any person who having acquired in this State in the original package or container fuel oil and/or diesel oil, shall distribute or sell the same, whether in such original package or container in which the same was imported or otherwise, or in any manner uses the same; * * *

While the fuel oil tax law includes administrative and certain other provisions of the motor fuel tax law (chapter 58, Laws of Washington, 1933), section 81 of the fuel oil tax law specifically excepts from application thereto those provisions (sections 5, 6, 18, etc.) of the motor fuel tax law which furnished the basis for concluding that the motor fuel tax was imposed upon the consumer. It appears, therefore, that it was the legislative intent to impose the fuel oil tax upon the distributor. The amount of such tax paid by the distributor is, therefore, deductible by him for Federal income tax purposes. The tax, however, may not be deducted separately as a tax if it has been included as a part of the business expense of the distributor or otherwise used to reduce his net income.

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## SECTION 23(e).—DEDUCTIONS FROM GROSS INCOME: LOSSES BY INDIVIDUALS.

ARTICLE 23(e)-1: Losses by individuals. XV-14-8026
G. C. M. 16255

REVENUE ACT OF 1934.

Where an automobile purchased for the taxpayer's personal use is damaged in a collision, the deduction allowable under section 23(e)3 of the Revenue Act of 1934 is the amount of the loss *actually sustained* but not in excess of the amount computed in accordance with the provisions of sections 23(h) and 113(b) of that Act.

Recommended that I. T. 2217 (C. B. IV-2, 53) and I. T. 2231 (C. B. IV-2, 53) be modified.

Advice is requested relative to the determination of the amount of the loss deductible under the provisions of section 23(e)3 of the Revenue Act of 1934 where an automobile purchased for the taxpayer's personal use was damaged in a collision.

In the year 1929 the taxpayer purchased an automobile for his personal use at a cost of $7x$ dollars. In the year 1934 he had a collision, not due to his own recklessness, at which time he carried no collision insurance. Just prior to the collision the automobile had been appraised for trade-in purposes at 3.60*x* dollars. After the collision the car was traded in but the allowance was only 1.07*x* dollars.

Section 23(e)3 of the Revenue Act of 1934 provides that in computing the taxable net income of an individual there shall be allowed as a deduction losses sustained during the taxable year and not compensated for by insurance or otherwise of property not connected with the trade or business, if the loss arises from fires, storms, shipwreck, or other casualty, or from theft. In interpreting the corresponding section of prior Revenue Acts, it has been held that a loss resulting from an automobile collision, where such accident was not due to the willful act or willful negligence of the taxpayer, is deductible as a loss arising from "other casualty." (*Shearer* v. *Anderson*, 16 Fed. (2d), 995; *W. S. Bronson* v. *Commissioner*, 9 B. T. A., 1008, acquiescence, C. B. VIII-1, 6; *Tracy V. Buckwalter* v. *Commissioner*, 20 B. T. A., 1005; I. T. 2408, C. B. VII-1, 85; and article 23(e)-1 of Regulations 86.)

Section 23(h) of the Revenue Act of 1934 provides that the basis for determining the amount of deduction for losses sustained, to be allowed under section 23(e) of that Act, shall be the adjusted basis provided in section 113(b) for determining the loss from the sale or other disposition of property. Under the provisions of section 113(b) of the Revenue Act of 1934, the basis for determining gain or loss from the sale or other disposition of property acquired after February 28, 1913, with certain exceptions inapplicable in the instant case, is the cost of such property, diminished as provided by section 113(b)1(B) for exhaustion, wear and tear, obsolescence, amortization, and depletion, to the extent allowed (but not less than the amount allowable) under that Act or prior income tax laws.

In *Tracy V. Buckwalter* v. *Commissioner*, supra, the Board of Tax Appeals allowed as a deduction in the case of an automobile damaged by fire in 1924 only the difference between the *actual* value immediately prior to the fire and the salvage value.

In *Heiner* v. *Tindle* (276 U. S., 582), arising under the Revenue Act of 1918, the taxpayer built a residence in 1888, used it as a residence until 1901, and leased it beginning in 1901 until he sold it in 1920. The United States Supreme Court held that there occurred in 1901 a transaction entered into for profit, and since the fair market value of the property on March 1, 1913, was less than the value in 1901, and less than actual cost, the taxpayer sustained a deductible loss of the difference between the March 1, 1913, value and the selling price.

In *Mitchell* v. *Commissioner* (48 Fed. (2d), 697, certiorari denied, 284 U. S., 646) the Circuit Court of Appeals for the Second Circuit said in a case arising under the Revenue Act of 1921—

> The allowance of anything beyond an actual loss would be most unlikely in the absence of a clear legislative mandate. The provision in section 214(a)6 that losses are to be computed upon the basis of the "fair market price or value as of March 1, 1913," should be construed, like other similar clauses, as merely a limitation upon losses that would otherwise have been deductible. While Congress can, of course, allow such deductions as it pleases and limit them as it will, it can not reasonably be thought to have intended in any case to have allowed more than actual losses * * *.

In *George Bullock* v. *Commissioner* (23 B. T. A., 710, acquiescence, C. B. XI-1, 2) the Board said:

The Tindle decision in effect holds that in determining the loss sustained from the sale of property originally acquired as a residence, and later converted into business property, the rule is to compute the amount of the loss, first, in accordance with the applicable statute dealing with the computation of gain or loss from the sale or other disposition of property, and, second, to allow as a deduction only that portion of the loss so determined as occurred subsequent to the time the property was converted into business uses.

* * * * * * *

It is our opinion that the instant case is controlled by section 204(b), supra, and that the value in 1916 should be used only as a limitation upon the actual loss prescribed by the statute. * * *

In *Charles J. Thatcher* v. *Commissioner* (24 B. T. A., 1130) the Board said:

* * * When residential property is converted into business property, it is the fair market value of the property at the time of conversion which represents the cost of the business property. * * *

The above reasoning has been carried into article 23(e)-1 of Regulations 86 in interpreting section 23(e) of the Revenue Act of 1934. That article provides in part as follows:

*Losses by individuals.*— * * *

* * * * * * *

* * * If, however, property so purchased or constructed is prior to its sale rented or otherwise appropriated to income-producing purposes and is used for such purposes up to the time of its sale, a loss from the sale of the property, computed as provided in section 111, is, subject to the limitations provided in section 117, an allowable deduction in an amount not to exceed the *excess of the value of the property at the time it was appropriated to income-producing purposes (with proper adjustment for depreciation) over the amount realized from the sale.* [Italics supplied.]

The example set forth in article 23(e)-1 shows clearly a computation wherein the allowable loss is limited to the actual loss sustained, based upon the value of the property when converted to income-producing purposes, although the provisions of section 23(h) are equally applicable.

Section 23(e)3 of the Revenue Act of 1934 allows as a deduction certain losses sustained during the taxable year, including losses arising from "other casualty." Such losses must be *actually sustained*. In such a case it is not the purchase price of the property which is lost but the value of the property at the time of the casualty. It is the opinion of this office that the provisions of section 23(e)3 are controlling with regard to the deductibility of such losses by individuals, and that such losses are limited thereby to the amount of loss *actually sustained;* and that section 23(h) which provides that a loss must be determined or measured by the adjusted basis is a limitation provision. Therefore, although computation must be made in accordance with section 23(h) and section 113, the amount deductible is the loss *actually sustained*, and not in excess of the amount computed under section 113. As stated above, this view was adopted in Regulations 86 and is clearly set forth in the example relating to loss from sale of property purchased as a residence but later converted to income-producing purposes.

In the present case the taxpayer's automobile was valued just prior to the collision at $3.60x$ dollars. Just after the collision its value was only $1.07x$ dollars. The loss *actually sustained* as a result of the collision was, therefore, the difference between those amounts, or $2.53x$ dollars. Since that amount is not in excess of the amount computed under section 113, it follows that 2.53*x* dollars is the amount of the loss allowable as a deduction under section 23(e)3.

In view of the fact that the position adopted herein is not in accord with the conclusion reached in I. T. 2217 (C. B. IV-2, 53) that upon the destruction of a residence by fire in the year 1924 the deductible loss sustained was the difference between the cost of the property (without any adjustment for depreciation) and the insurance or other compensation received, reduced by the salvage value, if any, of the property, or with the conclusion reached in I. T. 2231 (C. B. IV-2, 53) that the amount of a loss sustained by a taxpayer through the bursting of a boiler used in the heating of his residence is the difference between the basis of the boiler and the insurance or other compensation received, reduced by the salvage value of the boiler, if any, it is recommended that I. T. 2217 and I. T. 2231 be modified accordingly.

HERMAN OLIPHANT,
*General Counsel for the Department of the Treasury.*

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## SECTION 23(k).—DEDUCTIONS FROM GROSS INCOME: BAD DEBTS.

ARTICLE 23(k)-1: Bad debts. XV-15-8043
T. D. 4633

INCOME TAX.

Last paragraph of article 23(k)-1 of Regulations 86 and last paragraph of article 191 of Regulations 77, amended.

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

*To Collectors of Internal Revenue and Others Concerned:*

The last paragraph of article 23(k)-1 of Regulations 86 and the last paragraph of article 191 of Regulations 77 are amended to read:

Where banks or other corporations which are subject to supervision by Federal authorities (or by State authorities maintaining substantially equivalent standards) in obedience to the specific orders of such supervisory officers charge off debts in whole or in part, such debts shall be conclusively presumed, for income tax purposes, to be worthless or recoverable only in part, as the case may be, but in order that any amount of the charge-off may be allowed as a deduction for any taxable year it must be shown that the charge-off took place within such taxable year.

This document is issued under the authority prescribed by section 62 of the Revenue Act of 1934 and section 62 of the Revenue Act of 1932.

GUY T. HELVERING,
*Commissioner.*

Approved April 3, 1936.

WAYNE C. TAYLOR,
*Acting Secretary of the Treasury.*

(Filed with the Division of the Federal Register April 7, 1936)

ARTICLE 23(k)-1: Bad debts.

XV-26-8141
I. T. 2985

REVENUE ACTS OF 1932 AND 1934.

Treasury Decision 4633 [page 118, this Bulletin], relating to deductions for debts charged off by banks or other corporations in obedience to specific orders of Federal or State supervisory officers, is not applicable to charge-offs ordered by such officers on real estate taken in settlement of debts.

Advice is requested on the following question:

Where real estate, taken over in satisfaction of a debt, is set up on the books of a bank at its fair market value or at a value the same as the unpaid amount of a mortgage note and later a bank examiner orders that the value at which it is carried be written down and the bank complies, may the bank claim this amount as a deduction on its income tax return?

Treasury Decision 4633, which amends the last paragraph of article 23(k)-1 of Regulations 86, promulgated under the Revenue Act of 1934, and the corresponding article of Regulations 77, promulgated under the Revenue Act of 1932, relates solely to *debts* charged off during the year of ascertainment of worthlessness in whole or in part. A debt denotes the existence of the relationship of debtor and creditor. If a bank, in compliance with the order of a State or Federal bank examiner, charges off debts in whole or in part, the Bureau will allow a deduction (as a bad debt) for the amount of the charge-off made in compliance with such order, provided the charge-off is made in the year of ascertainment of worthlessness in whole or in part.

It is clear, however, from the language used in Treasury Decision 4633, supra, that unless the relationship of debtor and creditor exists the rule prescribed therein is not applicable. Real estate acquired in satisfaction of a debt becomes an asset of the bank and the relationship after such acquisition is not that of debtor and creditor. Accordingly, notwithstanding the requirements of the State or Federal bank examiners that the value of the real estate be written down, such a charge-off does not fall within the contemplation of the provisions of the Treasury decision.

## PART IV.—ACCOUNTING PERIODS AND METHODS OF ACCOUNTING.

## SECTION 41.—GENERAL RULE.

### ARTICLE 41-1: Computation of net income.

XV-6-7938
I. T. 2956

REVENUE ACT OF 1934.

The following rates of exchange are accepted by the Bureau of Internal Revenue as the current or market rates of exchange prevailng as of December 31, 1935:

| Country or city. | Monetary unit. | Value in terms of United States money. | Country or city. | Monetary unit. | Value in terms of United States money. |
|---|---|---|---|---|---|
| Argentina | Peso (gold) | $0.746931 | India | Rupee | $0.372185 |
| Argentina | Peso (paper) | .328650 | Italy | Lira | .080411 |
| Australia | Pound (Sterling). | 3.913437 | Japan | Yen | .287700 |
| Austria | Schilling | .188100 | Mexico | Peso | .277675 |
| Belgium | Belga | .168607 | Netherlands | Florin | .679478 |
| Brazil | Milreis | .083883 | New Zealand | Pound (Sterling) | 3.943750 |
| Bulgaria | Lev | .013375 | Norway | Krone | .247650 |
| Canada | Dollar | .993828 | Panama | Balboa | 1.000000 |
| Chile | Peso | .050950 | Peru | Sol | .247100 |
| China (Shanghai) | Yuan dollar | .295312 | Philippine Islands | Peso | .500000 |
| Colombia | Peso | .569800 | Poland | Zloty | .189020 |
| Cuba | Peso | .999200 | Portugal | Escudo | .044833 |
| Czechoslovakia | Koruna | .041553 | Rumania | Leu | .007875 |
| Denmark | Krone | .220045 | South Africa | Pound (Sterling). | 4.875250 |
| England | Pound (Sterling). | 4.930000 | Spain | Peseta | .137100 |
| Finland | Markka | .021743 | Straits Settlements | Dollar | .576250 |
| France | Franc | .066183 | Sweden | Krona | .254133 |
| Germany | Reichsmark | .402421 | Switzerland | Franc | .325389 |
| Greece | Drachma | .009400 | Uruguay | Peso (gold) | .802750 |
| Hong Kong | Dollar | .318437 | Venezuela | Bolivar | .255700 |
| Hungary | Pengo | .296375 | Yugoslavia | Dinar | .022925 |

### ARTICLE 41-1: Computation of net income.

XV-8-7963
I. T. 2958

REVENUE ACT OF 1934.

Taxpayers who regularly make their income tax returns on the cash receipts and disbursements basis should not include in such returns any increment in value of United States savings bonds, issued under the provisions of section 22(c) of the Second Liberty Bond Act, as amended, until they receive payment for the bonds, whether at or before maturity. The entire difference between the price paid for the bonds at issue and the amount received in payment therefor should be reported as income for the taxable year in which redemption occurs. (See G. C. M. 15875, C. B. XIV-2, 100, relative to taxpayers who employ the accrual method of accounting.)

# SECTION 42.—PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

ARTICLE 42-1: When included in gross income. XV-6-7939
G. C. M. 16121

REVENUE ACT OF 1934.

Compensation received in 1935 by the executors of the estate of A for services rendered by him prior to his death in November, 1934, but not payable until after January 1, 1935, should be included in his return for the taxable year 1934 even though his books of account were kept on the cash receipts and disbursements basis.

The opinion of this office is requested whether compensation for services rendered by A prior to the date of his death in 1934, but not payable until after January 1, 1935, should be included in his return of income for the taxable year 1934.

The taxpayer, A, was employed by the M Company under a contract dated January —, 1928, by the terms of which his compensation was fixed as a salary equal to — per cent of the net profits derived from the sale of merchandise in the stores directly under his control and management, payment to be made annually as soon as convenient after January 1, but not later than March 1. It was also provided that in the event of the death of A, the contract should thereupon terminate "and he or his legal representative shall be entitled to share in the profits only to the time of his death, * * * such share to be based upon the total net profits for the year, pro rata for the time served." It was further provided that "final settlement can not be required until after the succeeding annual inventory shall be finished, not later, however, than March 1, of the succeeding year."

Since the M Company did not determine its net profits until after the close of the calendar year, the amount of the taxpayer's compensation for services rendered in one year was not determined and paid until the following year. The taxpayer's books of account were kept on the cash receipts and disbursements basis. Pursuant to the method of determining and paying his compensation above described, the compensation for services rendered in one calendar year was reported by him as income for the succeeding year. The taxpayer died in November, 1934, and his executors, in filing his income tax return for the taxable year 1934, reported only the compensation which he had received in January, 1934, as compensation for services rendered in 1933. The revenue agent, relying upon section 42 of the Revenue Act of 1934, recommends the inclusion as taxable income of the decedent, A, for 1934 of $x$ dollars, representing compensation for services rendered by him in 1934, the amount of which was not determined and paid to the executors until January, 1935. The action of the revenue agent has been protested by the taxpayer's legal representatives.

Based upon the foregoing facts the following question is submitted: Can the salary received by the executors in 1935, representing compensation of the decedent, A, for services rendered by him in 1934, properly be considered as income accrued to the date of death of the decedent and included in the return filed in his behalf for the taxable year 1934?

Section 42 of the Revenue Act of 1934 reads as follows:

SEC. 42. *Period in which items of gross income included.*

The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. In the case of the death of a taxpayer there shall be included in computing net income for the taxable period in which falls the date of his death, amounts accrued up to the date of his death if not otherwise properly includible in respect of such period or a prior period.

The last sentence of the foregoing section is new in the Revenue Act of 1934, being added, as the report of the Committee on Finance discloses, for the purpose of making taxable as income in the year of his death amounts earned by, or accrued to, a taxpayer up to the date of his death, which amounts had theretofore entirely escaped taxation as income in cases where the decedent's books of account were kept on the cash receipts and disbursements basis. (See Senate Report No. 558, at page 28, and *Nichols* v. *United States*, 64 Ct. Cls., 241, certiorari denied, 277 U. S., 584.)

Under the circumstances of the present case, it is evident that the taxpayer had, at the date of his death, become legally entitled to receive a certain share of the net profits derived from the sale of merchandise in the stores under his management for the year 1934, to be computed by prorating the total net profits for the year upon the basis of the time served by him in such year prior to his death. Only the exact amount of his share of the profits remained to be determined. This office is, therefore, of the opinion that the taxpayer's share of the net profits had "accrued up to the date of his death" within the meaning of section 42 of the Revenue Act of 1934. Accordingly, the compensation received in 1935 by the executors of the estate of A for services rendered by him prior to his death in the year 1934 should be considered as income accrued to the date of death which is includible in A's return for the taxable year 1934.

HERMAN OLIPHANT,
*General Counsel for the Department of the Treasury.*

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## SECTION 43.—PERIOD FOR WHICH DEDUCTIONS AND CREDITS TAKEN.

ARTICLE 43-2: When charges deductible. XV-20-8085
G. C. M. 16279

REVENUE ACT OF 1934.

The entire amount expended in 1934 by the M Railroad Co. for incidental repairs (current maintenance cost) to railroad cars constitutes a proper deduction for the year 1934 for Federal income tax purposes, even though in that year the number of cars repaired was four times the average annual number and authorization was procured from the Interstate Commerce Commission to amortize the cost of such repairs over a period of four years.

An opinion is requested whether certain expenditures made by the M Railroad Co. in 1934 for the repair of railroad cars may be amortized, for Federal income tax purposes, over the years 1934 to 1937, inclusive.

The taxpayer repairs on an average $x$ cars each year, the expense of which is charged to current maintenance cost. In 1934, however, in order to increase employment, its directors authorized expenditures to cover repairs of $4x$ cars in the event that proper authority could be obtained from the Interstate Commerce Commission to make an accounting consistent with the company's best interests. The taxpayer accordingly made application to the commission for permission to amortize the contemplated repair expenditures over a 4-year period and in 1934 received from the commission the necessary authorization. The company began and completed the contemplated repair program during the year 1934. Because, however, the expenditures were equivalent to approximately four years' normal expenditures, the taxpayer deducted in its 1934 return only one-fourth of the total cost of repairing the $4x$ cars, with the intention of deducting as expenses the remaining three-fourths in equal amounts in its returns for 1935, 1936, and 1937. The question has been raised as to the proper treatment of such expenditures for Federal income tax purposes.

Section 43 of the Revenue Act of 1934 reads as follows:

SEC. 43. PERIOD FOR WHICH DEDUCTIONS AND CREDITS TAKEN.

The deductions and credits provided for in this title shall be taken for the taxable year in which "paid or accrued" or "paid or incurred," dependent upon the method of accounting upon the basis of which the net income is computed, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period. * * *

Article 43-2 of Regulations 86, promulgated under the Revenue Act of 1934, provides in part as follows:

ART. 43-2. *When charges deductible.*—Each year's return, so far as practicable, both as to gross income and deductions therefrom, should be complete in itself, and taxpayers are expected to make every reasonable effort to ascertain the facts necessary to make a correct return. The expenses, liabilities, or deficit of one year can not be used to reduce the income of a subsequent year. A taxpayer has the right to deduct all authorized allowances, and it follows that if he does not within any year deduct certain of his expenses, losses, interest, taxes, or other charges, he can not deduct them from the income of the next or any succeeding year. * * *

Article 23(a)-4 of Regulations 86 states:

ART. 23(a)-4. *Repairs.*—The cost of incidental repairs which neither materially add to the value of the property nor appreciably prolong its life, but keep it in an ordinarily efficient operating condition, may be deducted as expense, provided the plant or property account is not increased by the amount of such expenditures. Repairs in the nature of replacements, to the extent that they arrest deterioration and appreciably prolong the life of the property, should be charged against the depreciation reserve if such account is kept.

In view of the statutory provisions and regulations quoted above, it is held that since the expenditures made in 1934 to cover repairs of $4x$ cars constituted incidental repairs (current maintenance cost) rather than replacements or improvements, the amount thereof is not amortizable over a 4-year period but should be deducted for the year 1934. (Cf. *Old Colony Railroad Co.* v. *Commissioner*, 284 U. S., 552.)

HERMAN OLIPHANT,

*General Counsel for the Department of the Treasury.*

## PART V.—RETURNS AND PAYMENT OF TAX.

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## SECTION 51.—INDIVIDUAL RETURNS.

ARTICLE 51-2: Form of return. XV-20-8094
T. D. 4643

Preparation of income tax returns—Correct address of taxpayer required.—Amending article 51-2 of Regulations 86.

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

*To Collectors of Internal Revenue and Others Concerned:*

Article 51-2 of Regulations 86, relating to income returns required to be made under the Revenue Act of 1934, is hereby amended by adding at the end thereof the following:

The home or residential address of the taxpayer (including the street and number, if any) shall be given in the space provided at the top of the return for the name and address of the taxpayer. A taxpayer having a permanent business address may give that address as the principal or mailing address, provided that the complete home or residential address is also given within the space provided.

The foregoing amendment shall take effect 15 days after the date of approval of this Treasury decision.

This document is promulgated under the authority contained in section 62 of the Revenue Act of 1934.

GUY T. HELVERING,
*Commissioner of Internal Revenue.*

Approved May 11, 1936.
WAYNE C. TAYLOR,
*Acting Secretary of the Treasury.*

(Filed with the Division of the Federal Register May 13, 1936, 12.26 p. m.)

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## SECTION 53.—TIME AND PLACE FOR FILING RETURNS.

ARTICLE 53-2: Extensions of time for filing returns. XV-17-8060
T. D. 4636

INCOME TAX—MUTUAL INSURANCE COMPANIES OTHER THAN LIFE.

Extension of time for filing returns.

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

*To Collectors of Internal Revenue and Others Concerned:*

Pursuant to the provisions of section 53 of the Revenue Act of 1934, extensions of time for such period as may be necessary, but not later than June 15, 1936, are hereby granted to mutual insurance companies other than life for the filing of income tax returns, Form 1030, for the calendar year 1935.

This document is issued under the authority prescribed by sections 53 and 62 of the Revenue Act of 1934.

GUY T. HELVERING,
*Commissioner of Internal Revenue.*

Approved April 15, 1936.

WAYNE C. TAYLOR,
*Acting Secretary of the Treasury.*

(Filed with the Division of the Federal Register April 18, 1936, 9.34 a. m.)

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## SECTION 54.—RECORDS AND SPECIAL RETURNS.

ARTICLE 54-1: Aids to collection of tax. XV-7-7953
Mim. 4426

When a subsidiary's original return is not filed in the same district as the return of the common parent corporation, copies thereof filed in that district must be plainly designated as such.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
*Washington, D. C., January 27, 1936.*

*Collectors of Internal Revenue, Internal Revenue Agents in Charge, Officers and Employees of the Bureau of Internal Revenue, and Others Concerned:*

Information has been received that in many instances a subsidiary corporation, not permitted to be included in a consolidated return under section 141 of the Revenue Act of 1934, has failed to designate the copy of the original return as such when filing such copy, as required by the second paragraph of article 54-1 of Regulations 86, with the collector to whom the return of the common parent corporation was made, the subsidiary's separate original return having been filed with the collector in whose district is located its principal place of business or principal office or agency. As a result the copies are not readily distinguishable as such.

In order to assure proper handling of copies of the original returns of subsidiary corporations filed in accordance with the requirements of the second paragraph of article 54-1 of Regulations 86, such copies shall have plainly typed or written across the top of page 1 of the return form the words "COPY—SUBSIDIARY CORPORATION—ORIGINAL RETURN FILED WITH THE COLLECTOR AT (designate city and State)."

Correspondence in regard to the instructions contained herein should refer to the number of the mimeograph and to the symbols IT:E:RR.

GUY T. HELVERING,
*Commissioner.*

**Article 54–1: Aids to collection of tax.** XV–20–8086
I. T. 2974

REVENUE ACT OF 1934.

Assessments for failure to file duplicate income tax returns.

Under regulations prescribed by the Treasury Department (T. D. 4626, page 61, this Bulletin) to carry out the provisions of section 55(b) of the Revenue Act of 1934, as amended by the Act (Public, No. 40, Seventy-fourth Congress, C. B. XIV–1, 552) approved April 19, 1935, every person (except nonresident alien individuals) required to file an income return for a taxable year or period beginning on or after January 1, 1935, is also required to file with the return a copy thereof on the duplicate form on colored paper provided for that purpose or a photostatic or photographic copy of the original return. The regulations require such copy to be a complete duplicate of the return as filed except that the copy need not be signed or the affidavits on the duplicate form otherwise filled in. The regulations provide further that there shall be attached to the copy on the duplicate form a copy of any schedule or statement attached to the original return except (1) Schedule C–1 in the case of a corporation return, (2) the copy of the will or trust instrument in the case of a fiduciary return, (3) the power of attorney on Form 935 or Form 936 in the case of a return made by an agent, and (4) the copy of the annual statement made to the insurance department of the State, Territory, or District of Columbia in the case of a return of an insurance company.

Under the provisions of the Act entitled "An Act relating to the filing of copies of income returns, and for other purposes" (Public, No. 510, Seventy-fourth Congress, page 522, this Bulletin), approved April 10, 1936, which amends section 54 of the Revenue Act of 1934, as amended, by adding at the end thereof a new subsection (d), if any person required pursuant to the above-mentioned regulations to file a copy of his income return for any taxable year beginning on or after January 1, 1935, fails to file such copy at the time required, there will be assessed against such person \$5 in the case of an individual return, or \$10 in the case of a fiduciary, partnership, or corporation return, and the collector of internal revenue with whom the return is filed will prepare such copy. With respect to the filing of income returns for any taxable year beginning during the calendar year 1935, however, such amount of \$5 or \$10 will be assessed only if the copy is not filed before the expiration of 15 days after the mailing of a request therefor by the collector. In the case of an income return for a taxable year beginning on or after January 1, 1936, which is filed without the required copy, the taxpayer is subject to an immediate assessment of \$5 or \$10, as the case may be, because of the failure to file such copy and no request to supply it is necessary or will be made.

If an assessment of \$5 or \$10 is made because of the taxpayer's failure to file the required copy of his return, such assessment is payable under the law upon notice by the collector, as in the case of an assessment of an additional tax due on account of a mathematical error appearing on the face of the return, and the taxpayer has no right of appeal to the Board of Tax Appeals with respect to such assessment.

## SECTION 55.—PUBLICITY OF RETURNS.

SECTION 55(a).

REVENUE ACT OF 1934.

Special Committee Investigating Old Age Pension Organizations, House of Representatives. (See T. D. 4637, page 310.)

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## SECTION 57.—EXAMINATION OF RETURN AND DETERMINATION OF TAX.

ARTICLE 57–1: Examination of return and determination of tax by the Commissioner. XV–15–8035 I. T. 2967

REVENUE ACT OF 1934.

Determination of income and profits tax liability in the Cleveland, Ohio, division.

As a further step to improve administration of the income tax laws, the Bureau of Internal Revenue has authorized the internal revenue agent in charge of the Cleveland, Ohio, division, beginning April 1, 1936, to issue final notices of deficiency (90-day letters) in income tax cases arising in that division. These letters represent the final notice under the statute of the proposed assessment of additional taxes and advise the taxpayer that upon petition the case will become subject to the jurisdiction of the United States Board of Tax Appeals.

The Bureau has also authorized the internal revenue agent in charge at Cleveland to assume the responsibilities and authority of the Income Tax Unit in Washington in the conduct of negotiations for settlement in respect of proposed increases in tax liability and in the consideration of the entire record in the endeavor to reach agreements with taxpayers or their counsel. The primary purpose of this action is to afford taxpayers a more convenient and less costly method of disposing of their income tax questions and to enable the Bureau of Internal Revenue to expedite the work of audit and investigation.

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## SUBTITLE C.—SUPPLEMENTAL PROVISIONS.

SUPPLEMENT A.—RATES OF TAX.

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## SECTION 101.—EXEMPTIONS FROM TAX ON CORPORATIONS.

ARTICLE 101(11)–1: Farmers' or other mutual hail, cyclone, casualty, or fire insurance companies or associations. XV–15–8045 T. D. 4634

INCOME TAX.

First paragraph of article 101(11)–1 of Regulations 86, amended.

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

*To Collectors of Internal Revenue and Others Concerned:*

The first paragraph of article 101(11)-1 of Regulations 86 is amended to read:

To be exempt under section 101(11) the business of the organization must be purely mutual and its income must be used or held solely for the purpose of paying losses or expenses. Neither the extent of the territory in which the company may properly operate nor the fact that it accepts premium deposits instead of assessments is decisive as to its exemption. The writing of nonmutual insurance regardless of amount will deprive a company of the exemption.

This document is issued under the authority prescribed by section 62 of the Revenue Act of 1934.

GUY T. HELVERING,
*Commissioner.*

Approved April 7, 1936.

WAYNE C. TAYLOR,
*Acting Secretary of the Treasury.*

(Filed with the Division of the Federal Register April 10, 1936)

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SUPPLEMENT B.—COMPUTATION OF NET INCOME.

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## SECTION 111.—DETERMINATION OF AMOUNT OF, AND RECOGNITION OF, GAIN OR LOSS.

ARTICLE 111-1: Computation of gain or loss. XV-1-7887
G. C. M. 15766

REVENUE ACTS OF 1932 AND 1934.

In determining gain or loss recognized and interest received, if any, where a taxpayer whose books were kept on the cash receipts and disbursements basis exchanged a mortgage on which unpaid interest had accrued for Home Owners' Loan Corporation bonds, the amount realized (cash plus the fair market value of the bonds received and the accrued interest thereon) should be applied first to the basis of the mortgage to the extent of the principal, then the balance, if any, which does not exceed the unpaid accrued interest, to such interest, and the excess, if any, to the basis.

Recommended that I. T. 2773 (C. B. XIII-1, 78) be modified.

An opinion is requested relative to the proper treatment for Federal income tax purposes of an exchange by the M Company, whose books are kept on the cash receipts and disbursements basis, of a first mortgage on real estate for bonds of the Home Owners' Loan Corporation.

The facts are as follows:

| | |
|---|---|
| Principal and cost of mortgage acquired in 1927 | $10,000 |
| Unpaid interest thereon when exchanged for H. O. L. C. bonds in 1934 | 636 |
| Total | 10,636 |
| For which taxpayer received $10,100 par value H. O. L. C. bonds having a fair market value on the date of exchange of | 9,424 |
| Accrued interest thereon | 9 |
| Cash | 18 |
| Total | 9,451 |

Section 112 of the Revenue Act of 1934 provides that upon the sale or exchange of property the entire amount of the gain or loss shall be recognized, except as thereinafter provided. One of the exceptions is contained in section 112(b)1, which reads as follows:

(1) *Property held for productive use or investment.*—No gain or loss shall be recognized if property held for productive use in trade or business or for investment (not including stock in trade or other property held primarily for sale, nor stocks, bonds, notes, choses in action, certificates of trust or beneficial interest, or other securities or evidences of indebtedness or interest) is exchanged solely for property of a like kind to be held either for productive use in trade or business or for investment.

The present mortgage comes within the parenthetical portion of the language of section 112 quoted above and the gain or loss arising from the transaction must be recognized. (See I. T. 2773, C. B. XIII-1, 78.)

Under section 111(b) of the Revenue Act of 1934, the amount realized from the exchange in the instant case is the sum of the cash and the fair market value of the bonds received and the accrued interest thereon. It is the opinion of this office that in determining gain or loss recognized and interest received, if any, the amount realized should be applied first to the basis of the mortgage to the extent of the principal, then the balance, if any, which does not exceed the unpaid accrued interest, to such interest, and the excess, if any, to the basis. The basis of the mortgage here involved, under section 113 of the Revenue Act of 1934, is its cost ($10,000). The amount realized from the exchange of the mortgage being less than the principal of the mortgage ($10,000), the amount realized is applicable, under the above-stated rule, in its entirety to the basis of the mortgage, resulting in a loss (determined under section 111 (a) and (b) of the Revenue Act of 1934 and which is recognized under section 112 (a) and (b) of that Act) represented by the difference between the basis and the amount realized. Inasmuch as it appears that the amount realized (fair market value of the bonds on the date of the exchange plus the cash payment and accrued interest) from the exchange is less than the basis (cost of the mortgage) and also less than the principal, no portion of the amount realized should be considered as interest received but should be applied entirely to the basis, resulting, as previously indicated, in a recognized loss of the difference between the basis and the amount realized.

The mortgage in this case was a "capital asset" within the definition contained in section 117 of the Revenue Act of 1934 and the loss recognized upon the exchange thereof is subject to the provisions of that section. I. T. 2773, supra, in which it was held that gain or loss must be recognized upon the exchange of a real estate mortgage for bonds of the Home Owners' Loan Corporation, was not concerned with the exchange of a "capital asset" and a ruling based on that decision might produce an incorrect result in a case involving the exchange of such an asset. In I. T. 2773 it was not necessary to distinguish between the two classes of income, but that ruling is not strictly accurate in so far as it treats the excess there received entirely as a profit from the exchange rather than as a receipt of interest. (Cf. *National Life Insurance Co.* v. *United States*, 78 Ct. Cls., 869, 4 Fed. Supp., 1000, Ct. D. 810, C. B. XIII-1, 290, certiorari denied, 291 U. S., 683, holding that where a mortgage is foreclosed interest is received where the amount bid on the sale equals the unpaid principal and unpaid interest even where the mortgagee is the successful bidder; *John Hancock Mutual Life Insurance Co.* v. *Commissioner*, 10 B. T. A., 736, acquiescence, C. B. VII–2, 20, holding that interest is not received where the bid equals the face of the mortgage only; and *American Central Life Insurance Co.* v. *Commissioner*, 30 B. T. A., 1182, acquiescence, C. B. XIII–2, 1, holding that "interest" was derived where mortgaged property acquired in discharge of the debt was not shown to be worth less than the loans, costs, and interest.) There is no valid distinction between a case where the taxpayer is held to receive interest through foreclosure proceedings, or through the voluntary deeding of the property by the mortgagor, and the case where it is realized through receipt of Home Owners' Loan Corporation bonds which are exchanged on behalf of the debtor in settlement and satisfaction of the mortgagee's claim against him.

Inasmuch as the method prescribed herein of allocating the amount realized in the exchange may differ in results from the conclusion reached in I. T. 2773, supra, it is recommended that I. T. 2773 be modified to conform to the rule set forth in this memorandum.

This office is also of the opinion that the proper basis for determining gain or loss on the subsequent sale or disposition of the bonds received in exchange is their fair market value at the date of the exchange. (Section 113, Revenue Act of 1934.)

Arthur H. Kent,
*Acting Assistant General Counsel for the Bureau of Internal Revenue.*

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## SECTION 116.—EXCLUSIONS FROM GROSS INCOME.

Article 116–2: Compensation of State officers and employees. XV–5–7935 Mim. 3838 (Rev.)

Taxability of compensation received by officers and employees of a State or political subdivision.

Treasury Department,
Office of Commissioner of Internal Revenue,
*Washington, D. C., January 17, 1936.*

*Collectors of Internal Revenue, Internal Revenue Agents in Charge, and Other Officers and Employees of the Bureau of Internal Revenue Concerned:*

In order to insure greater uniformity in the administration of the Revenue Acts in regard to the imposition of the Federal income tax upon the compensation received by officers and employees of a State or its political subdivisions, and to secure the revenue to which the Federal Government is entitled from that source, it is desired to direct attention to the provisions of article 643 of Regulations 77, article 116–2 of Regulations 86, to rulings of the Bureau, and to certain court decisions and decisions of the United States Board of Tax Appeals which pertain to the subject.

Article 116-2 of Regulations 86 reads in part as follows:

* * * The operations of a State or political subdivision thereof essential to the exercise of its governmental functions, and which only the State or the political subdivision can do itself, are exempt from Federal taxation. Compensation received for services rendered to a State or a political subdivision thereof is to be included in gross income unless (*a*) the person receives such compensation from the State or political subdivision as an officer or employee thereof, and (*b*) the services are rendered in connection with the exercise of an essential governmental function. * * *

States and political subdivisions thereof have a dual character and possess two kinds of power, one that is a governmental power and one that is a corporate or proprietary power. In the exercise of the former, the State and its political subdivisions are clothed with sovereignty. In the exercise of the latter, they are treated as private corporations. (*Collector* v. *Day*, 11 Wall., 113; *State of South Carolina* v. *United States*, 199 U. S., 437; *Veazie Bank* v. *Fenno*, 8 Wall., 533; and *United States* v. *Railroad Co.* 17 Wall., 322.) However, there is a fundamental distinction between a "public" purpose and a "governmental" function. (*State of North Dakota* v. *Olson*, 33 Fed. (2d), 848.)

The doctrine of immunity from Federal taxation of State agencies or instrumentalities essential to the discharge of its "usual" and "essential" functions of government is not expressly stated in the Constitution but has been established by decisions of the United States Supreme Court which have held that due to an "implied" constitutional restriction the Federal Government can not interfere with the States in the discharge of such functions. The exemption does not exist for the benefit of the individual but solely to protect the exercise of the sovereign powers of the States and their political subdivisions. The protection of the sovereign power of the Federal Government to levy and collect taxes is no less important than the protection of governmental activities of States and political subdivisions.

That the doctrine of immunity should be confined within appropriate narrow bounds was recognized by the United States Supreme Court in *Willcuts* v. *Bunn* (282 U. S., 216 [Ct. D. 280, C. B. X-1, 309]) when it stated that "The limitation of this principle to its appropriate application is also important to the successful working of our governmental system. The power to tax is no less essential than the power to borrow money, and, in preserving the latter, it is not necessary to cripple the former by extending the constitutional exemption from taxation to those subjects which fall within the general application of nondiscriminatory laws, and where no *direct burden* is laid upon the governmental instrumentality, and there is only a remote, if any, influence upon the exercise of the functions of government." [Italics supplied.] The rule must be applied according to practical standards. (*Railroad Co.* v. *Peniston*, 18 Wall., 5; *Metcalf & Eddy* v. *Mitchell*, 269 U. S., 514 [T. D. 3824, C. B. V-1, 218] and *Burnet* v. *Jergins Trust*, 288 U. S., 508 [Ct. D. 653, C. B. XII-1, 214].) The United States Supreme Court in *Educational Films Corporation* v. *Ward* (282 U. S., 379) said that "The constitutional power of one government to reach this permissible object of taxation may not be curtailed because of the indirect effect which the tax may have upon the other." In that same decision the Court also said: "This Court, in drawing the line which defines the limits of the powers and immunities of State and National Governments, is not intent upon a mechanical application of the rule that government instrumentalities are immune from taxation, regardless of the consequences to the operations of government. The necessity for marking those boundaries grows out of our constitutional system, under which both the Federal and the State Governments exercise their authority over one people within the territorial limits of the same State. The purpose is the preservation to each government, within its own sphere, of the freedom to carry on those affairs committed to it by the Constitution, without undue interference by the other. * * *" (Cases cited).

The United States Supreme Court in *Flint* v. *Stone Tracy Co.* (220 U. S., 107) said that "The true distinction is between the attempted taxation of those operations of the States essential to the execution of its governmental functions, *and which the State can only do itself*, and those activities which are of a private character. The former, the United States may not interfere with by taxing the agencies of the State in carrying out its purposes; the latter * * * are not removed from the field of legitimate Federal taxation." [Italics supplied.]

The rule is not applicable where the public activity is one commonly undertaken by private corporations or individuals, as, for example, the operation of a municipal waterworks plant, an electric light plant, or a street railway. (*See Flint* v. *Stone Tracy Co.*, supra, and *Helvering* v. *Powers et al.*, 293 U. S., 214, Ct. D. 900, C. B. XIII–2, 213.) In *Helvering* v. *Powers et al.*, supra, the Court said:

> We see no reason for putting the operation of a street railway in a different category from the sale of liquors. In each case, the State, with its own conception of public advantage, is undertaking a business enterprise of a sort that is normally within the reach of the Federal taxing power and is distinct from the usual governmental functions that are immune from Federal taxation in order to safeguard the necessary independence of the State. * * *
>
> If the business itself, by reason of its character, is not immune, although undertaken by the State, from a Federal excise tax upon its operations, upon what ground can it be said that the compensation of those who conduct the enterprise for the State is exempt from a Federal income tax? Their compensation, whether paid out of the returns from the business or otherwise, can have no quality, so far as the Federal taxing power is concerned, superior to that of the enterprise in which the compensated service is rendered.

In *State of Ohio* v. *Helvering et al.* (292 U. S., 360, Ct. D. 836, C. B. XIII–1, 531), the Court said:

> * * * But, by the very terms of the rule, the immunity of the States from Federal taxation is limited to those agencies which are of a governmental character. Whenever a State engages in a business of a private nature it exercises nongovernmental functions, and the business, though conducted by the State, is not immune from the exercise of the power of taxation which the Constitution vests in the Congress. * * *
>
> * * * The argument seems to be that the police power is elastic and capable of development and change to meet changing conditions. Nevertheless, the police power is and remains a governmental power, and applied to business activities is the power to regulate those activities, not to engage in carrying them on. * * *

As stated by the United States Supreme Court in *Metcalf & Eddy* v. *Mitchell*, supra, "An office is a public station conferred by the appointment of government. * * * Where an office is created the law usually fixes its incidents, including its term, its duties and its compensation. * * * The term 'officer' is one inseparably connected with an office; * * *." A statute may authorize the employment or engagement of an individual and yet not create an "office" nor constitute the individual an "employee." An employee is one who is continuously employed to render services of a routine or recurring character and who is subject to direction not only as to what shall be done but as to "how it shall be done." (*Commissioner* v. *Modjeski*, 75 Fed. (2d), 468, certiorari denied, 295 U. S., 764.) One engaged to render a particular service to a State or political subdivision, or to bring about a desired result, or one who has entered into a contract to accomplish a specific object is an independent professional agent or an independent contractor, and not an employee, as there is not present a control of such a nature as characterizes an employer and employee relationship.

*Effect of sources of funds for compensation.*—If all or a part of the compensation of an officer or employee of a State or political subdivision thereof is paid directly or indirectly by the Federal Government, such compensation (or part) is taxable, as, for example, the compensation paid by the United States to officers of the National Guard of a State, or the compensation paid by a State to officers or employees of an agricultural school or college wholly or partly out of grants from the Federal Government. This is also applicable to State emergency relief administrations where compensation is paid from grants of Federal funds. (I. T. 2859, C. B. XIV-1, 101.) The ruling in regard to taxing the compensation of officers and employees of agricultural schools and colleges paid from Federal grants will be applied only for the year 1934 and subsequent years, as the regulations under prior Revenue Acts specifically provided that such compensation is not subject to Federal income tax.

*Receivers, liquidators of banks and insurance companies, and notaries public.*—It is also held that in certain other cases where the compensation is not paid out of public funds of the State or political subdivisions, the compensation is subject to Federal income tax, as the imposition of the tax would not so burden the State or political subdivisions as to constitute a substantial and direct interference by the Federal Government with the exercise of a usual sovereign function. Accordingly, the compensation of receivers appointed by State courts and liquidators of banks and insurance companies taken over by the States, which is paid out of the funds or assets of the corporations involved, is not exempt. (See G. C. M. 13488, C. B. XIII-2, 156, and G. C. M. 14116, C. B. XIV-1, 102.) Fees of notaries public are subject to tax. (Article 116-2, Regulations 86.)

*State alcoholic administrations.*—The Department has decided that it was not the intention of Congress to impose the Federal income tax directly on States or political subdivisions thereof. States and political subdivisions which engage in the manufacture and/or sale of alcoholic beverages will not be taxed on the profits made from such sales. (See G. C. M. 14407, C. B. XIV-1, 103.) However, as the activity is one that is proprietary in nature as distinguished from one that is essentially governmental, the compensation of the officers and employees engaged in the manufacture and/or sale of such beverages is subject to Federal income tax. (See *Ohio* v. *Helvering et al.*, supra.)

*Public parks and playgrounds.*—In regard to the taxable status of the compensation of officers and employees whose services are rendered in connection with the maintenance and operation of public parks, the decision in *Commissioner* v. *Sherman* (69 Fed. (2d), 755), upholding the decision of the United States Board of Tax Appeals (27 B. T. A., 1169) that the salary of the superintendent of public parks in New Bedford, Mass., is exempt from Federal income tax, is not accepted as a precedent for other cases involving the taxable status of the compensation of officers and employees of public parks. An appeal has been taken from the decision of the United States Board of Tax Appeals in *Bernard Peter Lamb* v. *Commissioner*, docket No. 70050 (unpublished), which is now pending before the Circuit Court of Appeals for the Ninth Circuit. That case involves the question of the taxability, for Federal income tax purposes, of the compensation of an employee of the Board of Park Commissioners of San Francisco, Calif. Pending a final judicial determination of the question presented in the Lamb case, supra, the Bureau will adhere to its ruling that the compensation of individuals who render services in connection with the maintenance and operation of public parks and playgrounds is not exempt from Federal income tax. (See I. T. 2627, C. B. XI-1, 119.)

*Hospitals.*—It is held that the operation of charitable, isolation, or insane hospitals by States or political subdivisions constitutes the exercise of an essential governmental function, and the compensation of the officers and employees of such hospitals is exempt from Federal income tax. On the other hand, in the case of the operation by a State or political subdivision of a general hospital, where all classes of patients are admitted and charges made to such as can pay, even though the amount of such charges is less than the cost, the activity is classed as a proprietary one and the compensation of the officers and employees of such a hospital is subject to Federal income tax. (I. T. 2357, C. B. VI-1, 52; I. T. 2642, C. B. XI-2, 44.) As to hospitals coming between these extremes, no definite rule can be laid down and each case must be decided on the particular facts. In submitting information with respect to such institutions you should give fully all the facts, particularly as to the statutes or ordinances providing for their establishment and operation, the practice with respect to admission of patients and charges therefor, and all other pertinent facts.

*Independent contractors.*—Particular attention should be given to cases of professional men who engage in private practice and who also serve States or their political subdivisions professionally. As a general rule they will be held to be independent contractors or independent professional agents on the authority of *Metcalf & Eddy* v. *Mitchell*, supra; *Commissioner* v. *McDonough* (46 Fed. (2d), 944, Ct. D. 338, C. B. X-1, 367); *Burnet* v. *Jones* (50 Fed. (2d), 14); *Underwood* v. *Commissioner* (56 Fed. (2d), 67); *John Reid, Jr.*, v. *Commissioner* (28 B. T. A., 1217); *Commissioner* v. *Modjeski*, supra; and *Walter G. Winne* v. *Commissioner* (27 B. T. A., 369). In *Register* v. *Commissioner* (69 Fed. (2d), 607, Ct. D. 863, C. B. XIII-2, 284), the court said that "It is settled doctrine, however, that one of a class subject to taxation claiming the benefit of an exemption * * * must bring himself exactly within the exception he claims. * * * To hold moneys which petitioner has earned in the practice of his profession exempt from income tax merely because the client who paid them was a city, would be to set unreasonable bounds to the doctrine of the immunity of the sovereign to press its consequences far beyond the practical necessities of either government." This class of cases is the most difficult upon which to reach a decision. In submitting information relative to them it is desired that you do not merely draw a conclusion that the individual is an officer or an employee but that you give very fully all the facts, etc., upon which you base your opinion, so that this office may be in a position to determine the correctness of your conclusions. Very complete and definite information should be furnished in regard to the nature of their activities, whether a public office is provided for them, whether they are required to observe regular office hours, whether the position is specifically provided for by statute or by ordinance, and, if so, the provision of the law or ordinance should be secured, and the citation to the law given by volume and page. (See *F. A. Pease* v. *Commissioner*, 30 B. T. A., 17, now pending on appeal before the United States Circuit Court of Appeals for the Sixth Circuit.) In *Register* v. *Commissioner*, supra, the court said that "In deciding those cases as we did we laid down no general rule. We did not undertake to, we did not, mark out for other cases the line beyond which the Federal taxing power could not go. We recognized that on what side of that line each case would fall must be precisely and separately determined in each case as it arises. * * *"

*State banks.*—The operation of a State bank has also been held to be the discharge of a proprietary function and, therefore, the compensation of its officers and employees is subject to tax. (*The State of North Dakota* v. *Olson*, supra.)

*Harbors.*—The construction, ownership, and operation by a State or political subdivision of wharves, piers, elevators, terminals, icing plants, warehouses, and other port facilities to promote shipping and commerce are proprietary activities. (S. M. 2232, C. B. III-2, 83; and *Packet Co.* v. *Keokuk*, 95 U. S., 80.) (Cases involving compensation of employees of the Port of New York Authority are now pending before the United States Board of Tax Appeals.)

*Appointees of State courts.*—As a general rule the compensation of masters appointed by State courts to hear and report on specific cases, receivers, auditors, examiners, guardians of estates of incompetent persons, appraisers, and public administrators will be subject to tax. (I. T. 1245, C. B. I-1, 103; I. T. 1305, C. B. I-1, 104; I. T. 2030, C. B. III-1, 117; S. M. 5287, C. B. V-1, 222; G. C. M. 14116, supra; and *Miller* v. *McCaughn*, 22 Fed. (2d), 165 (affirmed 27 Fed. (2d), 128), C. B. VII-2, 266.) The acquiescence in the decision of the United States Board of Tax Appeals in *David K. Cochrane* v. *Commissioner* (26 B. T. A., 1167, C. B. XII-1, 3) was withdrawn (C. B. XIII-2, 23).

*Rural credit board.*—The function of a rural credit board has been held to be proprietary in character and the compensation of its officers and employees is, therefore, subject to tax. (S. M. 5490, C. B. V-1, 37.)

*Harbor pilots.*—The compensation of harbor pilots is taxable. (See rulings in C. B. VI-2, 39 to 58, and *Bew* v. *United States*, 35 Fed. (2d), 977.)

*Irrigation and reclamation districts.*—The functions of irrigation and reclamation districts are proprietary in nature and the compensation of the officers and employees thereof is subject to tax.

*Tax collectors.*—Persons appointed only for the purpose of collecting delinquent taxes or particular taxes are not officers or employees of a State or its political subdivisions and the compensation received for such services is subject to tax. (G. C. M. 809, C. B. V-2, 28, and *Reed* v. *Commissioner*, 34 Fed. (2d), 263, reversed by the Supreme Court, 281 U. S., 699.)

*School cafeterias.*—The operation of school cafeterias is an activity that is proprietary in nature and the compensation of the officers and employees whose services are rendered in connection therewith is taxable. (See *Eugene Hoskins et al.* v. *Commissioner*, 32 B. T. A., 682.)

*Mixed activities.*—In some cases individuals render services to States or political subdivisions in connection with an instrumentality embracing both proprietary and governmental activities. In such cases the taxability of the compensation received will depend upon "the nature of the enterprise, and not the particular incidents of its management." The fact that a part of the activity may be governmental in nature does not warrant exemption when that part is merely incident to the main purpose. (See *M. S. Denman, ex.*, v. *Commissioner*, 27 B. T. A., 256, affirmed 73 Fed. (2d), 193; and *Helvering* v. *Powers*, supra.) When a taxpayer claims the benefit of an exemption from taxation, the burden is upon him to show clearly that he is within the exemption claimed. (*Phoenix Fire & Marine Insurance Co.* v. *Tennessee*, 161 U. S., 174; *Chicago, Burlington & Kansas City R. R.* v. *Guffey*, 120 U. S., 569; *Metcalf & Eddy* v. *Mitchell*, supra.) In regard, therefore, to the administrative difficulties involved in cases where a State or a political subdivision combines in one agency activities which are partly proprietary and partly governmental and neither can be said to be merely incidental, it may be stated that it devolves upon the taxpayer to substantiate from records the division of his time between the two, such as the number of months, days, etc., devoted to each. If he can furnish no basis for the division of his time or salary which appears reasonable, the total amount should be included in taxable income.

Correspondence in regard to this mimeograph should refer to the number thereof and to the symbols IT:E:RR.

GUY T. HELVERING,
*Commissioner.*

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## SECTION 117.—CAPITAL GAINS AND LOSSES.

ARTICLE 117-2: Limitations on capital gains and capital losses. XV-26-8142 I. T. 2986

REVENUE ACT OF 1934.

Where the M Improvement District refunded its bonds prior to maturity with the intention of not reissuing them, losses sustained by the holders thereof are subject to the limitations contained in section 117 (a) and (d) of the Revenue Act of 1934, unless the bonds were not held as "capital assets" as defined in the Act.

Advice is requested as to the applicability of section 117 of the Revenue Act of 1934 to losses sustained by individuals and corporations through the refunding of bonds of the M Improvement District for an amount less than the face value of such bonds. That district obtained a loan for the purpose of refinancing its outstanding bonded indebtedness and used the proceeds of the loan in the refunding of all of its outstanding bonds on the basis of — cents on each dollar of principal in full satisfaction of the principal and accrued interest on such bonds.

Section 117 of the Revenue Act of 1934 provides in part as follows:

(a) *General rule.*—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net income:

100 per centum if the capital asset has been held for not more than 1 year;

80 per centum if the capital asset has been held for more than 1 year but not for more than 2 years;

60 per centum if the capital asset has been held for more than 2 years but not for more than 5 years;

40 per centum if the capital asset has been held for more than 5 years but not for more than 10 years;

30 per centum if the capital asset has been held for more than 10 years.

(b) *Definition of capital assets.*—For the purposes of this title, "capital assets" means 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 close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.

* * * * * * *

(d) *Limitation on capital losses.*—Losses from sales or exchanges of capital assets shall be allowed only to the extent of $2,000 plus the gains from such sales or exchanges. If a bank or trust company incorporated under the laws of the United States or of any State or Territory, a substantial part of whose business is the receipt of deposits, sells any bond, debenture, note, or certificate or other evidence of indebtedness issued by any corporation (including one issued by a government or political subdivision thereof), with interest coupons or in registered form, any loss resulting from such sale (except such portion of the loss as does not exceed the amount, if any, by which the adjusted basis of such instrument exceeds the par or face value thereof) shall not be subject to the foregoing limitation and shall not be included in determining the applicability of such limitation to other losses.

* * * * * * *

(f) *Retirement of bonds, etc.*—For the purposes of this title, amounts received by the holder upon the retirement of bonds, debentures, notes, or certificates or other evidences of indebtedness issued by any corporation (including those issued by a government or political subdivision thereof), with interest coupons or in registered form, shall be considered as amounts received in exchange therefor.

In the opinion of this office the term "*retirement of bonds*," as used in section 117(f) of the Revenue Act of 1934, includes the purchase or refunding by a corporation of its bonds prior to their maturity date with the intention of not reissuing the same bonds.

It is held, therefore, that the loss sustained by an individual holder of bonds of the M Improvement District as the result of the refunding of such bonds on the basis above set forth is subject to the limitations contained in section 117 (a) and (d) of the Revenue Act of 1934, and that such a loss sustained by a corporate holder of the bonds is subject to the limitation of section 117(d), unless the bonds in both cases do not constitute "capital assets" as defined in section 117(b) of the Act.

## SECTION 119.—INCOME FROM SOURCES WITHIN UNITED STATES.

ARTICLE 119-7: Income from sources without the United States. XV-22-8102 I. T. 2976

REVENUE ACT OF 1934.

The rental or benefit payments made by the Secretary of Agriculture under the provisions of the Agricultural Adjustment Act to the M Company, a foreign corporation operating in Puerto Rico, for reduction in acreage, or reduction in production for market of sugar cane, are income from sources without the United States.

Advice is requested whether the rental or benefit payments received by the M Company, a sugar cane producer in Puerto Rico, by reason of sugar cane production adjustment contracts under the provisions of the Agricultural Adjustment Act constitute income from sources within or without the United States.

The M Company conducts all its business in Puerto Rico, where its offices are located, and for Federal income tax purposes is considered a foreign corporation. Its income is derived primarily from the cultivation and sale of sugar cane produced in Puerto Rico.

It was held in I. T. 2767 (C. B. XIII-1, 35) that the rental or benefit payments made to producers by the Secretary of Agriculture under the provisions of the Agricultural Adjustment Act for the reduction in acreage, or the reduction in production for market of any basic agricultural commodity specified in section 11 of that Act, as amended, constitute taxable income to the recipient. However, the acreage for which the rentals were paid in the instant case, or upon which production was reduced, is located in Puerto Rico. Accordingly, the income in question arose from the ownership of land by the M Company without the United States and constitutes income from sources without the United States.

The fact that the Agricultural Adjustment Act has been held to be unconstitutional (*United States* v. *Butler et al., Receivers of Hoosac Mills Corporation*, 297 U. S., 1) does not have any effect on the question of whether payments made under that Act constitute income.

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SUPPLEMENT C.—CREDITS AGAINST TAX.

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## SECTION 131.—TAXES OF FOREIGN COUNTRIES AND POSSESSIONS OF UNITED STATES.

ARTICLE 131-1: Analysis of credit for taxes. XV-13-8017 I. T. 2964

REVENUE ACT OF 1934.

The tax imposed by Canada on nonresidents in connection with the use of copyrights in Canada is an allowable credit under section 131 of the Revenue Act of 1934, subject to the limitations provided in that section.

Advice is requested relative to the allowance of a credit against United States income tax for taxes levied by the Canadian Government in respect of copyrights under chapter 97 of the income war tax act, enacted by Canada in 1917, and chapters 12, 24, 41, 55, and 40, all of which are amendments to the income war tax act. The inquiry relates particularly to a new provision written into the law (chapter 40, assented to June 28, 1935), by virtue of which American film producers will be subject to a 5 per cent tax at the source based on sales made in Canada.

The following provisions of the Canadian tax law are pertinent:

Chapter 97. 9. There shall be assessed, levied and paid upon the income during the preceding year of every person * * *

Chapter 41. 9B. (1) * * *

(2) In addition to any other tax imposed by this act an income tax of 5 per centum is hereby imposed on all persons who are nonresidents of Canada in respect of

(a) All dividends received from Canadian debtors irrespective of the currency in which the payment is made, and

(b) All interest received from Canadian debtors if payable solely in Canadian funds except the interest from all bonds of or guaranteed by the Dominion of Canada.

Chapter 55. 5. * * *

(c) All interest received by a nonresident parent company from a Canadian subsidiary company * * *.

(d) All income for any taxation period received from any Canadian estate or trust, * * *.

Chapter 40. 9. * * *

(e) All payments received directly or indirectly from Canadian debtors in respect of

(i) any copyright, used in Canada, relating to books, music, articles in periodicals, newspaper syndicated articles, pictures, comics and other newspaper or periodicals features, and (ii) any rights in and to the use of any copyrighted work subsequently produced or reproduced in Canada by way of the spoken word, print or mechanical sound on or from paper, composition, films or mechanical devices of any description.

The tax payable by virtue of this paragraph shall be deducted by the Canadian debtor from the amount paid or credited to such nonresident at the time of payment or crediting, and shall be remitted to the receiver general of Canada.

Section 31 of the Revenue Act of 1934 provides that income taxes imposed by foreign countries shall be allowed as a credit to the extent provided in section 131, which in turn places certain limitations upon the credit. Section 131(a) of that Act provides in part:

(a) *Allowance of credit.*—If the taxpayer signifies in his return his desire to have the benefits of this section, the tax imposed by this title shall be credited with:

(1) *Citizen and domestic corporation.*—In the case of a citizen of the United States and of a domestic corporation, the amount of any income, war-profits, and excess-profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States; * * *.

In order that the credit may be allowed, it is essential that the tax paid to the foreign country be an income, war-profits, or excess-profits tax. If the tax is in the nature of an income tax, it must be a tax on income according to the concept of income as defined by the Supreme Court of the United States in *Eisner* v. *Macomber* (252 U. S., 189 [T. D. 3010, C. B. 3, 25]). The Court stated:

Income may be defined as the gain derived from capital, from labor or from both combined, provided it be understood to include profit gained through a sale or conversion of capital assets * * *.

The 5 per cent tax deducted at the source by the Canadian debtors is a tax imposed upon royalties or similar payments for the use of copyrighted materials.

Applying the foregoing principles to the tax imposed by Canada on nonresidents in connection with the use of copyrights in Canada, it clearly appears that the tax is an allowable credit under section 131 of the Revenue Act of 1934, subject to the limitations provided in that section.

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ARTICLE 131-5: Countries which do or do not satisfy the similar credit requirement. XV-1-7888 I. T. 2949

REVENUE ACT OF 1934.

Germany does not satisfy the similar credit requirement of section 131(a)3 of the Revenue Act of 1934.

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ARTICLE 131-5: Countries which do or do not satisfy the similar credit requirement. XV-24-8121 I. T. 2980

REVENUE ACT OF 1934.

The Netherlands Government does not satisfy the similar credit requirement of section 131(a)3 of the Revenue Act of 1934.

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SUPPLEMENT E.—ESTATES AND TRUSTS.

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## SECTION 161.—IMPOSITION OF TAX.

ARTICLE 161-1: Imposition of the tax. (Also Section 166, Article 166-1.) XV-11-8003 T. D. 4629

INCOME TAX.

**Estates and trusts—Article 161-1 and article 166-1 of Regulations 86, amended.**

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

*To Collectors of Internal Revenue and Others Concerned:*

(1) Article 161-1(*a*) of Regulations 86 is hereby amended by deleting from the end of the first sentence of the first paragraph of that article the parenthetical phrase "except in the case of those trusts within the scope of sections 165, 166, and 167."

(2) The last paragraph of article 161-1(*a*) of Regulations 86 is amended to read as follows:

The provisions of sections 161, 162, and 163 (relating to estates and trusts, fiduciaries and beneficiaries) contemplate that the corpus of the trust, or the income therefrom, is, within the meaning of the Act, no longer to be regarded as that of the grantor. If, by virtue of the nature and purpose of the trust, the corpus or income therefrom remains attributable to the grantor, these provisions do not apply. Thus the provisions of sections 166 and 167 deal with certain trusts which are excluded from the scope of sections 161, 162, and 163. And other trusts, not specified in sections 166 and 167, where in contemplation of law the corpus of the trust or the income therefrom is regarded as remaining in substance that of the grantor are likewise excluded from the scope of sections 161, 162, and 163. Some of such trusts are dealt with in article 166-1 and article 167-1. Special rules are prescribed in section 165 with respect tc the taxation of employees' trusts.

(3) Article 161-1(*b*) of Regulations 86 is amended by adding, at the end of the first sentence thereof after the reference to sections 165, 166, and 167, the phrase "and articles 166-1 and 167-1."

(4) Article 166-1 of Regulations 86 is amended to read as follows:

ART. 166-1. *Trusts, with respect to the corpus of which, the grantor is regarded as remaining in substance the owner.*—(*a*) If the grantor of a trust is regarded, within the meaning of the Act, as remaining in substance the owner of the corpus thereof, the income therefrom is not taxable in accordance with the provisions of sections 161, 162, and 163 but remains attributable and taxable to the grantor. This article deals with the taxation of such income. As used in this article, the term "corpus" means any part or the whole of the property, real or personal, constituting the subject matter of the trust.

(*b*) Section 166 defines with particularity instances in which the grantor is regarded as in substance the owner of the corpus by reason of the fact that he has retained power to revest the corpus in himself. For the purposes of this article the grantor is deemed to have retained such power if he, or any person not having a substantial interest in the corpus or the income therefrom adverse to the grantor, or both, may cause the title to the corpus to revest in the grantor. If the title to the corpus will revest in the grantor upon the exercise of such power, the income of the trust is attributed and taxable to the grantor regardless of—

(1) whether such power or ability to retake the trust corpus to the grantor's own use is effected by means of a power to revoke, to terminate, to alter or amend or to appoint;

(2) whether the exercise of such power is conditioned on the precedent giving of notice, or on the elapsing of a period of years, or on the happening of a specified event;

(3) the time at which the title to the corpus will revest in the grantor in possession and enjoyment, whether such time is within the taxable year or not, or whether such time be fixed, determinable, or certain to come;

(4) whether the power to revest in the grantor title to the corpus is in the grantor, or in any person not having a substantial interest in the corpus or income therefrom adverse to the grantor, or in both. A bare legal interest, such as that of a trustee, is never substantial and never adverse;

(5) when the trust was created.

But the provisions of section 166 are not to be regarded as excluding from taxation to the grantor the income of other trusts, not specified therein, in which the grantor is, for the purposes of the Act, similarly regarded as remaining in substance the owner of the corpus. The grantor is regarded as in substance the owner of the corpus, if, in view of the essential nature and purpose of the trust, it is apparent that the grantor has failed to part permanently and definitively with the substantial incidents of ownership in the corpus.

In determining whether the grantor is in substance the owner of the corpus, the Act has its own standard, which is a substantial one, dependent neither on the niceties of the particular conveyancing device used, nor on the technical description which the law of property gives to the estate or interest transferred to the trustees or beneficiaries of the trust. In that determination, among the material factors are: the fact that the corpus is to be returned to the grantor after a specific term; the fact that the corpus is or may be administered in the interest of the grantor; the fact that the anticipated income is being appropriated in advance for the customary expenditures of the grantor or those which he would ordinarily and naturally make; and any other circumstances bearing on the impermanence and indefiniteness with which the grantor has parted with the substantial incidents of ownership in the corpus.

Thus the grantor is regarded as being in substance the owner of the corpus if, in any case, the trust amounts to no more than an arrangement whereby the grantor, in the ordering of his affairs, finds it expedient to entrust for a period the title to, and custody or management of, certain of his property to a trustee, the income from such property to be used by the trustee during such period to make those expenditures which the grantor would customarily or ordinarily or naturally make and to which the grantor chooses to commit himself in advance, while the corpus is to be held intact, for return in due course to the grantor. In such a case, it is immaterial that, at the time of the creation of the trust, an irrevocable disposition or consummated gift was made of those property rights which consist of the right to the expected future income of the corpus for the specified period. On the other hand, if the grantor, incident to a definitive and permanent disposition of certain of his property, creates the trust in order to conserve the property, not for himself but for the donees, who will ultimately enjoy it, the provisions of sections 161, 162, and 163 are applicable.

(*c*) For example, a grantor is regarded as remaining in substance the owner of the corpus of the trust, if he has placed it in trust for his son, John.

(A) for the term of three years, at the end of which time the trust might be extended for a like period at the option of the grantor and successively thereafter, but in the absence of such an extension the title is once more to revest in the grantor in possession and enjoyment; or

(B) for the term of a year and a day, then to be distributed to whomsoever the wife of the grantor shall by deed appoint (the wife not having a substantial adverse interest in the disposition of the corpus or the income therefrom); or

(C) for the term of the grantor's life, then to be distributed to John, the grantor reserving, however, the right to alter, amend, or revoke any provision of the trust instrument, upon notice of a year and a day.

In these typical cases the grantor is regarded as having retained the substantial incidents of ownership with respect to the income-producing property since the corpus will or may once more revest in himself in (A) upon the expiration of the trust period if the grantor does not exercise his option to extend the trust, in (B) upon the designation of the grantor as distributee, by a person not substantially and adversely interested, and in (C) upon the revocation of the trust instrument or an alteration or amendment thereof, resulting in the designation of the grantor as distributee.

(*d*) If the grantor is regarded as remaining in substance the owner of the corpus the gross income of such corpus shall be included in the gross income of the grantor, and he shall be allowed those deductions with respect to the corpus as he would have been entitled to had the trust not been created.

If the grantor strips himself of the substantial incidents or attributes of ownership in the corpus retained by him so that he ceases to be regarded as in substance the owner of the corpus, the income thereof realized after the effective date of such divesting is not taxable to the grantor but is taxable as provided in sections 161, 162, and 163.

CHAS. T. RUSSELL,
*Acting Commissioner of Internal Revenue.*

Approved March 7, 1936.

WAYNE C. TAYLOR,
*Acting Secretary of the Treasury.*

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## SECTION 166.—REVOCABLE TRUSTS.

ARTICLE 166–1: Trusts in the corpus of which the grantor retains an interest.

REVENUE ACT OF 1934.

Amendment of Regulations 86, article 166–1. (See T. D. 4629, page 140.)

## SECTION 167.—INCOME FOR BENEFIT OF GRANTOR.

ARTICLE 167-1: Trusts in the income of which the grantor retains an interest. XV-11-7995 Mim. 4435

Income of trust taxable to grantor.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
*Washington, D. C., February 26, 1936.*

*Collectors of Internal Revenue, Internal Revenue Agents in Charge, and Others Concerned:*

Reference is made to the decision of the United States Supreme Court in *Douglas* v. *Willcuts* (296 U. S., 1, Ct. D. 1041, C. B. XIV-2, 250), rendered on November 11, 1935, in which the Court held that the income of the trust created by the taxpayer providing for annual payments out of such income to his wife in lieu of alimony and any other interest in his property or estate was taxable to the husband, the grantor, under the provisions of the Revenue Acts of 1926 and 1928. The trust agreement was executed three days before the wife was granted a decree of absolute divorce in a district court of the State of Minnesota and its provisions were approved by the court and incorporated in the decree. In holding that the trust income was used to pay a legal obligation of the taxpayer, the Court stated in part:

> * * * The creation of a trust by the taxpayer as the channel for the application of the income to the discharge of his obligation leaves the nature of the transaction unaltered. (*Burnet* v. *Wells*, supra.) In the present case, the net income of the trust fund, which was paid to the wife under the decree, stands substantially on the same footing as though he had received the income personally and had been required by the decree to make the payment directly.

On December 9, 1935, the Supreme Court under the authority of its decision in *Douglas* v. *Willcuts*, supra, rendered per curiam decisions reversing the decisions of the circuit courts in the following cases: *Helvering* v. *Edmond O. Schweitzer* (56 S. Ct., 304); *Helvering* v. *Lucy A. Blumenthal* (56 S. Ct., 305); and *Helvering* v. *Francis J. Stokes* (56 S. Ct., 308). In such cases the circuit courts had held that the income of the trust was not taxable to the grantor. The material facts in these cases are as follows:

In *Helvering* v. *Edmond O. Schweitzer*, supra, reversing the Circuit Court of Appeals for the Seventh Circuit (75 Fed. (2d), 702), arising under the Revenue Acts of 1926 and 1928, the taxpayer created trusts for the benefit of his three minor children, the income of which was payable to him to be used solely for their support, maintenance, and education. In *Helvering* v. *Lucy A. Blumenthal*, supra, reversing the Circuit Court of Appeals for the Second Circuit (76 Fed. (2d), 507), arising under the Revenue Act of 1928, the taxpayer created a trust which contained a provision directing the trustee to apply the unpaid accumulated dividends on the stock placed in trust, when paid, toward the liquidation and payment of the principal and interest thereon of a loan obtained by the taxpayer from a bank. The Circuit Court of Appeals for the Second Circuit had looked upon the corpus of the trust as the primary fund for the payment of the debt, the taxpayer standing in the relation of surety only, and had held that the payment of the indebtedness through the satisfaction of the lien had primarily benefited those to whom the corpus belonged. In *Helvering* v. *Francis J. Stokes*, supra, reversing the Circuit Court of Appeals for the Third Circuit (79 Fed. (2d), 256), arising under the Revenue Act of 1928, a trust was created for the maintenance, education, and support of the settlor's children during their respective minorities. The agreement directed the trustee, as each child became 21 years of age or died prior to that time, to transfer the equal share of the fund of such child to the wife of the taxpayer, or if she should not be living, to the taxpayer himself, and if neither should be living, to other persons for the purposes therein expressed.

The provisions of the Revenue Acts of 1926 and 1928 relating to trusts, the income of which inures to the benefit of the grantor, are substantially the same as the corresponding provisions of the Revenue Acts of 1932 and 1934 (section 167). The above-mentioned decisions of the Supreme Court uphold the position which the Bureau is taking under such provisions, which position is expressly stated in article 167-1 of Regulations 86, that is, that in cases in which the income of a trust may be applied to the support of minor children, the payment of alimony, or the discharge of other legal obligations of the grantor, such income is taxable to the grantor. Care should be exercised in the examination of returns involving the question of the proper treatment for Federal income tax purposes of the income of trusts which inures to the benefit of the grantor in order that the examination of such returns and the determination of the tax liability of the taxpayers concerned may be made in accordance with the position of the Bureau.

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CHAS. T. RUSSELL,
*Acting Commissioner.*

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SUPPLEMENT H.—NONRESIDENT ALIEN INDIVIDUALS.

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## SECTION 211.—GROSS INCOME.

ARTICLE 211-7: Exclusion of earnings of foreign ships from gross income. XV-16-8049 I. T. 2969

REVENUE ACTS OF 1928, 1932, AND 1934.

Belgium meets the equivalent exemption provisions of sections 212(b) and 231(b) of the Revenue Act of 1928 (from January 1, 1931), section 212(b) and 231(b) of the Revenue Act of 1932, and sections 211(b) and 231(b) of the Revenue Act of 1934.

ARTICLE 211-7: Exclusion of earnings of foreign ships from gross income. XV-20-8087 I. T. 2975

REVENUE ACTS OF 1932 AND 1934.

Spain does not satisfy the equivalent exemption requirements of sections 211(b) and 231(b) of the Revenue Act of 1934 and the corresponding provisions of the Revenue Act of 1932.

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# TITLE IA.—ADDITIONAL INCOME TAXES.

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## SECTION 351.—SURTAX ON PERSONAL HOLDING COMPANIES.

ARTICLE 351-2: Classification of a personal holding company. XV-17-8057 I. T. 2970

REVENUE ACT OF 1934.

Where a lease of certain land provided that the lessor was entitled to one-eighth of the oil and gas produced from the premises, payments made in 1934 to the lessor by the lessee on account of such one-eighth interest constitute "royalties" within the meaning of that term as used in article 351-2(1) of Regulations 86.

A ruling is requested whether certain payments received by the M Company under an oil and gas lease come within the meaning of the term "royalties" as used in article 351-2(1) of Regulations 86 for the purpose of determining whether that company is a "personal holding company."

On May —, 1929, a lease of certain premises was entered into between the M Company as lessor and the N Company as lessee. Article II of the lease provides for the delivery to the lessor of one-eighth part of the amount of all oil and other substances (except gas produced and saved from the land) and for the sale of all royalty oil by the lessor to the lessee at the price stated. Article III of the lease provides that the lessor shall be entitled to receive and take one-eighth of all gas (in excess of that used by the lessee in operation under the lease) which is saved and utilized from the premises. While the lessee is not obligated to save any gas produced on the premises, it is stipulated that in case the lessee desires to save and utilize the gas the lessee shall have the right to purchase the lessor's royalty share at the price mentioned therein. Article IV of the lease provides as a further consideration for the lease a fixed annual rental of $x$ dollars commencing three years from the date of the lease. It is stated that if the payments under Articles II and III of the lease may properly be treated as rentals and not as royalties the taxpayer would not be a "personal holding company" within the meaning of section 351 of the Revenue Act of 1934.

Article 351-2(1) of Regulations 86 provides in part as follows:

(1) *Royalties.*—The term "royalties" includes amounts received for the use of or for the privilege of using patents, copyrights, secret processes and formulas, good will, trade marks, trade brands, franchises, and other like property. It does not include rents, nor overriding royalties received by an operating company. * * *

The term "rental" must be taken in its usual and ordinary sense, that is, as applying to a fixed sum to be paid at stated dates for the use of property. (*Duffy* v. *Central Railroad Co. of New Jersey*, 268 U. S., 55; *Frank & Seder Co.* v. *Commissioner*, 44 Fed. (2d), 147.) In *J. T. Sneed, Jr.*, v. *Commissioner* (33 B. T. A., 478) it was said: "The word 'royalty' as used in a gas lease generally refers to 'a share of the product or profit reserved by the owner for permitting another to use the property' [citing cases]. It is a compensation for the privilege of drilling and producing oil and gas and consists of a share in the product [citing cases]." Royalties under an ordinary oil and/or gas lease are not paid as fixed rents but for oil and/or gas taken out and do not constitute "rental" within the ordinary meaning of that term. (*State* v. *Hatcher*, 115 Tex., 332, 281 S. W., 192.)

While it is apparent that the fixed annual payments of *x* dollars provided in Article IV of the lease here in question are rents, it is also clear that the payments provided in Articles II and III of the lease are "royalties" within the meaning of that term as used in article 351–2(1), supra.

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## TITLE IV.—EXCISE TAXES.

### SECTION 607.—ENFORCEMENT OF LIABILITY FOR TAXES COLLECTED.

SECTION 607. XV–23–8115
I. T. 2979

REVENUE ACT OF 1934.

Where a deficiency is determined in income tax required to be withheld at the source under the Revenue Act of 1934, deficiency notice will be sent to the withholding agent under the provisions of section 272(a) of that Act.

The Board of Tax Appeals having held in *Sisters of the Third Order of St. Francis of the Diocese of Pittsburgh, Pa.*, v. *Commissioner* (Docket No. 82367, memorandum opinion dated March 11, 1936) that it has jurisdiction with respect to income tax required to be withheld at the source under the Revenue Act of 1934, notice will be issued to the withholding agent by registered mail, as provided by section 272(a) of that Act, in the case of a deficiency in such tax.

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## TITLE V.—CAPITAL STOCK AND EXCESS-PROFITS TAXES.

### SECTION 702.—EXCESS-PROFITS TAX.

SECTION 702. XV–3–7908
G. C. M. 15937

REVENUE ACT OF 1934.

In computing the excess-profits tax under section 702 of the Revenue Act of 1934, the income of a corporation having an income-tax taxable year consisting of a period of less than 12 months due to a change in accounting period should not be placed on an annual basis.

Advice is requested with respect to the excess-profits tax liability of the M Company under section 702 of the Revenue Act of 1934 for the period January 1 to June 30, 1935. The question presented is whether the net income of a corporation should be placed on an annual basis where a return is filed for a period of less than a year due to a change in its accounting period.

The provisions of the Revenue Act of 1934 relating to excess-profits tax read as follows:

SEC. 702. EXCESS-PROFITS TAX.

(a) There is hereby imposed upon the net income of every corporation, for each income-tax taxable year ending after the close of the first year in respect of which it is taxable under section 701, an excess-profits tax equivalent to 5 per centum of such portion of its net income for such income-tax taxable year as is in excess of 12½ per centum of the adjusted declared value of its capital stock (or in the case of a foreign corporation the adjusted declared value of capital employed in the transaction of its business in the United States) as of the close of the preceding income-tax taxable year (or as of the date of organization if it had no preceding income-tax taxable year) determined as provided in section 701. If the income-tax taxable year in respect of which the tax under this section is imposed is a period of less than 12 months, such adjusted declared value shall be reduced to an amount which bears the same ratio thereto as the number of months in the period bears to 12 months. For the purposes of this section the net income shall be the same as the net income for income tax purposes for the year in respect of which the tax under this section is imposed.

(b) All provisions of law (including penalties) applicable in respect of the taxes imposed by Title I of this Act, shall, in so far as not inconsistent with this section, be applicable in respect of the tax imposed by this section, except that the provisions of section 131 of that title shall not be applicable.

Section 702(a) provides that for its purposes the term "net income," as used therein, shall be the same as the net income for income tax purposes. Section 702(a) makes applicable, in so far as not inconsistent therewith, all provisions of law relating to income taxes. Section 47(c) of the Revenue Act of 1934, relating to income taxes, reads as follows:

(c) *Income placed on annual basis.*—If a separate return is made under subsection (a) on account of a change in the accounting period, the net income, computed on the basis of the period for which separate return is made, shall be placed on an annual basis by multiplying the amount thereof by 12 and dividing by the number of months included in the period for which the separate return is made. The tax shall be such part of the tax computed on such annual basis as the number of months in such period is of 12 months.

It will be observed that section 702(b) of the Revenue Act of 1934 states that the income tax provisions of the law shall be applicable in respect of the excess-profits tax "*in so far as not inconsistent with this section* [702]." Section 702(a) provides that if the income-tax taxable year in respect of which the tax under this section is imposed is a period of less than 12 months, the adjusted declared value of capital stock shall be reduced to an amount which bears the same ratio thereto as the number of months in the period bears to 12 months. These provisions are specific and prescribe the exact method by which the computation shall be made. Accordingly, the general provisions of section 47(c), supra, of the Revenue Act of 1934 requiring income to be placed on an annual basis where a return for a period of less than 12 months is filed due to a change in accounting period are not applicable in computing the excess-profits tax under section 702 of the Revenue Act of 1934 for a period of less than 12 months. The correct computation of the tax is as follows:

| | |
|---|---|
| Net income for 6-month period ended June 30, 1935 | $10,000.00 |
| Adjusted declared value of capital stock as of December 31, 1934, $100,000, reduced to a 6-month basis | 50,000.00 |
| 12½ per cent of $50,000 | 6,250.00 |
| Amount subject to excess-profits tax ($10,000 minus $6,250) | 3,750.00 |
| Excess-profits tax, 5 per cent of $3,750 | 187.50 |

In view of the foregoing, it is the opinion of this office that in computing the excess-profits tax under the provisions of section 702 of the Revenue Act of 1934, the income of a corporation having an income-tax taxable year consisting of a period of less than 12 months due to a change in accounting period should not be placed on an annual basis.

(See I. T. 2951, page 469, this Bulletin, for method of computation under the National Industrial Recovery Act. With respect to the case where a corporation dissolves during the taxable year, see I. T. 2817, C. B. XIII-2, 116.)

ROBERT H. JACKSON,
*Assistant General Counsel for the Bureau of Internal Revenue.*

# INCOME TAX RULINGS.—PART II.

REVENUE ACT OF 1932.

## SUBTITLE B.—GENERAL PROVISIONS.

PART II.—COMPUTATION OF NET INCOME.

## SECTION 22(a).—GROSS INCOME: GENERAL DEFINITION.

ARTICLE 51: What included in gross income.

REVENUE ACT OF 1932.

Taxability of income of restricted Indians of the Five Civilized Tribes. (See G. C. M. 16020, page 78.)

ARTICLE 51: What included in gross income.

REVENUE ACT OF 1932.

Taxability of income of restricted members of the Osage Indian Tribe. (See G. C. M. 16100, page 80.)

ARTICLE 51: What included in gross income.

REVENUE ACT OF 1932.

Proceeds of embezzlement. (See G. C. M. 16572, page 82.)

## SECTION 23(c).—DEDUCTIONS FROM GROSS INCOME: TAXES GENERALLY.

ARTICLE 151: Taxes.

REVENUE ACT OF 1932.

Mississippi property taxes. (See G. C. M. 15894, page 90.)

ARTICLE 151: Taxes.

REVENUE ACT OF 1932.

Ohio liquid fuel tax. (See I. T. 2968, page 104.)

ARTICLE 151: Taxes.

REVENUE ACT OF 1932.

Wisconsin chain store tax. (See G. C. M. 16491, page 109.)

## SECTION 23(j).—DEDUCTIONS FROM GROSS INCOME: BAD DEBTS.

ARTICLE 191: Bad debts.

REVENUE ACT OF 1932.

Amendment of Regulations 77, article 191. (See T. D. 4633, page 118.)

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ARTICLE 191: Bad debts.

REVENUE ACT OF 1932.

Charge-offs ordered by bank examiners with respect to real estate taken in settlement of debts. (See I. T. 2985, page 119.)

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### PART V.—RETURNS AND PAYMENT OF TAX.

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## SECTION 55.—PUBLICITY OF RETURNS.

ARTICLE 421: Inspection of returns.

REVENUE ACT OF 1932.

Special Committee Investigating Old Age Pension Organizations, House of Representatives. (See T. D. 4637, page 310.)

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# SUBTITLE C.—SUPPLEMENTAL PROVISIONS.

### SUPPLEMENT A.—RATES OF TAX.

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## SECTION 101.—CAPITAL NET GAINS AND LOSSES.

ARTICLE 501: Definition and illustration of capital net gain. XV–3–7909
Mim. 4409

Property acquired by intestacy or general bequest.—Determination, for capital gain and loss purposes, of period "held by the taxpayer."—Effect of Supreme Court decision.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
*Washington, D. C., December 27, 1935.*

*Collectors of Internal Revenue, Internal Revenue Agents in Charge, and Other Officers and Employees of the Bureau Concerned:*

Reference is made to the decision of the United States Supreme Court, rendered on November 11, 1935, in the cases entitled *Nancy K. McFeely* v. *Commissioner of Internal Revenue*, No. 24; *The United States of America* v. *The First National Bank of Boston et al.*, No. 110; *Commissioner of Internal Revenue* v. *Frances G. Lee*, No. 111; *Rufus R. Rand, Jr.*, v. *Commissioner of Internal Revenue*, No. 439; and *Isabel K. Dibblee* v. *Commissioner of Internal Revenue*, No. 494 (56 S. Ct., 54, Ct. D. 1040, C. B. XIV–2, 209).

The above-mentioned cases arose under section 101 of the Revenue Act of 1928, which permits taxpayers at their option to pay Federal income tax at the rate of 12½ per cent on net gains from the sale or exchange of capital assets. Section 101(c)8 of that Act, so far as material, provides that "'capital assets' means property held by the taxpayer for more than two years * * *." The question presented to the Court was whether property acquired from a decedent by intestacy or by general bequest is, within the meaning of section 101(c)8, held by the taxpayer from the date of the decedent's death or from the date of the distribution of the property. The Court held that in such cases the property was held by the taxpayer from the date of the decedent's death.

In each of the above-mentioned cases the taxpayer sold the property more than two years after the death of the decedent but less than two years after distribution to the taxpayer by the representatives of the decedent's estate. In each case a return was made of the profit from the sale as capital net gain taxable at 12½ per cent, as provided in section 101 of the Revenue Act of 1928.

The Government contended that until actual distribution property can not be said to be held by one having an interest in a decedent's estate, and even if this be not true, section 113(a)5 of the Revenue Act of 1928, making the value at the date of distribution the basis for determining the gain in such cases, requires that the word "held" in section 101(c)8 be construed to set the same date as the time at which the holding begins.

The taxpayers contended that property is, in contemplation of law, held from the date of acquisition, and one deriving property from a decedent's estate through devise, bequest, or intestacy acquires the property at the date of death and holds it from that date; that all prior Acts using similar phraseology have been so interpreted by the Treasury Department; that the reenactment of those Acts without significant change constitutes a legislative confirmation of the administrative interpretation; and that section 113, relating to the basis for determining gain or loss, can not alter the plain meaning of section 101, which prescribes the length of time property must be held in order to constitute a capital asset.

In sustaining the taxpayers' contentions the Court stated in part as follows:

In common understanding to hold property is to own it. In order to own or hold one must acquire. The date of acquisition is, then, that from which to compute the duration of ownership or the length of holding. Whether under local law title to personal property passes from a decedent to the legatee or next of kin at death subject to a withholding of possession for purposes of administration, * * * or passes to the personal representative for the purposes of administration, * * * the title of the beneficiary, though derived through the executor, relating back to the date of death, * * * is for present purposes immaterial. In either case, the date of acquisition within the intent of the Revenue Act is the date of death. * * * [*Brewster* v. *Gage*, 280 U. S., 327, and cases cited.]

* * * * * * *

We are of opinion that section 101(c)8 is clear on its face; that it deals solely with the tenure necessary to claim a rate of 12½ per cent on capital net gain as distinguished from the normal and surtax rate upon ordinary gain; that section 113(a)5 deals only with the basis for the calculation of the tax in cases falling under section 101(c)8; that the sections are not inconsistent; and that each should be read as affecting the subject to which alone it applies.

Inasmuch as section 101 of the Revenue Act of 1932, in so far as material, is substantially the same as section 101 of the Revenue Act of 1928, the rule announced by the Supreme Court in the above-mentioned cases is also applicable to cases arising under section 101 of the Revenue Act of 1932, which in general applies to the taxable years 1932 and 1933.

Inquiries in regard to this mimeograph should refer to the number thereof and the symbols IT: E: RR: CTR.

GUY T. HELVERING,
*Commissioner.*

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SUPPLEMENT B.—COMPUTATION OF NET INCOME.

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## SECTION 112.—RECOGNITION OF GAIN OR LOSS.

ARTICLE 571: Recognition of gain or loss. XV-1-7889
I. T. 2950

REVENUE ACT OF 1932.

I. T. 2773 (C. B. XIII-1, 78) is modified, in view of G. C. M. 15766, page 128.

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## SECTION 116.—EXCLUSIONS FROM GROSS INCOME.

ARTICLE 643: Compensation of State officers and employees.

REVENUE ACT OF 1932.

Taxability of compensation received by officers and employees of a State or political subdivision. (See Mim. 3838, revised, page 130.)

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SUPPLEMENT C.—CREDITS AGAINST TAX.

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## SECTION 131.—TAXES OF FOREIGN COUNTRIES AND POSSESSIONS OF UNITED STATES.

ARTICLE 691: Analysis of credit for taxes. XV-9-7972
G. C. M. 16144

REVENUE ACT OF 1932.

Method of computing the credit for foreign taxes under section 131(a)4 of the Revenue Act of 1932 in the case of an American citizen who has a capital net loss or a capital net gain for the taxable year.

An opinion is requested relative to the method of computing the credit for foreign taxes under section 131(a)4 of the Revenue Act of 1932 where the taxpayer, an American citizen, has a capital net loss or a capital net gain for the taxable year.

The taxpayer, A, is a member of a foreign partnership and his pro rata share of the foreign income taxes paid by the partnership was claimed by him as a credit against his United States tax in accordance with the provisions of section 131(a)4 of the Revenue Act of 1932. The return for the calendar year 1932 disclosed no tax due, since the credit for foreign taxes exceeded the United States tax liability. The taxpayer sustained a capital net loss from sources within the United States which exceeded the ordinary net income, and, consequently, instead of having a net income under section 21 of the Act the taxpayer had a net loss. Nevertheless, he is subject to tax, in view of section 101 of the Revenue Act of 1932, which permits the tax on ordinary net income to be reduced by only 12½ per cent of the capital net loss. In view of this situation, the following questions are submitted:

(1) Where a capital net loss from sources within the United States exceeds the ordinary net income of the taxpayer, may a credit for foreign taxes be allowed?

(2) If the amount of such capital net loss is less than the ordinary net income, should the total net income used in the limiting ratio on the foreign tax credit reflect the capital loss?

(3) Are capital net gains to be included in total net income forming the denominator of the limiting ratio?

Section 131 of the Revenue Act of 1932, in so far as applicable, reads as follows:

SEC. 131. TAXES OF FOREIGN COUNTRIES AND POSSESSIONS OF UNITED STATES.

(a) *Allowance of credit.*—If the taxpayer signifies in his return his desire to have the benefits of this section, the tax imposed by this title shall be credited with:

(1) *Citizen and domestic corporation.*—In the case of a citizen of the United States and of a domestic corporation, the amount of any income, war-profits, and excess-profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States; and

* * * * * * *

(4) *Partnerships and estates.*—In the case of any such individual who is a member of a partnership or a beneficiary of an estate or trust, his proportionate share of such taxes of the partnership or the estate or trust paid or accrued during the taxable year to a foreign country or to any possession of the United States, as the case may be.

(b) *Limit on credit.*—The amount of the credit taken under this section shall be subject to each of the following limitations:

(1) The amount of the credit in respect of the tax paid or accrued to any country shall not exceed the same proportion of the tax against which such credit is taken, which the taxpayer's net income from sources within such country bears to his entire net income for the same taxable year; and

(2) The total amount of the credit shall not exceed the same proportion of the tax against which such credit is taken, which the taxpayer's net income from sources without the United States bears to his entire net income for the same taxable year.

Section 101 of the Revenue Act of 1932 reads as follows:

SEC. 101. CAPITAL NET GAINS AND LOSSES.

(a) *Tax in case of capital net gain.*—In the case of any taxpayer, other than a corporation, who for any taxable year derives a capital net gain (as hereinafter defined in this section), there shall, at the election of the taxpayer, be levied, collected, and paid, in lieu of all other taxes imposed by this title, a tax determined as follows: A partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted and the total tax shall be this amount plus 12½ per centum of the capital net gain.

(b) *Tax in case of capital net loss.*—In the case of any taxpayer, other than a corporation, who for any taxable year sustains a capital net loss (as hereinafter defined in this section), there shall be levied, collected, and paid in lieu of all other taxes imposed by this title, a tax determined as follows: a partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted, and the total tax shall be this amount minus 12½ per centum of the capital net loss; but in no case shall the tax of a taxpayer who has sustained a capital net loss be less than the tax computed without regard to the provisions of this section.

(c) *Definitions.*—For the purposes of this title—

* * * * * * *

(7) "Ordinary net income" means the net income, computed in accordance with the provisions of this title, after excluding all items of capital gain, capital loss, and capital deductions.

The difficulty in applying the provisions of section 131(b) of the Revenue Act of 1932 lies in the interpretation of the words "net income" contained in the limitation on the credit for foreign taxes. In other words, the question is what denominator should be used in arriving at the same proportion of the tax against which such credit is taken which the taxpayer's "net income from sources without the United States bears to his entire net income for the same taxable year." Section 21 of the Revenue Act of 1932 states that "net income" means gross income computed under section 22 less the deductions allowed by section 23. The limitation on the credit for foreign taxes, based on net income, has been in the Revenue Acts since the enactment of the Revenue Act of 1921. (See section 222(a)5 and section 238(a) of the Revenue Act of 1921 and corresponding provisions of subsequent Revenue Acts.) In the Revenue Act of 1921 a provision was made in section 206(b) to permit the taxpayer at his election to be taxed on capital net gains at the rate of 12½ per cent. In section 208 of the Revenue Act of 1924, the provision permitting taxation of capital net gains at the rate of 12½ per cent was retained in section 208(b), and in section 208(c) a limitation was put upon capital net losses by requiring the tax to be first computed on ordinary net income and allowing the tax on ordinary income to be reduced by 12½ per cent of the capital net loss. Thus, although the method of computing income tax due the United States in the case of capital losses was changed in 1924, no corresponding change was made in the Revenue Act of 1924 and subsequent Revenue Acts with respect to the limitation on the credit for foreign taxes. The result is that to apply the provisions of section 131(b) of the Revenue Act of 1932 with a strict interpretation of the words "net income" would in some cases lead to a ridiculous conclusion. If the taxpayer sustained a large capital net loss from sources within the United States, the effect would be to eliminate entirely any tax on income derived from sources within the United States if the denominator based on section 131(b) of the Revenue Act of 1932 is to be considered net income as defined in section 21, that is, gross income under section 22 less deductions allowed by section 23. The real intent of the provision relating to foreign taxes, as contained in section 131 of the Revenue Act of 1932, was to avoid double taxation. It was not the purpose of the law, where the taxpayer derived income from sources within and without the United States, to eliminate the United States tax entirely but only to give the taxpayer a fair proportion of the foreign taxes as a credit. This seems clear from a reading of House Report No. 708, dated March 8, 1932, relating to the Revenue Act of 1932, at page 23, wherein it was stated that "Under section 131(b) of the existing law the credit allowed for taxes paid to foreign countries is subjected to a limitation *in order to prevent foreign taxes from absorbing the tax on income from sources within the United States.*" [Italics supplied.] The scheme of all the Revenue Acts since that of 1916 has been to sweep all income of every sort, including capital gains, into what is denominated gross income and to authorize certain deductions therefrom in order to arrive at net income, the base for calculation of the tax. (*Helvering* v. *Bliss*, 293 U. S., 144, Ct. D. 884, C. B. XIII-2, 191.) Where a taxpayer has a capital net gain, the base of the tax is " net income " for the reason that the tax is not only computed on the ordinary income but is also computed on the capital net gain. Therefore, in arriving at the limitation under section 131(b) of the Revenue Act of 1932 on the credit for foreign taxes, the proportion or fraction would be as follows:

$$\frac{\text{Net income from sources without U. S.}}{\text{Total net income}} \times \text{U. S. tax} = \text{Credit.}$$

Where, however, there is a capital net loss instead of a capital net gain, the base of the tax is not gross income computed under section 22 less deductions allowed by section 23. On the contrary, the base of the computation is the ordinary net income, although the tax on ordinary net income is reduced by a percentage of the capital net loss. Therefore, the limitation under section 131(b) of the Revenue Act of 1932, where there is a capital net loss, would be expressed as follows:

$$\frac{\text{Net income from sources without U. S.}}{\text{Ordinary net income}} \times \text{U. S. tax} = \text{Credit.}$$

The result of the foregoing is to permit in every case a fair allowance for foreign taxes paid where there is income from sources within the United States, but the formulae or fractions shown above do not permit the foreign taxes to absorb entirely the taxes applicable to net income from sources within the United States. The above conclusions do no violence to the statute but give effect to the intention of Congress to avoid double taxation by permitting a credit for foreign taxes and at the same time requiring the taxpayer to pay tax on income derived from sources within this country. In answer to the specific questions submitted, it is held that:

(1) The credit for foreign taxes may be allowed even though a taxpayer has a capital net loss from sources within the United States which exceeds his ordinary net income.

(2) Where such capital net loss is less than the ordinary income, the denominator to be used under section 131(b) of the Revenue Act of 1932 is " ordinary net income."

(3) Where the taxpayer has a capital net gain from sources within the United States, the amount thereof should be included in the denominator of the fraction used as the limitation under section 131(b) of the Revenue Act of 1932, that is to say, the denominator is " total net income."

HERMAN OLIPHANT,
*General Counsel for the Department of the Treasury.*

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ARTICLE 695: Countries which do or do not satisfy the similar credit requirement.

REVENUE ACT OF 1932.

Netherlands Government. (See I. T. 2980, page 140.)

ARTICLE 698: Limitations on credit for foreign taxes. XV-2-7899 G. C. M. 16029

REVENUE ACT OF 1932.

A dividend received by a citizen of the United States on stock of a domestic corporation must be treated as income from sources without the United States, for the purpose of computing the limitation on the credit for foreign taxes under section 131 of the Revenue Act of 1932, if such dividend under section 119 of the Act is defined as income from sources without the United States.

A dividend received by a citizen of the United States from a foreign corporation must be treated as income from sources within the United States, for the purpose of computing the limitation on the credit for foreign taxes under section 131 of the Revenue Act of 1932, if such dividend under section 119 of that Act is defined as income from sources within the United States.

An opinion is requested relative to the computation of the credit for foreign taxes under the following circumstances:

During the year 1932, the taxpayer, a citizen of the United States, received a dividend of $x$ dollars from the M Corporation and a dividend of $2x$ dollars from the O Corporation. The M Corporation is a domestic corporation, incorporated under the laws of the State of R, and during the three preceding years derived its entire gross income from a foreign country. The O Corporation is a foreign corporation and during the three preceding years derived 50 per cent or more of its gross income from sources within the United States. The question submitted makes it necessary to consider the meaning of certain phraseology used in section 119 of the Revenue Act of 1932 and its relationship to similar phraseology contained in section 131 of that Act.

Section 119 of the Revenue Act of 1932, relating to income from sources within the United States, in so far as material, reads as follows:

SEC. 119. INCOME FROM SOURCES WITHIN UNITED STATES.

(a) *Gross income from sources in United States.*—The following items of gross income shall be treated as income from sources within the United States:

* * * * * * *

(2) *Dividends.*—The amount received as dividends—

(A) from a domestic corporation other than a corporation entitled to the benefits of section 251, and other than a corporation less than 20 per centum of whose gross income is shown to the satisfaction of the Commissioner to have been derived from sources within the United States, as determined under the provisions of this section, for the 3-year period ending with the close of the taxable year of such corporation preceding the declaration of such dividends (or for such part of such period as the corporation has been in existence), or

(B) from a foreign corporation unless less than 50 per centum of the gross income of such foreign corporation for the 3-year period ending with the close of its taxable year preceding the declaration of such dividends (or for such part of such period as the corporation has been in existence) was derived from sources within the United States as determined under the provisions of this section;

* * * * * * *

(c) *Gross income from sources without United States.*—The following items of gross income shall be treated as income from sources without the United States:

* * * * * * *

(2) Dividends other than those derived from sources within the United States as provided in subsection (a) (2) of this section.

Section 131 of the Revenue Act of 1932, relating to credit for foreign taxes, reads in part as follows:

(b) *Limit on credit.*—The amount of the credit taken under this section shall be subject to each of the following limitations:

(1) The amount of the credit in respect of the tax paid or accrued to any country shall not exceed the same proportion of the tax against which such credit is taken, which the taxpayer's net income from sources within such country bears to his entire net income for the same taxable year; and

(2) The total amount of the credit shall not exceed the same proportion of the tax against which such credit is taken, which the taxpayer's net income from sources without the United States bears to his entire net income for the same taxable year.

It is the opinion of this office that in applying section 131(b) the territorial source of the taxpayer's income is to be determined by reference to the provisions of section 119. This is the implication of section 131(e) of the Revenue Act of 1932, which provides in part as follows:

The credits provided in this section shall be allowed only if the taxpayer establishes to the satisfaction of the Commissioner (1) the total amount of income derived from sources without the United States, determined as provided in section 119, * * *.

It is also the implication of article 692, Regulations 77, which contains the statement, "As to the meaning of 'sources,' see section 119." Likewise, in enacting the Revenue Act of 1934, Congress assumed that section 119 defined the territorial source of income for the purpose of applying section 131. The report of the Senate Committee on Finance (Report No. 558, on the revenue bill of 1934, page 38) contains the following statement:

An amendment has been made to subsection (a)2(B) of the House bill. Under the House bill dividends from foreign corporations (50 per cent or more of the gross income of which was derived from sources within the United States) are subject both to normal tax and surtax in the hands of an individual and are fully subject to income tax in the hands of a recipient corporation, and at the same time such dividends are taxable in full by the country under the laws of which the corporation is organized. Unless such dividends are treated for credit purposes as income from sources without the United States, a citizen of the United States or a domestic corporation will be unable to take a credit against its Federal income tax for the income taxes paid to a foreign country on such dividends. This follows because of the limitation on the credit for foreign taxes contained in section 131(b) of the House bill. In order to rectify this situation and provide for a credit in such cases, your committee has amended the House bill so that dividends from such foreign corporations will be treated for purposes of section 131 as income from sources without the United States.

Consequently, there was added to section 119(a)2(B) the words "but dividends from a foreign corporation shall, for the purposes of section 131 (relating to foreign tax credit), be treated as income from sources without the United States." It is evident that the amendment to section 119(a)2(B) as it appears in the Revenue Act of 1934 was not regarded as being merely clarifying, but was intended to make a material change in the law.

In view of the foregoing, it is the opinion of this office that in applying section 131 of the Revenue Act of 1932 dividends received from a foreign corporation must be considered as income from sources within the United States if 50 per cent or more of the foreign corporation's gross income for the period prescribed by statute was derived from sources within the United States; and that dividends received from a domestic corporation must be considered as income from sources without the United States if 80 per cent or more of its gross income for the period prescribed by statute was derived from sources without the United States.

From the above it is concluded:

(1) A dividend received by a citizen of the United States on stock in a domestic corporation must be treated as income from sources without the United States, for the purpose of computing the limitation on the credit for foreign taxes under section 131 of the Revenue Act of 1932, if such dividend under section 119 of the Act is defined as income from sources without the United States, and

(2) A dividend received by a citizen of the United States from a foreign corporation must be treated as income from sources within the United States for the purpose of computing the limitation on the credit for foreign taxes under section 131 of the Revenue Act of 1932, if such dividend under section 119 of that Act is defined as income from sources within the United States.

Robert H. Jackson,
*Assistant General Counsel for the Bureau of Internal Revenue.*

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SUPPLEMENT E.—ESTATES AND TRUSTS.

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## SECTION 167.—INCOME FOR BENEFIT OF GRANTOR.

Article 881: Income of trusts taxable to grantor.

REVENUE ACT OF 1932.

Income of trust which inures to benefit of grantor. (See Mim. 4435, page 143.)

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SUPPLEMENT H.—NONRESIDENT ALIEN INDIVIDUALS.

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## SECTION 212.—GROSS INCOME.

Article 1042: Exclusion of earnings of foreign ships from gross income.

REVENUE ACT OF 1932.

Belgium, equivalent exemption. (See I. T. 2969, page 144.)

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Article 1042: Exclusion of earnings of foreign ships from gross income.

REVENUE ACT OF 1932.

Equivalent exemption—Spain. (See I. T. 2975, page 144.)

# INCOME TAX RULINGS.—PART III.

REVENUE ACT OF 1928.

## SUBTITLE B.—GENERAL PROVISIONS.

### PART II.—COMPUTATION OF NET INCOME.

## SECTION 22(a).—GROSS INCOME: GENERAL DEFINITION.

ARTICLE 51: What included in gross income.

REVENUE ACT OF 1928.

Taxability of income of restricted Indians of the Five Civilized Tribes. (See G. C. M. 16020, page 78.)

ARTICLE 51: What included in gross income.

REVENUE ACT OF 1928.

Taxability of income of restricted members of the Osage Indian Tribe. (See G. C. M. 16100, page 80.)

ARTICLE 51: What included in gross income. XV-10-7983
Ct. D. 1087

INCOME TAX—REVENUE ACT OF 1928—DECISION OF COURT.

INCOME—ASSIGNMENT—TESTAMENTARY TRUST.

An assignment, by the life beneficiary of a testamentary trust, of all right, title, and interest in the trust fund was invalid, where the will provided that payments of trust income should be made to the beneficiary without power of anticipation by voluntary or involuntary assignment or otherwise, and trust income paid to the assignee, pursuant to the instrument of assignment, was taxable to the beneficiary.

DISTRICT COURT OF THE UNITED STATES FOR THE DISTRICT OF MASSACHUSETTS.

*Alice S. King* v. *United States of America.*

[November 4, 1935.]

OPINION.

SWEENEY, J.: This is an action at law to recover a deficiency assessment of income tax for the years 1929 and 1930. The point of law involved disposes of the claims for both years as they are filed under the same circumstances. The plaintiff contends that since the petitioner had assigned all of her right, title and interest in a trust fund hereinafter set forth in the agreed statement of facts, and that, not being entitled to income under that trust fund, the income was not taxable to her. The defendant questions the validity of the assignment by the petitioner, and contends that, since the purported assignment was invalid, the income thereunder was income due her within the meaning of section 21 of the Revenue Act of 1928 (26 U. S. C. A., section 2021).

The court adopts as its findings of fact the following agreed statement of facts:

"It is hereby stipulated by and between the parties hereto by their respective attorneys, that the following facts may be taken as true upon the trial of this case, subject to the right of either party to object, on grounds of irrelevancy or immateriality, to any of the facts herein stipulated, and subject further to the right of either of the parties to introduce other and further evidence not inconsistent with any of the facts herein stipulated to be true.

"On December 1, 1913, the will of Henry P. King, late of Beverly, Mass., deceased, was duly proved and allowed in the probate court for the county of Essex. The said will, in so far as pertinent to this case contains the following provisions:

"'All the rest and residue of my property of every nature I give to my trustees hereinafter named upon the following trust, to pay the net income thereof to my wife Alice S. King upon her own sole order or receipt for and during her life and after her death to apply so much of said income for the maintenance and education of my son Henry P. King, Jr., as my trustees shall deem necessary adding the unexpended balance of income to principal until he shall have attained the age of twenty-one (21) years and thereafter to pay over to him as much of the net income of said trust fund as in their absolute discretion my trustees shall decide as best for his interests adding the unexpended balance thereof if any to principal until he shall have attained the age of thirty (30) years and after my said son shall have attained the age of 30 years to pay over to him such part or the whole of the principal of said trust fund at such time or times as my trustees shall in their absolute discretion decide as best for his interests paying over or withholding (or part each) in their discretion the net income of such part or the whole of said trust fund as shall not have been paid over to him as aforesaid and upon the death of my said son to pay over and distribute such of said trust fund as shall not have been previously paid over and distributed to and among his children in equal shares and/or to their issue by right of representation and in case my said son shall die without leaving issue surviving him then to my sister Sarah K. Weld or if she shall be not then living to her children in equal shares and/or their issue by right of representation. I also empower my trustees in case my said son shall marry to pay over during his lifetime to or for the benefit of his wife, or children or both such portion or the whole of the income of said trust fund as my trustees in their absolute discretion shall deem best and in such manner as they deem best. Payments of income hereunder are to be made upon the sole order or receipt of the beneficiary without power of anticipation by voluntary or involuntary assignment or otherwise and free from the control of any creditors.'

"The petitioner in this case is the Alice S. King mentioned in said will. The petitioner and the trustees under the said will and Henry P. King, formerly Jr., all executed a certain instrument on April 1, 1920, in these words:

"'KNOW ALL MEN BY THESE PRESENTS

"'That whereas Henry P. King late of Beverly, Mass., deceased, by his will duly proved and allowed in the probate court, county of Essex, December 1, 1913 (Rec. Book 710, page 42), gave all the rest and residue of his property to his trustees upon trust to pay the net income thereof to his wife Alice S. King for and during her life, and after her death for the benefit of his son, Henry P. King, Jr., and upon certain other trusts therein more particularly set forth, and

"'Whereas said Henry P. King, Jr., has now attained the age of twenty-one (21) years and has married, and I desire to waive in his behalf and release to him absolutely my beneficial life estate under said will.

"'NOW THEREFORE, I, Alice S. King, widow of said Henry P. King, in consideration thereof and of one dollar and other valuable considerations paid by said Henry P. King, Jr., receipt of which is acknowledged, do hereby waive, release and surrender, and in confirmation of such waiver, release and surrender, do hereby assign, transfer and set over unto the said Henry P. King, Jr., all of my said life estate and all my beneficial interest under said trust, and authorize and direct to the trustees hereunder henceforth to pay over to him the income at such times and in such manner as is provided in said will to be paid to me, and I hereby release and discharge the trustees from all liability and obligation to me under said will, and agree to indemnify them and hold them harmless for all liability or damage which they shall incur for any payments made or acts done in consequence hereof.

(Signed) "'ALICE S. KING.

"'In consideration of the foregoing assignment and agreement of indemnity we, William S. Spaulding, John T. Spaulding and Edward M. Weld, trustees under the will of Henry P. King, hereby accept said waiver and assignment and agree to be governed thereby so far as is consistent with the terms of said will.

(Signed) "'WILLIAM S. SPAULDING.
(Signed) "'JOHN T. SPAULDING.
(Signed) "'EDWARD M. WELD.

"'In consideration of the foregoing I, Henry P. King (formerly Henry P. King, Jr.), hereunto set my hand and seal in token of my assent thereto and acceptance thereof.

(Signed) "'HENRY P. KING. [Seal.]

"'APRIL 1, 1920.'

"Said Henry P. King, Jr., was born on January 12, 1898, and is now known as Henry P. King. In pursuance of said instrument the said trustees in the years 1929 and 1930 paid over all the net income from the said trust to the said Henry P. King. The petitioner did not include the said income in her Federal income tax returns for the calendar years 1929 and 1930. With respect to the petitioner's Federal income tax for the calendar year 1929 a deficiency assessment of $4,540.26 was assessed to the petitioner on account of the said income from the said trust for the year 1929. A like deficiency was assessed against the petitioner for the year 1930 in the amount of $2,175.62 on account of the income from the said trust during the year 1930.

"The petitioner is and has been at all material times a citizen of the United States and a resident of Beverly in the Commonwealth of Massachusetts. The petitioner paid the above-mentioned deficiency assessment for the calendar year 1929 on May 18, 1932, and later on August 9, 1932, the petitioner paid $606.65 as interest assessed on said deficiency for 1929. The petitioner paid the amount of the deficiency assessment for the calendar year 1930 on July 1, 1932, and later on August 12, 1932, paid $176.58 as interest assessed on said deficiency for the calendar year 1930. All the aforementioned payments were made to Thomas W. White, collector of internal revenue at Boston, Mass., who was no longer in office as collector of internal revenue when the present petition was brought. On April 17, 1933, petitioner filed claims for refund for the tax years 1929 and 1930 in the respective amounts of $4,540.26 with interest, and $2,175.62 with interest. The said claims for refund alleged the same grounds for the redetermination of tax liability of the petitioner as were set forth in the petition in this case. The petition was filed within two years of the disallowance of the respective claims for refund."

Under these facts it is clear that the decision in this case must turn on the right of the petitioner to alienate the income provided for her by the trust fund.

In deciding this question this court is bound by the Massachusetts decisions as to the validity and construction of a spendthrift trust. (*Warburton* v. *White*, 176 U. S., 484; *Freuler* v. *Helvering*, 291 U. S., 35, 45 [Ct. D. 782, C. B. XIII-1, 242].)

It has long been the settled rule in Massachusetts that a testator may, in creating an equitable interest in a trust fund for another, impose such limitations on the right to alienate or anticipate the fund as may be deemed necessary, and to restrict the fund created from the direct or indirect attachment of creditors. (*Broadway National Bank* v. *Adams*, 133 Mass., 170; *Boston Safe Deposit & Trust Co.* v. *Luke*, 220 Mass., 484; *Haskell* v. *Haskell*, 234 Mass., 442.)

In construing a trust created by a will, recourse must be had to the intent of the testator as expressed in the will. In the instant case the testator set up a spendthrift trust providing that the beneficiary was "without power of anticipation by voluntary or involuntary assignment." Considering the instrument as a whole, it seems obvious that the testator intended to create a trust, the income of which would be paid to the petitioner during her lifetime. Plainly it was intended that she would not have the right to receive other than the income from this fund as it matured, and was without the power to dispose of her future interest in the fund by assignment or otherwise.

The petitioner argues that the prohibition against anticipation by assignment does not in any way limit the power to assign, and that since the power to assign was not denied to her that the conveyance of her interest in the trust to her son was valid. It is difficult to follow this line of argument. Anticipation is defined as "used in the present for what is to accrue; dealing with the income before it is due." (Words and Phrases, Volume I, 216.) The testator particularly set up a limitation against the right of the beneficiary to anticipate or dispose of her future income. He particularly provided that she could not dispose in the present of her future interest. To hold that the assignment here is valid would in effect run counter to the intent of the testator.

The contention of the petitioner that she was in effect merely releasing the trustees from the further obligations of making payments to her under the trust falls to the ground by the force of its own weight, when reference is made to the fact that she directed the trustees to pay her future income to her son.

The third contention of the petitioner is that the assignment if not good as a present assignment was, nevertheless, a binding and unconditional contract under which the petitioner never had an equitable right to the income. It is unsound in the light of the foregoing. Under a valid spendthrift trust such a contract would be invalid. It could not be valid as an assignment of a future interest for the right of anticipation was particularly denied this petitioner.

In view of this decision it is not necessary to pass on the respondent's request for rulings. The petitioner's requests for rulings in so far as they are consistent with this opinion are granted; in so far as they are inconsistent with this opinion are not granted.

The action is dismissed.

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## ARTICLE 51: What included in gross income.

REVENUE ACT OF 1928.

Proceeds of embezzlement. (See G. C. M. 16572, page 82.)

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## ARTICLE 68: Sale and retirement by corporation of its bonds.

XV-11-7996
Ct. D. 1091

INCOME TAX—REVENUE ACT OF 1928—DECISION OF COURT.

1. INCOME—PURCHASE BY CORPORATION OF ITS OWN BONDS.

An operating railroad corporation (on the accrual basis) which purchased some of its own bonds in 1930 at a price less than par, at which they were issued in 1909, realized taxable gain in the year of purchase to the extent of the difference between the par issue price and the lower purchase price.

2. DECISION AFFIRMED.

Decision of the Board of Tax Appeals (31 B. T. A., 62) affirmed.

3. CERTIORARI DENIED.

Petition for certiorari denied October 14, 1935.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

*Montana, Wyoming & Southern Railroad Co., petitioner*, v. *Commissioner of Internal Revenue, respondent.*

Petition for review from the United States Board of Tax Appeals.

Before BUFFINGTON and THOMPSON, Circuit Judges, and JOHNSON, District Judge.

[May 16, 1935.]

OPINION.

*Per curiam:* In this income tax case it appears the taxpayer, an operating railroad corporation, had, in 1909, in the purchase of railroad property, issued $900,000 of its own bonds at par. In the tax year of 1930 it bought back

$55,000 par value of these bonds for $39,832.50. While it has not surrendered such bonds to the trustee for cancellation, it still owns them and by its purchase has proportionately paid such part of its indebtedness. On hearing, the Commissioner held the taxpayer had made a profit of the difference between the par issue price and the lower purchase price. The Tax Board approved the Commissioner's holding, saying "The principle applicable here is that of *United States* v. *Kirby Lumber Co.* (284 U. S., 1 [Ct. D. 420, C. B. X-2, 356]) and *Helvering* v. *American Chicle Co.* (291 U. S., 426 [Ct. D. 809, C. B. XIII-1, 265]), in both of which the taxpayers bought in bonds at less than face value."

Finding no error in the Tax Board's ruling, it is affirmed.

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## SECTION 23(a).—DEDUCTIONS FROM GROSS INCOME: EXPENSES.

ARTICLE 121: Business expenses.

REVENUE ACT OF 1928.

Commissions paid by corporation on sale of stock at or near time of organization. (See Ct. D. 1099, page 198.)

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ARTICLE 121: Business expenses.

REVENUE ACT OF 1928.

Fees of attorneys for prosecution of claims before Mixed Claims Commission. (See Ct. D. 1100, page 172.)

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ARTICLE 121: Business expenses.

REVENUE ACT OF 1928.

Dividends on preferred stock of lessor corporation paid by lessee under guaranty. (See Ct. D. 1125, page 167.)

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## SECTION 23(c).—DEDUCTIONS FROM GROSS INCOME: TAXES GENERALLY.

ARTICLE 151: Taxes.

REVENUE ACT OF 1928.

Revocation of I. T. 2472 (C. B. VIII-1, 74). (See I. T. 2968, page 104.)

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## SECTION 23(e).—DEDUCTIONS FROM GROSS INCOME: LOSSES BY INDIVIDUALS.

ARTICLE 171: Losses.

XV-8-7964
Ct. D. 1081

INCOME TAX—REVENUE ACT OF 1928—DECISION OF COURT.

1. DEDUCTION—LOSS—PURCHASE AND SALE OF SECURITIES—PARENT AND SUBSIDIARY CORPORATIONS.

Where a corporation (not an insurance company), with the evident purpose of bettering the financial standing of its wholly owned subsidiaries (insurance companies), purchased from them certain securities at their original cost, which greatly exceeded their then market value, and immediately sold the securities through brokers at market price, it is not entitled to deduct as a loss the difference between the amount paid for the securities and the price at which they were sold.

2. Decision Affirmed.

Decision of the Board of Tax Appeals (30 B. T. A., 413) affirmed.

3. Certiorari Denied.

Petition for certiorari denied October 14, 1935.

United States Circuit Court of Appeals for the Third Circuit.

*Pennsylvania Indemnity Co., petitioner, v. Commissioner of Internal Revenue, respondent.*

Petition for review from the United States Board of Tax Appeals.

Before Buffington, Davis, and Thompson, Circuit Judges.

[March 27, 1935.]

OPINION.

*Per curiam:* The pertinent facts in this income tax case are as follows: The Pennsylvania Indemnity Co. acquired in 1930 from its wholly owned subsidiaries certain securities having a then market value of $420,051, which it immediately sold through brokers for $420,732.25. For those securities the taxpayer paid $666,967.37 to its subsidiaries. The sole question is whether the taxpayer has a right to deduct $247,637.29 from its gross income, representing the difference between the amount it paid its subsidiaries and the amount ultimately received from resale. The Tax Board held it had no right to deduct; thereupon the taxpayer took this appeal. We are of opinion no error was committed by the Board.

The situation was that the financial standing of the taxpayer's two, wholly owned, subsidiary companies had been, to that extent, impaired by the drop in value of their assets of some $270,000. Evidently with the purpose of restoring such depreciation, the owning company took over the depreciated assets, not at their then market price, but at their original cost price, and immediately sold the same at market price and at a loss of some $246,000. Measured by the ordinary relations of life, it was the old story of a father making good the loss of his son's business and starting him again with an unimpaired capital. The order of the Board is affirmed.

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Article 171: Losses.

XV-11-7997
Ct. D. 1092

INCOME TAX—REVENUE ACT OF 1928—DECISION OF COURT.

1. Deduction—Loss—Sale of Stock—Whether Bona Fide Sale.

Where the taxpayer authorized her husband to deliver to a broker for sale certain shares of stock, with the admitted purpose of establishing a tax loss, her son purchased the stock with borrowed money, within two weeks of the sale the taxpayer gave the son the money to discharge his loan, and within a year the son returned the stock to her without consideration, the alleged sale was not bona fide, and no deductible loss was sustained.

2. Board of Tax Appeals—Findings of Fact—Conclusion of Law.

The facts presented to the Board of Tax Appeals furnished substantial evidence from which it could find that no bona fide sale was made. The Board's finding was not so arbitrary as to constitute a denial of due process and was not contrary to the "undisputed evidence," nor was its conclusion, from the ultimate facts found, unwarranted in law.

3. Decision Affirmed.

Decision of the Board of Tax Appeals (29 B. T. A., 931) affirmed.

4. Certiorari Denied.

Petition for certiorari denied October 14, 1935.

United States Circuit Court of Appeals for the First Circuit.

*Luella Hoyt Slayton, petitioner for review,* v. *Commissioner of Internal Revenue.*

Appeal from Board of Tax Appeals.

Before Bingham, Wilson, and Morton, JJ.

[March 26, 1935.]

OPINION.

Wilson, J.: This is a petition by a taxpayer for a review of a decision of the Board of Tax Appeals under section 1003(a)(b) of the Revenue Act of 1926. It involves a deficiency tax for the year 1928. The deficiency tax was assessed by reason of a refusal by the Commissioner to allow a deduction for a loss of approximately $139,000 due to an alleged sale by the taxpayer of 1,500 shares of stock in the Hoyt Shoe Co. The stock at the time of sale was represented by trust certificates which were transferable. They were a part of a large issue of such certificates which had been issued at the request of bankers, who had in 1927 advanced to the shoe company large sums of money and taken over the management of the company, which at the time was financially embarrassed. Both Mrs. Slayton and her husband held other stock in the company than the shares, the transfer of which has given rise to this controversy.

The Commissioner, upon a report of the facts connected with the sale by the deputy collector as a result of an examination of the taxpayer's return and an investigation of the alleged sale by a Federal revenue agent, disallowed the deductions on the ground that no bona fide sale was made. The Board of Tax Appeals affirmed his finding.

The 18 assignments of error in her petition for review may be summarized as follows: That the Board erred in finding that no *bona fide* sale took place, that its findings do not support its judgment, and that the Board erred in not basing its conclusion on facts supported by "undisputed testimony."

The Board of Tax Appeals is not a court. It is an executive or administrative board, upon the decision of which the parties are given an opportunity to base a petition for review to the courts. (*Old Colony Trust Co.* v. *Commissioner*, 279 U. S., 716, 725 [Ct. D. 80, C. B. VIII-2, 222].) On review the courts may modify or reverse a decision of the Board only when it is not in accordance with law.

In speaking of the scope of review of administrative boards, the Supreme Court in *Phillips* v. *Commissioner* (283 U. S., 589, 600 [Ct. D. 350, C. B. X-1, 264]) said:

"It has long been settled that determinations of fact for ordinary administrative purposes are not subject to review. * * * Such administrative findings on issues of fact are accepted by the court as conclusive if the evidence was legally sufficient to sustain them and there was no irregularity in the proceedings."

In *Tagg Bros. & Moorehead et al.* v. *United States et al.* (280 U. S., 420, 442) the court said:

"It has been settled in cases arising under the Interstate Commerce Act that if an order rests upon an erroneous rule of law (*Interstate Commerce Commission* v. *Diffenbaugh*, 222 U. S., 42), or is based upon a finding made without evidence (*Chicago Junction case*, 264 U. S., 258, 263), or upon evidence which clearly does not support it (*Interstate Commerce Commission* v. *Union Pacific R. R. Co.*, 222 U. S., 541, 547; *New England Divisions case*, 261 U. S., 184, 203; *Colorado* v. *United States*, 271 U. S., 153, 166), the order must be set aside."

In *Interstate Commerce Commission* v. *Louisville & Nashville R. R. Co.* (227 U. S., 88, 91), the court said:

"In the comparatively few cases in which such questions have arisen it has been distinctly recognized that administrative orders, quasi judicial in character, are void if a hearing was denied; if that granted was inadequate or manifestly unfair; if the finding was contrary to the 'indisputable character of the evidence' (*Tang Tun* v. *Edsell*, 223 U. S., 673, 681; *Chin Yoh* v. *United States*, 208 U. S., 8, 13; *Low Wah Suey* v. *Backus*, 225 U. S., 460, 468; *Zakonaite* v. *Wolf*, 226 U. S., 272); or, if the facts found do not, as a matter of law, support the order made."

In *Tracy* v. *Commissioner* (53 Fed. (2d), 575, 578 [Ct. D. 468, C. B. XI-1, 205]) the Circuit Court of Appeals for the Sixth Circuit, in interpreting the decisions of the Supreme Court, well said:

"We assume, therefore, that the court may, and should, in every case in which a hearing was had and evidence was introduced before the Board, look into such evidence to determine whether it was 'legally sufficient to sustain' the findings made. The court need go no further. It is not required to weigh the evidence, or to determine the credibility of witnesses; nor may it usurp the power of administrative decision. * * * The analogy to an appeal in equity, suggested but not adopted in our decision in *Collin* v. *Commissioner* (32 Fed. (2d), 753), can not now be considered a close one. The question of the March 1, 1913, value of property is a question of fact, and a decision of this sort reached by the taxing officer or board within the scope of the authority conferred by law, when made in good faith, and in the absence of gross mistake or other irregularity, has long been held by the courts as conclusive. (Cf. *Hagerty* v. *Huddleston, Hubbard & Co.*, 60 Ohio St., 149, 165, 166.) This is but another way of saying that the decision of the Taxing Board must prevail if it is not contrary to the 'indisputable character of the evidence' or if the evidence is 'legally sufficient to sustain' such finding. The evidence is legally sufficient to sustain the finding if there be substantial evidence to support it, and the record as a whole does not clearly, convincingly, or even possibly, 'indisputably' require a contrary conclusion."

In order to reverse the Board of Tax Appeals under section 1003(b) of the 1926 Act, because it is contrary to law, it must appear that the Board has found the facts on which its decision rests, without any substantial evidence to support its findings; or it has denied the taxpayer a fair hearing, either by refusing to receive relevant and material evidence, or by other arbitrary proceedings; or has erred as a matter of law in the conclusion it reached from the ultimate facts found. A fact found contrary to "indisputable evidence" or without "legally sufficient evidence" is only another way of saying that the finding was without substantial evidence to support it.

It is urged, because the taxpayer in this case testified that, acting upon her husband's advice she indorsed the certificate of stock in question and authorized her husband to deliver it to some broker for sale at a price established by her husband, and that she did not know her son had bought it until her husband told her and asked her if she was willing to give her son the money to pay for it, which she did; and because her son corroborated this testimony, and the Government presented no witness who disputed it; a finding that the sale was not *bona fide* was contrary to the "undisputed evidence" and without any evidence to support it, and was therefore erroneous in law. Oral testimony may be "undisputed," but may not from all the evidence in the case constitute "indisputable evidence."

There are some unusual features to this case which we think warranted the Board in arriving at the conclusion it did. It was not an open, direct sale to a member of the family, as in *Commissioner* v. *Hale* (67 Fed. (2d), 561), in which the purchase was made after sales in the open market, and paid for out of the independent means of the purchaser.

To determine whether the Board's conclusion had support in the evidence, it is necessary to have a clear understanding of the situation of the parties at the time of transfer to the son. The husband, Hovey E. Slayton, became connected with the Hoyt Shoe Co. in 1903, and, after the death of his wife's father, who organized the company, Mr. Slayton became its president, treasurer and general manager. It met financial reverses in 1927 and the management was taken over by a banking house which has advanced large sums of money to enable it to continue. Mr. Slayton then organized a corporation known as the Slayton-Learoyd Co. to take over the sale of the trust shares in the Massachusetts Investors Trust, the agency for which had formerly been handled by the Learoyd, Foster & Co., a brokerage house dealing in these shares and in other stocks.

The son, after graduating from college, worked for a time for the Hoyt Shoe Co., and in August, 1928, was employed or was connected with Learoyd, Foster & Co., and on November 1, 1928, was employed by the Slayton-Learoyd

Co., of which his father was an officer, and which occupied the same offices as Learoyd, Foster & Co.

Mrs. Slayton knew little about the business of the Hoyt Shoe Co. except as she was told by her husband. Her transfer of the stock was at his suggestion and from her testimony he clearly acted as her agent in arranging for the transfer of the shares.

It is significant that the alleged sale was not made direct to the son. Mrs. Slayton apparently did not know to what brokerage house the certificate was given for sale. The husband arranged it all. The son's account of his alleged purchase of the stock was as follows: "I can explain how I came to go to E. M. Hamlin & Co. to buy the securities. When I first spoke to father about buying the stock, I knew that he was anxious to establish it as a tax loss, and I said I was willing to buy the stock at its fair value, which he set on it, and I made arrangements with Learoyd, Foster & Co. to find out where I could take care of that stock, to pick it up as I should, in a legal way, and I left the matter at that time entirely up to them."

Of course, both the father and son knew where it could be "picked up." No adequate reason appears why the son could not have dealt directly with E. M. Hamlin & Co. and borrowed the money of Slayton-Learoyd Co., in which his father was an officer and he was an employee, or his father and mother at the outset could not have given him the money to purchase the stock, except it would not then have had the appearance of a bona fide sale. We think the Board was warranted in finding from the testimony that, while Mrs. Slayton did not know at the time of the sale that arrangements had been made by the husband for the son to buy, she intrusted the entire transaction to her husband to carry it out as her agent, and as a matter of law his knowledge was hers as were his acts. The Board may well have found that the father, through E. M. Hamlin & Co., who sold a like amount of the stock to the son at the same time, delivered his and his wife's certificates to E. M. Hamlin & Co., and that the son, who conferred with the father with reference to the transaction, knew perfectly well where they could be "picked up" when he intrusted the deal to Learoyd, Foster & Co.

Within two weeks of the sale the money was given to the son by Mrs. Slayton to pay for her stock, or to discharge his loan, and before the end of the next year the son returned to each parent without consideration the same shares he had acquired in this manner. It was not necessary for the Board to find that the testimony of Mrs. Slayton, or that of the son, was or was not truthful, and the testimony of counsel has little, if any, bearing on the issue here.

The wife naturally relied on her husband; the husband was advised that by a sale a deductible tax loss could be created. He attempted to perfect it, but from the indirect course taken to bring it about, together with the admitted fact that Mrs. Slayton gave the son the money for the stock, who within a year returned the stock to her without any consideration, furnished substantial evidence from which the Board could find that no bona fide sale was made. It can not be said that there was no evidence to support the findings of the Board, or that it was so arbitrary as to constitute a denial of due process, or was arrived at against "indisputable testimony," or that the conclusion of the Board from the facts found was not warranted in law.

The actual facts and not form is the determining factor in these cases. See *Gregory, Petr.*, v. *Helvering, Commissioner* (decided by the Supreme Court January 7, 1935 [Ct. D. 911, C. B. XIV-1, 193]), involving an alleged *bona fide* reorganization of a corporation to reduce taxation.

The decision of the Board of Tax Appeals is affirmed.

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## SECTION 23(k).—DEDUCTIONS FROM GROSS INCOME: DEPRECIATION.

Article 201: Depreciation. XV-24-8122
(Also Section 23(a), Article 121.) Ct. D. 1125

INCOME TAX—REVENUE ACT OF 1928—DECISION OF COURT.

1. Deduction—Depreciation—Lessor and Lessee Corporations.

Where a railway company leased all its properties for a period of 999 years, the lessee company agreeing to maintain, repair, and renew the leased property during the term of the lease and to return it to the lessor at the termination thereof in good order and condition, neither the lessor nor the lessee is entitled to a deduction for depreciation with respect to the leased property, under section 23(k) of the Revenue Act of 1928, since the lessee had no capital investment therein and the lessor had sustained no loss.

2. DEDUCTION—ORDINARY AND NECESSARY EXPENSE—LOSS—PAYMENTS MADE IN PERFORMANCE OF GUARANTY.

A railroad company which acquired the common stock of another for a stated consideration and agreed to guarantee the payment of dividends on the preferred stock of the latter is not entitled to a deduction in the amount of the payments made in performance of the guaranty, either as an ordinary and necessary expense of the business or as a loss sustained in the course of its operation, since such payments were part of the consideration paid for the common stock and were therefore capital expenditures.

3. DECISION AFFIRMED.

Decision of the Board of Tax Appeals (31 B. T. A., 730) affirmed.

4. CERTIORARI DENIED.

Petition for certiorari denied April 6, 1936.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.

*Atlantic Coast Line Railroad Co., petitioner,* v. *Commissioner of Internal Revenue, respondent.*

*Carolina, Clinchfield & Ohio Railway, petitioner,* v. *Commissioner of Internal Revenue, respondent.*

On petition to review the decisions of the United States Board of Tax Appeals.

Before PARKER, NORTHCOTT, and SOPER, Circuit Judges.

[January 6, 1936.]

OPINION.

SOPER, Circuit Judge: Two questions are presented by the petition for review in these cases—(1) whether either the lessor or the lessee is entitled to a deduction for depreciation under section 23(k) of the Revenue Act of 1928 (45 Stat., 791), when one railroad company leases equipment from another for 999 years and agrees to maintain, repair and renew the property during the term of the lease, and (2) whether a railroad company which acquires the common stock of another in exchange for a stated consideration, including a guaranty to pay dividends on the other's preferred stock, and makes payments under its guaranty, is entitled to deduct the amounts paid as ordinary and necessary expenses or losses under section 23 (a) and (f) of the Revenue Act of 1928. Income taxes for the years 1928, 1929, and 1930 are involved.

Under a lease of October 16, 1924, the Carolina, Clinchfield & Ohio Railway, hereinafter called the Carolina company, and its subsidiaries, leased all their properties to the Atlantic Coast Line Railroad Co., hereinafter called the Coast Line, and the Louisville & Nashville Railroad Co., jointly, for a period of 999 years. The Coast Line owns 51 per cent of the stock of the Louisville & Nashville. The lease provided for the payment by the lessees of money rental in stated amounts, certain corporate expenses of the lessors, interest on outstanding obligations of the lessors, and all taxes upon the lessors or the leased property, including Federal income taxes. In addition thereto, the lessees agreed at their own expense to maintain, repair, renew and replace the leased property so that the same should at all times be in substantial repair, working order and condition, but with the right in their discretion to replace with other property of equal value; to make such additions and betterments as in their judgment should be advisable at their own expense and accept the bonds or other obligations of the lessors therefor; during the term of the lease, to assume all liability of the lessors in respect to maturing obligations as set out in the lease, with the right only to receive new bonds of the lessors payable in effect at the end of the lease and without interest; during the term of the lease to abide by, keep and perform all agreements and covenants binding on the lessors under any of their mortgages, deeds of trust and equipment trust agreements; and to return the leased property at the end of the term or upon earlier termination of the lease in good order and condition, ordinary wear and tear excepted.

Since the effective date of the lease, the accounts of all the railroad companies involved have been kept in accordance with the uniform system of accounts prescribed by the Interstate Commerce Commission pursuant to the authority vested in it by the Interstate Commerce Act. In accordance with this system, no charge has been made on the books of the lessors on account of depreciation computed on the leased equipment, but depreciation has been computed thereon and currently accrued on the books of the lessees.

The taxpayers concede that their tax liability is not controlled by the system of accounts established in accordance with the rules and regulations of the Interstate Commerce Commission; but the Coast Line, one of the taxpayers, seeks to deduct from its gross income an allowance for depreciation with respect to the property in which it had no capital investment but which it held under the lease for 999 years. The Carolina company, the other taxpayer, seeks in the alternative to deduct from its gross income an allowance for said depreciation on the same property which during the term of the lease, the Coast Line was obliged to retain, repair and renew. In our opinion neither position is tenable. It has been uniformly held that where property is leased for a long term of years and the lessee covenants to maintain, repair and renew the property, the lessee is not entitled to an allowance for depreciation because it has invested no capital in the property. (See *Weiss* v. *Wiener*, 279 U. S., 333 [Ct. D. 60, C. B. VIII-1, 257]; *Belt Railway Co.* v. *Commissioner*, 86 F. (2d), 541, certiorari denied, 281 U. S., 742; *Tunnel Railroad Co.* v. *Commissioner*, 61 F. (2d), 166, certiorari denied, 288 U. S., 604.) In respect to the lessor under such a lease, the decisions are also unanimous to the effect that it is not entitled to an allowance for depreciation because it has sustained no loss, in view of the fact that the lessee has assumed an obligation to maintain, repair and renew. (*Commissioner* v. *Terre Haute Electric Co.*, 67 F. (2d), 697 [Ct. D. 838, C. B. XIII-1, 295]; *Georgia Railway & Electric Co.* v. *Commissioner*, 77 F. (2d), 897, certiorari denied, October 14, 1935, 56 Sup. Ct., 117.)

It is suggested by the taxpayers that in none of the cases in which these questions have been considered did the court have before it at the same time both the lessor and lessee railroad, and therefore did not meet the alternative propositions that the allowance for depreciation with respect to the property should be made either to one or the other. The contention that the allowance must be made to one or the other of the parties to such a lease was, however, considered and rejected in *New York Central Railroad Co.* v. *Commissioner* (79 F. (2d), 247, certiorari denied, December 23, 1935), in the following language:

"The petitioner argues that either the lessor or the lessee of property should have a right to deduct a reasonable amount for exhaustion and depreciation, that under the facts at bar the lessor sustains no loss of capital, since he will receive equivalent property upon the termination of the lease, and that therefore the loss falls upon the lessee who has the burden of restoring the property's value. The Commissioner relies upon *Weiss* v. *Wiener* (279 U. S., 333, 49 S. Ct., 337, 73 L. Ed., 720), as did the Board, as establishing that the claimed deductions should not be allowed. There the taxpayer was engaged in the business of taking 99-year leases, renewable forever, and subletting. He claimed a deduction for depreciation of the buildings, which, it was assumed for purposes of the decision, he undertook to keep up to their present condition. In disallowing the deduction, Mr. Justice Holmes pointed out that the lessee had not yet made any capital investment, and concluded that 'it is not enough that he has made a contract that very possibly may not be carried out to replace that capital at some future time.' (279 U. S., 333, at page 336, 49 S. Ct., 337, 338, 73 L. Ed., 720.) Despite possible verbal differences in the leases, we think *Weiss* v. *Wiener* is controlling and requires affirmance of the Board on this issue. In the case at bar the lessee made no capital investment in the leased property."

The facts with regard to the second question raised by the Coast Line relate to an agreement of February 23, 1926, between the Coast Line and a committee representing the bondholders of the Atlantic, Birmingham & Coast Railroad Co. which was placed in receivership in 1915, and operated by the receiver up to and including the year 1926. During the taxable years involved, all of its stock was owned by the Coast Line and its income tax returns were included in the consolidated returns filed by the latter. The agreement of February 23, 1926, provided that a new company should be organized to acquire the property of the company in receivership which should have a capitalization of $5,200,000 par value preferred stock entitled to 5 per cent cumulative dividends, payable semiannually, and 150,000 shares of no par value common stock; that the preferred stock should have no power to vote except in case of a continuing default in the payment of two semiannual dividends, in which event the preferred stock should have exclusive voting power so long as the default continued; that the dividends of the preferred stock should be guaranteed by the Coast Line; that the Coast Line should provide cash for certain specified requirements in the total amount of approximately $3,600,000 and that the Coast Line should be entitled to receive the entire issue of common stock in exchange for the cash so provided. The agreement was performed and the stock of the company distributed as therein provided. During each of the years 1928, 1929, and 1930, the Coast Line in compliance with its guaranty, paid the dividends on the preferred stock, including the sum of $257,059 to owners thereof other than the Coast Line itself. In its returns for these years, it claimed the said sum as a deduction, but it was disallowed by the Commissioner.

The taxpayer contends that the obvious purpose of this agreement was to place it in a position to maintain and exercise continuous control of the properties of the A., B. & C. Railroad Co. and to operate these properties as a part of its railroad system. It is pointed out that the taxpayer acquired nothing new or in addition to what it already had by the payments, and that each payment preserved for the six months' period the existing right to exclusive voting control over the affairs of the A., B. & C. Railroad and the management of its property. It is therefore contended that the payments were a regularly recurring expense necessary to preserve control over the physical operations of a part of the taxpayer's railroad system, and should be regarded either as an ordinary and necessary expense of the business or as a loss sustained in the course of its operation.

The argument is not without persuasive force, but we are of opinion that the payments made by the Coast Line under its guaranty were part of the consideration paid by it for the common stock and were therefore capital expenditures rather than losses or ordinary and necessary business expenditures. In *Newark Milk & Cream Co.* v. *Commissioner* (34 F. (2d), 854), a dispute between two sets of stockholders of a corporation was settled by an agreement whereby one set acquired the stock formerly held by the other; and as part of the agreement, the corporation guaranteed a return of 8 per cent upon the consideration so paid for its stock for a period of 10 years. It was held that the amounts paid under this guaranty by the corporation were not deductible from income as an ordinary and necessary business expense, but constituted part of the price paid by the stockholders who acquired the business in order to get control of the company.

The Coast Line contends that if a similar view is adopted in the present case, it will be impossible to determine the basic cost of the stock now or at any particular time in the future, and since the Coast Line would not be relieved from the obligation of its guaranty by a sale, the transaction could never be closed for tax purposes. This consideration, however, would not necessarily determine the character of the expenditures made under the guaranty, nor would any practical difficulty arise in the determination of the gain or loss by the taxpayer for purposes of taxation in case of a sale. If such a sale should take place, the cost of the stock would then be determined by reference to the cash outlay made under the agreement in 1926, including therein such amounts as would have been paid in the performance of the guaranty, and the profit or loss could be calculated accordingly. If additional payments under the guaranty should subsequently be required, they would be deductible as losses for the year in which they should occur.

The decisions of the Board of Tax Appeals are affirmed.

# SECTION 23(n).—DEDUCTIONS FROM GROSS INCOME: CHARITABLE AND OTHER CONTRIBUTIONS.

ARTICLE 262: Donations by corporations. XV–14–8027
Ct. D. 1101

INCOME TAX—REVENUE ACT OF 1928—DECISION OF COURT.

1. DEDUCTION—ORDINARY AND NECESSARY EXPENSE—CONTRIBUTIONS TO COMMUNITY CHEST.

A corporation publishing a newspaper, which took aggressive leadership in and made substantial contributions to a Community Chest campaign in 1929 and 1930, was not entitled to deduct the amounts of the donations as ordinary and necessary expenses, within the meaning of section 23(a) of the Revenue Act of 1928, although its attitude no doubt materially aided in the maintenance of its good will and the expenditure may have had an advertising value.

2. DECISION REVERSED.

Decision of the Board of Tax Appeals (28 B. T. A., 762) reversed.

3. CERTIORARI DENIED.

Petition for certiorari denied October 21, 1935.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.

*Guy T. Helvering, Commissioner of Internal Revenue, petitioner*, v. *Evening Star Newspaper Co., respondent.*

On petitions to review the decision of the United States Board of Tax Appeals.

Before SOPER, Circuit Judge, and MCCLINTIC and HAYES, District Judges.

[June 10, 1935.]

OPINION.

HAYES, District Judge: This is an appeal by the Commissioner of Internal Revenue from a decision of the Board of Tax Appeals, reported in 28 B. T. A., 762, and involves the right of the Evening Star, a corporation publishing a newspaper, to deduct as "ordinary and necessary expenses" within the meaning of section 23(a) of the Revenue Act of 1928 contributions to the Washington Community Chest in the years of 1929 and 1930.

The taxpayer publishes the Evening Star, a newspaper of the largest circulation and having more than half the advertising business in the city of Washington. Its circulation in 1929 was 105,978 daily and 111,076 Sunday, yielding advertising revenue of $2,211,722, and in the year 1930, the figures were 110,018, 115,389, and $2,068,442 respectively.

The Community Chest was sponsored by 57 charitable agencies for the purpose of making an appeal to the people of Washington to support the enterprise for the charitable needs of the city. In the campaign for each year, the taxpayer took the aggressive leadership through the news and editorial columns and in addition contributed $20,000 and $25,000 in 1929 and 1930 respectively. Its net income as determined by the Commissioner, for 1929 was $1,382,530.88 and for 1930, $1,061,122.54.

The Board of Tax Appeals decided that the taxpayer was entitled to deduct these contributions as necessary and ordinary expenses.

In *Old Mission Portland Cement Co.* v. *Helvering* (293 U. S., 289 [Ct. D. 903, C. B. XIV–1, 332]), Mr. Justice Stone says: "The privilege of deducting donations from gross income, conferred on individual taxpayers by section 214(a) of the Revenue Acts of 1921, 1924, and 1926, has not been extended to corporations.

"A proposal to extend it to them was rejected by Congress pending the passage of the Revenue Act of 1918. (Congressional Record, House, Volume 56, Part 10, 10426–10428.) Section 234(a)1 of the Revenue Acts of 1921, 1924, and 1926 authorizes corporations to deduct from gross income 'all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business.'

"Article 562 of the Treasury Regulations 62, interpretative of the 1921 Act, declared that corporations were not entitled to deduct charitable donations. But it recognized the right to deduct donations 'made by a corporation for purposes connected with the operation of its business * * * when limited to charitable institutions, hospitals or educational institutions conducted for the benefit of its employees,' and also donations 'which legitimately represent a consideration for a benefit flowing directly to the corporation as an incident of its business.'

"These provisions were retained, without substantial change, in the regulations promulgated under the 1924, 1926, and 1928 Acts. (Article 562 of Treasury Regulations 65, 69; article 262 of Treasury Regulations 74.) As section 234(a)1 to which they pertain has been reenacted in several Revenue Acts, the regulation now has the force of law. (*McCaughn* v. *Hershey Chocolate Co.*, 283 U. S., 488, 492 [Ct. D. 345, C. B. X-1, 444]; *Massachusetts Mutual Life Insurance Co.* v. *United States*, 288 U. S., 269, 273 [Ct. D. 638, C. B. XII-1, 286].)

"It is a question of fact in each case whether a donation is made to an institution conducted for the benefit of the donor's employees or is consideration for a benefit flowing directly to the donor as an incident of its business."

The taxpayer contends the contributions were a "consideration for a benefit flowing directly to the donor as an incident of its business." The manager and the associate editor in substance stated that they do not know whether the Star sold any more papers because of its support of the Community Chest; nor do they have definite information as to how much advertising resulted from the contribution; but, while they have no way of showing, they think definitely the result was a larger sale of papers; the prestige of the paper was enhanced and, having urged others to give until it hurt, its prestige would have suffered if it had not contributed in a liberal manner.

Whether the contributions resulted in an increase in the circulation or advertising of the Star, and, if any, to what extent, is of necessity, mere conjecture. The evidence falls far short of establishing either proposition. If any benefit, in either respect, did accrue, it is so indirect and remote that it can not rise to the dignity of being substantial, nor warrant a finding that the donations involved were, in a genuine sense, necessary and ordinary expenses within the meaning of section 23 of the Revenue Act of 1928, or of the Treasury Regulations 74. It is not enough that the expense be necessary; it must be ordinary and necessary. (*Welch* v. *Helvering*, 290 U. S., 111 [Ct. D. 755, C. B. XII-2, 112].)

The taxpayer's attitude no doubt materially aided in the maintenance of its good will. Such would be the effect on any paper published in that or another city, although in a different degree. But the act was a contribution by a corporation. Congress did not authorize a corporation to deduct charitable contributions. The taxpayer advertised it as a donation laying claim, by its act, to a response of a generous impulse; giving until it hurts, by example, in order that its precept might be effective. There was no suggestion of a reward desired or anticipated. Certainly the expenditure was not an ordinary and necessary expense, although it may have had an advertising value. (*Eitigon-Schild Co.*, 21 B. T. A., 1163.)

The decision of the Board of Tax Appeals is reversed.

Reversed.

## PART IV.—ACCOUNTING PERIODS AND METHODS OF ACCOUNTING.

## SECTION 41.—GENERAL RULE.

ARTICLE 321: Computation of net income. XV-14-8028
(Also Section 23(a), Article 121; Section 131, Ct. D. 1100
Article 691.)

INCOME TAX—REVENUE ACT OF 1928—DECISION OF COURT.

1. INCOME—PAYMENT OF AWARDS—RETURN OF CAPITAL.

Amounts received in 1928 by the taxpayer, who had been a member of a banking house in Germany, in part payment of awards of the Mixed Claims Commission in respect of accounts to his credit in German banks during the war period (the awards representing capital, and interest from January 1, 1920, to January 1, 1928), constituted a return of capital and no part thereof was taxable as income, in view of evidence showing the improbability of the receipt of further payments. Principle announced in *Burnet* v. *Logan* (Ct. D. 351, C. B. X-1, 345; 283 U. S., 404) followed.

2. INCOME—COLLECTIONS CREDITED PRIOR TO JULY 2, 1921—CASH RECEIPTS AND DISBURSEMENTS BASIS.

Collections of interest, dividends, and profits made by German banks, and credited to the taxpayer's accounts therein prior to July 2, 1921, can not be taxed as received in 1928 or any subsequent year, his books having been kept on the cash receipts and disbursements basis.

3. DEDUCTION—ATTORNEYS' FEES.

The entire amount of attorneys' fees paid in 1928 for prosecution of taxpayer's claims before the Mixed Claims Commission was deductible as a business expense, under the provisions of section 23(a) of the Revenue Act of 1928.

4. DEDUCTION—CREDIT—TAXES OF FOREIGN COUNTRY.

Income taxes for 1916 assessed against the taxpayer by the German Government and paid during the following four years, and deducted from the award entered by the Mixed Claims Commission in 1926, were not allowable as a credit or deduction in 1928 under the provisions of sections 23(c) and 131 of the Revenue Act of 1928, those sections limiting the credit or deduction to taxes paid or accrued within the taxable year.

5. DECISION AFFIRMED.

Decision of the Board of Tax Appeals (30 B. T. A., 517) affirmed.

6. CERTIORARI DENIED.

Petition for certiorari denied October 28, 1935.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

*Commissioner of Internal Revenue, petitioner,* v. *James Speyer, respondent.*

*James Speyer, petitioner,* v. *Commissioner of Internal Revenue, respondent.*

Petitions to revise a determination of the Board of Tax Appeals (30 B. T. A., 517). Both the Commissioner and the taxpayer file petitions. Determination affirmed.

Before MANTON, SWAN, and CHASE, Circuit Judges.

[June 10, 1935.]

OPINION.

MANTON, Circuit Judge: In 1928, the taxpayer, pursuant to the Settlement of War Claims Act (45 Stat., 254), received $485,912.43 part payment on account of awards of the Mixed Claims Commission (United States and Germany). The awards were made in respect of reichsmark accounts to his credit in German banks during the World War period. The awards were $996,738.47 principal, and $397,775.52 interest from January 1, 1920, to January 1, 1928. The principal of the awards contained interest, dividends and profits credited to the taxpayer's account in the German banks prior to July 1, 1921. The taxpayer contended and the Board of Tax Appeals held that the amount paid was in part restoration of the principal and not taxable income.

The taxpayer was in the banking business in New York City, with a partner, in April, 1917. He was also a member of a banking house at Frankford-on-Main, Germany. At this time the New York firm had mark accounts with various banks in Germany. April 4, 1917, the taxpayer withdrew from the German firm. He had five accounts in marks with his German firm. The interest of his partner in the New York City partnership was assigned to him December 31, 1923. The taxpayer's books were kept on a cash basis.

German war legislation resulted, August 9, 1917, in the extension of a moratorium to debts payable to persons in the United States. A decree of November 10, 1917, resulted in the restriction on sales, assignments and charges of enemy owned property and it became applicable to persons of the United States. January 30, 1918, a decree provided that property of United States residents would be taken over for administration by the German Government. Under the German law a bank account deposit creates a debtor-creditor relationship between a depositor and his bank. The accounts of this taxpayer were never taken over under the decree authorizing the Treuhander to do so. The accounts were continued in the name of the taxpayer, and that of his New York firm, throughout the war period.

Before the Mixed Claims Commission, appointed pursuant to statute, after controversy, a compromise was reached between the agent of Germany and our Government, whereby Germany assumed a joint liability with the German banks in respect to the mark balances. By the terms of that agreement, these awards were made to the taxpayer. By the War Claims Act (45 Stat., 254) means of payment of awards were provided. Section 4(c) lists priorities of payment. The amounts received and the disbursements made, as the record discloses, indicate a very long delay—estimated at 24 years—before this taxpayer would be paid in full the amount of his award. Moreover, upon convincing evidence, the Board of Tax Appeals conclusion that there is not only a lack of certainty of future payments, but that it is highly probable that the taxpayer will never receive any substantial part of that which is due him, is justified.

The taxpayer's capital investment in the bank accounts on which the award was based was $1,228,748.28. Of the payment received—$485,912.43—the Commissioner determined $181,535.45 was taxable income. This conclusion was reached by analyzing the taxpayer's capital, interest on the awards from January 1, 1920, to January 1, 1928, and interest, dividends and profits paid into the bank accounts in Germany prior to December 31, 1920. The Commissioner treated the interest on the awards, and the interest, dividends and profits paid into the bank accounts, as income, and on this basis found that the awards stated as of January 1, 1928, were made up of 61 per cent capital and 39 per cent income. He then determined that as each payment is made out of the German special deposit fund on the awards it would contain 39 per cent taxable income. In this manner he arrived at the amount of income and taxed it accordingly. The Board of Tax Appeals disagreed.

The taxpayer's capital in the bank accounts was far in excess of the payment received in 1928. In order to arrive at gain or loss, there must be withdrawn from the gross proceeds an amount sufficient to restore capital that existed at the commencement of the period under consideration. (*Eisner* v. *Macomber*, 252 U. S., 189 [T. D. 3010, C. B. 3, 25]; *Doyle* v. *Mitchell Bros. Co.*, 247 U. S., 179.) In *Drier* v. *Helvering* (72 Fed. (2d), 76 (C. A. D. C.)), the court considered income tax on an award of the Mixed Claims Commission. The award made on August 1, 1928, amounted to $68,782.70, of which $48,000 was principal and $21,128, interest. At the time of the seizure of Drier's property, it was worth $68,782.70. The value of the taxpayer's property at the time it was acquired by her was equal to the sum received by her under the award of the Claims Commission; the total sum received was sufficient only to restore the capital value that existed at the commencement of the period under consideration, and the court held that there was no realized gain and no income tax assessable.

In the instant case, the Board found that there was no reasonable prospect of the full amount being paid. In *Automobile Insurance Co. of Hartford* v. *Commissioner* (72 Fed. (2d), 265), the taxpayer keeping its books on an accrual basis, received 80 per cent of the amount due as an award of the Mixed Claims Commission and we held that it was entitled to accrue the difference for that year. The case is distinguishable because this taxpayer kept his books on a cash basis. Moreover, the record in the Automobile Insurance company case contained no evidence showing the improbability of receiving further payments from Germany, as is shown in the instant case and as found by the Board.

In *Burnet* v. *Logan* (283 U. S., 404) [Ct. D. 351, C. B. X-1, 345], the court considered the attempt of the Commissioner to base income tax on a speculative assumption wherein he determined the value of the seller's promise to pay 60 per cent a ton for ore mined. Adding this value to the cash, the Commissioner then deducted the seller's basis for the stock and found the taxable profits. The court held there would be no taxable income until actual receipts by the seller exceeded his basis for the stock. We think the same principle is applicable here.

The taxpayer rightfully contends that the items collected by the German banks which consisted of interest, dividends and profits paid and credited to the taxpayer's accounts prior to July 2, 1921, and which the taxpayer did not report in his Federal income tax returns for the year when collected, could not be taxed as received in 1928. The reason advanced for not reporting these taxes was the lack of means of communication between Germany and the United States during the period of the war and for some time thereafter. The taxpayer was not advised of their deposit. These items collected by the German bank and deposited to the credit of the taxpayer in the accounts were received in the years such deposits were made and accordingly could not be treated as income to this taxpayer in 1928 or any subsequent year. Accordingly, the decision of the Board of Tax Appeals, that of the payment received in 1928 no part thereof is taxable income, is affirmed.

The Commissioner's appeal also involves the deductibility of the attorneys' fees charged as a business expense and disbursements under section 23(a). The Commissioner determined that a portion of the attorney's fees allocable to what he concedes to be the taxpayer's capital in the awards, is not deductible as an expense for the reason that it is a capital charge. This contention was rejected by the Board of Tax Appeals which held that the full amount was deductible from gross income in accordance with the provisions of section 23(a) of the Revenue Act of 1928. It must be remembered that this taxpayer had a banking house in Germany where balances were kept. The cost of the recovery of these balances through the Mixed Claims Commission comes directly within the specifications of deductions for expenses. The proceedings before the Mixed Claims Commission were for the purpose of recovering assets for the taxpayer. It is not questioned but that the attorneys were paid the amounts claimed in connection with the transaction of this business. Such fees are deductible as an expense of the business. (*Kornhauser* v. *United States*, 276 U. S., 145 [T. D. 4222, C. B. VII-2, 267].)

The taxpayer appeals from the determination of the Board of Tax Appeals disallowing deduction in 1928 for taxes paid to the German Government in behalf of the taxpayer from 1917 to 1920. During that period, without the taxpayer's consent or knowledge, the German partnership paid to Germany, and charged the taxpayer's personal accounts on its books, $59,805.31 for income taxes assessed against the taxpayer on the German income for 1916. In the claim filed with the Mixed Claims Commission in 1922, the taxpayer asked for an award for the mark balance in his capital account on December 31, 1916, with the German partnership, plus interest. The commission, in 1926, entered an award for that amount, stated in dollars, less the amount owing by the taxpayer to the German partnership which included the German taxes paid. The taxpayer maintains that this balancing of the accounts with the German partnership had the effect of forcing him to pay the taxes in 1928. The taxpayer relies on section 23(c) and section 131 of the Revenue Act of 1928, as authority for a credit and deduction for payment of foreign taxes, but those sections limit the deductions to taxes paid or accrued within the taxable year. The taxable year here involved was 1928; these taxes accrued in 1916, and were paid during the following four years. Such deductions must be taken in the year of their occurrence. (*Darling* v. *Commissioner*, 49 Fed. (2d), 111; *DeLoss* v. *Commissioner*, 28 Fed. (2d), 803.)

The determination is affirmed.

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## ARTICLE 321: Computation of net income.

XV-14-8029
G. C. M. 16166

REVENUE ACT OF 1928.

No taxable income is derived by taxpayers from awards of the Mixed Claims Commission, United States and Germany, under the Settlement of War Claims Act of 1928, until there has been a recovery by the taxpayers of their capital bases, if any.

G. C. M. 9210 (C. B. X-1, 129) and G. C. M. 9466 (C. B. X-1, 133) modified.

Reference is made to the court decisions in *Commissioner* v. *Speyer* and *Commissioner* v. *Ullmann* (77 Fed. (2d), 824, and 77 Fed. (2d), 827), respectively, certiorari denied, 56 S. Ct., 155. In those cases the Circuit Court of Appeals for the Second Circuit affirmed the decisions of the Board of Tax Appeals and held that no taxable income was received by the taxpayers (whose accounts were kept on the cash receipts and disbursements basis) as the result of awards of the Mixed Claims Commission, United States and Germany, under the Settlement of War Claims Act of 1928 until the taxpayers had received a return of their capital bases. The circuit court declined to follow G. C. M. 9210 (C. B. X–1, 129), in which it was held that in determining the amount of taxable income derived by taxpayers on the cash receipts and disbursements basis from payments received pursuant to the Settlement of War Claims Act the Bureau should ascertain the part of the award so received which represents interest upon the principal of the award accruing prior to January 1, 1928, the part attributable to interest included in the principal of the award, and the part attributable to the amount awarded as compensation for the property seized or destroyed by Germany during the war and giving rise to the award in question; and that the part attributable to interest constitutes taxable income to the recipient in the year in which the taxpayer on the cash receipts and disbursements basis receives such amount, but that no income is realized with respect to the part attributable to the amount awarded as compensation for the property taken until there has been a recovery of the capital basis, if any.

The position taken by the Circuit Court of Appeals for the Second Circuit is in accord with the position of the United States Court of Appeals for the District of Columbia in *Drier* v. *Helvering* (72 Fed. (2d), 76) and the Circuit Court of Appeals for the Fourth Circuit in *Helvering* v. *Drier* (79 Fed. (2d), 501).

In view of the foregoing, G. C. M. 9210, supra, which deals with taxpayers on the cash receipts and disbursements basis, and G. C. M. 9466 (C. B. X–1, 133), which deals with taxpayers on the accrual basis, are modified to hold that no taxable income is derived by taxpayers from awards of the Mixed Claims Commission, United States and Germany, under the Settlement of War Claims Act of 1928 until there has been a recovery by the taxpayers of their capital bases, if any.

Herman Oliphant,
*General Counsel for the Department of the Treasury.*

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## SECTION 42.—PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

Article 331: When included in gross income. XV–8–7965
Ct. D. 1082

INCOME TAX—REVENUE ACT OF 1928—DECISION OF COURT.

1. Income—Discounts—Method of Accounting.

A trust company filed returns for 1929 and prior years, using a combination of the cash receipts and disbursements method and the accrual method, and treating discounts on commercial paper as income at the time the loans were made, irrespective of the date of payment. Later it filed an amended return for 1929 on the cash receipts and disbursements basis, reporting all discounts actually received in 1929, which resulted in the inclusion of discounts accrued and reported in 1928. The discounts received in 1929 were properly included in gross income for that year, under section 42 of the Revenue Act of 1928 and article 331 of Regulations 74, it not being shown that there had been any reasonable consistency in the treatment of items of gross income in prior years or that the method of accounting used in 1928 clearly reflected income for that year.

2. CERTIORARI DENIED.

Petition for certiorari denied October 14, 1935.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

*Mount Vernon Trust Co., petitioner, v. Commissioner of Internal Revenue, respondent.*

Petition to review a decision of the United States Board of Tax Appeals.

Before L. HAND, SWAN, and CHASE, Circuit Judges.

[March 11, 1935.]

OPINION.

This proceeding involves income taxes for the year 1929. The taxpayer seeks to review a decision of the Board sustaining the action of the Commissioner in including in gross income items of discount received in 1929 which had been reported as accrued income in the taxpayer's return for 1928. Order affirmed.

SWAN, Circuit Judge: The question presented by this appeal is whether the Commissioner properly included in the petitioner's gross income for 1929 certain discounts received in that year which had been reported as accrued income for the year 1928 and were used in computing the 1928 tax. From the stipulated facts it appears that in conducting its business as a trust company the petitioner, among other things, discounts commercial paper. Up to and including 1928 the petitioner used a method of accounting which was a combination of the cash receipts and disbursements method and the accrual method; that is, some items of income or expense were recorded when received or disbursed, while others were recorded when earned or incurred irrespective of the date of payment. Discounts were treated as income at the time loans were made, whether payment of such discounts was made then or later. The petitioner's income tax returns for 1928 and prior years were made in accordance with the method of accounting above described and were accepted and closed by the Commissioner without objection thereto. The original return for 1929 was made on the same basis as the returns for former years, but subsequently an amended return for 1929 was filed on the cash receipts and disbursements basis. This was done without having obtained the prior consent of the Commissioner, but he audited the return for 1929 on the basis of cash receipts and disbursements. In its amended return the petitioner reported all discounts actually received in 1929, regardless of the time as of which they accrued, and this resulted in including discounts of $146,133.33 which had accrued in 1928 and had been reported in the return for that year. In other words, this sum was included as income in both years and has been twice taxed. This duplication was called to the Commissioner's attention by a claim for refund, but the claim was rejected and a deficiency for 1929 was determined based on other adjustments which are not here involved. The petitioner claims an overpayment of some $16,500. A closing agreement under section 606 of the Revenue Act of 1928 has been entered into, precluding the petitioner from claiming any refund on account of the 1928 tax.

The petitioner contends that this is a case where the change from one proper basis of reporting income to another proper basis has resulted in a duplication of items in successive years, and that the Commissioner has, and should exercise, discretionary power to eliminate such duplication. The respondent, on the other hand, contends that this is merely a case where the taxpayer is seeking to correct an error in the 1928 tax, which arose from the use of an improper and "hybrid" system of accounting, by the exclusion of income from the year 1929, in which year it is properly taxable.

If we were faced with a case in which a taxpayer on an accrual basis for an earlier year was forced to duplicate items of income for the ensuing year when he went upon a cash basis, we should find the petitioner's argument very persuasive. It is unlikely that Congress intended that a change in the taxpayer's method of bookkeeping should result in double taxation, and it may well be that section 42 of the Revenue Act of 1928 (45 Stat., 805) and article 322 of Regulations 74 should be construed to give the Commissioner power to eliminate the duplication of items under such circumstances. (See *National Bank of South Carolina* v. *Lucas*, 36 F. (2d), 1013 (App. D. C.).) The recent decision of this court in *Chemung Canal Trust Co.* v. *Commissioner*, January 7, 1935, in which we affirmed without opinion the decision of the Board of Tax Appeals reported in 30 B. T. A., 230, did not decide this question, for there the taxpayer kept his books on a cash basis in both years. Nor do we find it necessary to decide it now.

The petitioner kept its books for the year 1928 on an amorphous basis. Its counsel suggests that the items recorded on the cash basis may have been few, but the record does not bear this out. "Some items of income or expense" were recorded on the cash basis, while "others" were recorded on the accrual basis. For all that appears the method of accounting may have been a hotchpot of cash and accrual items. Taken literally section 41 seems to recognize any "method of accounting regularly employed in keeping the books" of the taxpayer, provided that it should "clearly reflect the income." (See *Morris-Poston Coal Co.* v. *Commissioner*, 42 F. (2d), 620, (C. C. A. 6); compare *Niles Bement Pond Co.* v. *United States*, 281 U. S., 357, 361 [Ct. D. 185, C. B. IX-1, 295].) But the regulations (article 322, Regulations 74) contain the following provision:

"ART. 322. *Bases of computation.*—Approved standard methods of accounting will ordinarily be regarded as clearly reflecting income. A method of accounting will not, however, be regarded as clearly reflecting income unless all items of gross income and all deductions are treated with reasonable consistency."

This is a proper and valid regulation. When section 41 speaks of "the method of accounting" it can not mean to include a merely haphazard division between cash and accrual bases. (Compare *United States* v. *Mitchell*, 271 U. S., 9 [T. D. 3865, C. B. V-1, 233]; *United States* v. *Anderson*, 269 U. S., 422 [T. D. 3839, C. B. V-1, 179]; *Aluminum Castings Co.* v. *Routzahn*, 282 U. S., 92 [Ct. D. 270, C. B. X-1, 352].) A different situation might be presented if the record showed that the books of the petitioner were kept on an accrual basis with some exceptions of small items which were entered only when paid and received. See article 342, Regulations 74, which recognizes that "particularly in a going business of any magnitude there are certain overlapping items both of income and deductions, and so long as these overlapping items do not materially distort the income they may be included in the year in which the taxpayer, pursuant to a consistent policy, takes them into his accounts." The present record does not disclose that there was any "reasonable consistency" in the treatment of items of gross income, "some" were on the cash basis and "others" on the accrual basis. Therefore the petitioner has not shown that the discounts were properly included in its 1928 return and that its method of accounting clearly reflected its income for that year. Consequently, under section 42 and article 331 of Regulations 74 the discounts received in 1929 were properly included "in the gross income for the taxable year in which received by the taxpayer," and the case becomes like *Chemung Canal Trust Co.* v. *Commissioner*, supra, and a mistake in the 1928 return can not be offset by excluding from 1929 income properly returnable in that year. *National Bank of South Carolina* v. *Lucas* (36 F. (2d), 1013 (App. D. C.)), upon which the petitioner strongly relies, was treated by the court as a case in which the taxpayer's books were properly kept upon an accrual basis "in so far as matters here are concerned." From the facts appearing in the Board's opinion (10 B. T. A., 642) it would seem that the only items treated on the accrual basis were items of discount. We should find difficulty in agreeing with the conclusion that those were properly returned in the earlier year (see *Chemung Canal Trust Co.* v. *Commissioner*, supra), but in any event the case is not precisely in point since in the appeal at bar the record fails to disclose that only discounts were accrued; as already stated the petitioner's method may have been a complete hotchpot of the cash and accrual bases.

It is urged that the Commissioner's acceptance of the returns for 1928 and prior years is a recognition that the method used in those years was proper, but no estoppel can arise against the Commissioner from his acceptance of the return. In *Niles Bement Pond Co.* v. *United States* (281 U. S., 357, 362) a similar argument was rejected, with the suggestion that the failure of the Commissioner to correct the return may as well be attributable to error or oversight or lack of information as to his opinion of the propriety of the item. (See also *J. C. Nichols Land Co.* v. *Commissioner*, 65 F. (2d), 437, 438 (C. C. A. 8); *Tonningsen* v. *Commissioner*, 61 F. (2d), 199, 200 (C. C. A. 9) [Ct. D. 669, C. B. XII-1, 251]; *Bonwit Teller & Co.* v. *Commissioner*, 53 F. (2d), 381, 384 (C. C. A. 2).)

The order is affirmed.

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ARTICLE 331: When included in gross income. XV-25-8130
(Also Section 43, Article 342.) G. C. M. 16730

REVENUE ACT OF 1928.

Where A, who kept his books on the cash receipts and disbursements basis, received income under a claim of right and without restriction as to its disposition, such income was properly reported in his income tax returns for the years in which received, although he was subsequently required to pay the amount to another. He is, however, entitled to a deduction for the amount of such payment for the year in which paid.

G. C. M. 1582 (C. B. VI-1, 171) modified. Recommended that O. D. 825 (C. B. 4, 95) and I. T. 1164 (C. B. I-1, 17) be revoked and that O. D. 1141 (C. B. 5, 134) be modified.

An opinion is requested whether certain profits included in the taxpayer's income tax returns for the years 1928 and 1929 should be eliminated therefrom because in a later year he was required to account for such profits to another.

In 1928 the taxpayer, A, who kept his books on the cash receipts and disbursements basis, was a director of the M Company. In that year it was essential for the M Company to acquire rights to manufacture under certain basic patents and it was believed that such rights might be acquired through the N Company, then in receivership. It developed that this purpose might be accomplished by the M Company acquiring *y* shares of N Company stock. Later it appeared that the M Company could not raise the funds with which to purchase this stock (or so it was claimed) and the stock was acquired by a number of persons, including the taxpayer, who made large profits in 1928 and 1929 dealing in the shares. The M Company later went into bankruptcy and the trustee brought suit against the taxpayer and his associates to compel them to account for the profits realized from their dealings in the N Company stock. The basis of the suit was that the profit was made in violation of the defendants' fiduciary duty as officers and agents of the M Company. The taxpayer denied liability. The trial court decided in favor of the defendants but its decree was reversed by the circuit court as against the taxpayer and certain other defendants. Certiorari was denied by the United States Supreme Court.

The taxpayer reported as income for the years 1928 and 1929 his profits from the sale of the stock, but now contends that such profits should be eliminated from income for those years because of the adverse judgment rendered in a later year.

It is well settled that when a taxpayer receives earnings under a claim of right and uses them as his own, he has received income which he is required to return, for Federal income tax purposes, in the year of receipt even though another may be asserting a right to those earnings and may subsequently, by litigation or otherwise, compel him to pay them over. (*North American Oil Consolidated* v. *Burnet*, 286 U. S., 417, Ct. D. 499, C. B. XI–1, 293; *Board* v. *Commissioner*, 51 Fed. (2d), 73, certiorari denied, 284 U. S., 658; *Trojan Oil Co.* v. *Commissioner*, 26 B. T. A., 659.)

In *North American Oil Consolidated* v. *Burnet*, supra, the taxpayer, in 1916, was operating certain oil properties legal title to which stood in the name of the United States. The Government, claiming also the beneficial ownership, instituted suit to oust the taxpayer from possession and in 1916 secured the appointment of a receiver to operate the property and to hold the net income thereof. In 1917 a decree was entered dismissing the bill and the money impounded was paid to the defendant corporation. The Government took an appeal, which was not finally determined until 1922. The court held that the taxpayer should report the amount as income for 1917, when it collected it, and not for 1922, when its right was finally established. In so holding the court said:

* * * If a taxpayer receives earnings under a claim of right and without restriction as to its disposition, he has received income which he is required to return, even though it may still be claimed that he is not entitled to retain the money, and even though he may still be adjudged liable to restore its equivalent. (See *Board* v. *Commissioner*, 51 F. (2d), 73, 75, 76. Compare *United States* v. *S. S. White Dental Mfg. Co.*, 274 U. S., 398, 403.) If in 1922 the Government had prevailed, and the company had been obliged to refund the profits received in 1917, it would have been entitled to a deduction from the profits of 1922, not from those of any earlier year. (Compare *Lucas* v. *American Code Co.*, supra.)

*Board* v. *Commissioner*, supra, affords another illustration of the rule that income received under a claim of right and without restriction as to disposition must be reported in the year of receipt. In that case corporation O sold all of its assets and went into liquidation. At that time O had entered into a contract for the construction of a pipe line. The other party to the contract was unable to finance his part of the agreement. The project was taken over by the liquidating trustees and two other officers and constructed on the joint credit of O and those individuals. Upon the sale of the properties of O the liquidating trustees distributed a part of the proceeds to the officers and other liquidating trustees in 1920. Certain stockholders contested this distribution and filed an action which was not finally settled until 1927. In holding that the taxpayer was required to report the amount as income for 1920 rather than for 1927, the court stated in part as follows:

We are of the opinion that the Board was right in allocating this income to the year 1920. That it was actually received during that year is not disputed; nor is it disputed that it was received under a claim of right and as profits to which the petitioner was justly entitled. The only claim made is that the contract whereby petitioner purported to secure his interest in the pipe line was illegal and unenforceable by reason of his position as a director of the Old Dominion Oil Co. In this contention the petitioner of course never acquiesced. The payment was never refunded. Possibly it might have been recovered in the litigation which was instituted for that purpose, but it was not, and it is at least unusual that a taxpayer should be heard to assert the possibility of an adjudication of alleged misconduct and breach of trust, as relieving him from tax liability which is predicated upon the assumption of the honesty and legality of his acts. Obviously, the sum involved must be considered as income either for the year 1920 or 1927, and we think that it

**must be allocated to the year 1920, in which it was actually received, rather than to the year 1927, in which the taxpayer's right to retain it was established.**

In the Trojan Oil Co. case a similar conclusion was reached under circumstances closely analogous to those presented in *North American Oil Consolidated* v. *Burnet*, supra, although the litigation terminated in a later year unfavorably to the taxpayer. The Board commented as follows:

Although in the instant case more than one year's earnings were impounded and the litigation was decided in favor of the Government, we think the decision in the *North American Consolidated* case governs in this case. * * *

In the instant case the taxpayer received the income under a claim of right and without restriction as to its disposition. On authority of the cases cited herein, this office is of the opinion that the profits in question should not be eliminated from the taxpayer's gross income for the years 1928 and 1929, but that the taxpayer is entitled to a deduction, for the year in which paid, of the amount of the profits paid to the trustee for the M Company.

G. C. M. 1582 (C. B. VI–1, 171) is modified in so far as it is inconsistent with the views herein expressed. It is recommended that O. D. 825 (C. B. 4, 95) and I. T. 1164 (C. B. I–1, 17) be revoked and that O. D. 1141 (C. B. 5, 134) be modified in so far as it is inconsistent with the views herein expressed.

HERMAN OLIPHANT,
*General Counsel for the Department of the Treasury.*

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ARTICLE 332: Income not reduced to possession.

REVENUE ACT OF 1928.

G. C. M. 9466 (C. B. X–1, 133) modified. (See G. C. M. 16166, page 175.)

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## SECTION 43.—PERIOD FOR WHICH DEDUCTIONS AND CREDITS TAKEN.

ARTICLE 342: When charges deductible.

REVENUE ACT OF 1928.

Income included in return required to be paid to another. (See G. C. M. 16730, page 179.)

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## SECTION 45.—ALLOCATION OF INCOME AND DEDUCTIONS.

SECTION 45. XV–16–8050
Ct. D. 1105

INCOME TAX—REVENUE ACT OF 1928—DECISION OF COURT.

1. INCOME—ALLOCATION—SALES BETWEEN DOMESTIC AND FOREIGN CORPORATIONS OF A RELATED GROUP.

The petitioner, a domestic corporation whose stock was owned by two foreign corporations, sold at cost certain property which had appreciated in value to a foreign corporation, the stock of which was owned by the same interests that owned petitioner's stock, and on the following day the foreign purchaser sold the property to a domestic corporation at a substantial profit, both sales taking place outside the United States. The provisions of section 45 of the Revenue Act of 1928 are applicable to these facts, and the profits from the ultimate sale were properly allocated to the petitioner. The legislative purpose of the section was to prevent the avoidance of tax or the distortion of income by shifting profits from one related trade or business to another by means of transactions such as these.

2. CONSTITUTIONALITY.

Section 45 of the Revenue Act of 1928 as applied to the facts in this case is not unconstitutional as depriving the taxpayer of property without due process of law. It does not measure the tax of one corporation by the income of another, but looks through form to reality.

3. DECISION AFFIRMED.

Decision of the Board of Tax Appeals (31 B. T. A., 1152) affirmed.

4. CERTIORARI DENIED.

Petition for certiorari denied November 25, 1935.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

*Asiatic Petroleum Co. (Delaware), Ltd., petitioner,* v. *Commissioner of Internal Revenue, respondent.*

Petition to review an order of the United States Board of Tax Appeals.

Before MANTON, SWAN, and CHASE, Circuit Judges.

[August 16, 1935.]

OPINION.

The taxpayer, Asiatic Petroleum Co. (Delaware), Ltd., seeks reversal of an order determining a deficiency in its income tax for the year 1929. Order affirmed.

SWAN, Circuit Judge: This case was heard by the Board upon stipulated facts, which included a stipulation that if the Commissioner was correct in applying section 45 of the Revenue Act of 1928 (45 Stat., 806) there was a deficiency of $303,083 in the petitioner's tax for the year 1929; otherwise there was no deficiency. The Board sustained the Commissioner.

The agreed facts are these. Two foreign corporations, one organized under the laws of the Netherlands (called Royal Dutch) and the other under the laws of Great Britain (called British Shell), owned respectively 60 and 40 per cent of the stock of another Netherlands corporation (called Bataafsche) and of the petitioner (hereafter referred to as Asiatic). Neither Royal Dutch nor British Shell has ever done any business in the United States other than holding stock of domestic corporations. Bataafsche deals in petroleum products in various parts of the world other than the United States. Asiatic is a Delaware corporation, organized in 1920, and has always been a holding company engaged in holding the stocks of various subsidiary corporations. For the year 1929 Asiatic filed a consolidated return, for itself and its subsidiaries, which omitted to include any profit from the transactions now to be described. Asiatic owned 39,997 shares of a Louisiana corporation (referred to as Norco) and on January 8, 1929, contracted in London, England, to sell said Norco shares to Bataafsche for the price of $3,999,700, which was the cost basis of the stock to Asiatic. Payment was made in London, and on the following day, January 9, 1929, the stock certificates, properly indorsed in blank, were delivered to a representative of Bataafsche in Montreal, Canada. On the same date Bataafsche sold and delivered in Montreal said Norco shares to a Delaware corporation known as Shell Union for the sum of $6,755,000. No part of the purchase price paid by Shell Union was ever received by Asiatic. Bataafsche owned 59 per cent or more of the voting stock of Shell Union. On May 3, 1929, Shell Union sold said Norco shares to Shell Petroleum Corporation of St. Louis, a Virginia corporation whose stock was wholly owned by Shell Union, for $6,755,000. Thereupon Shell Petroleum took over the assets and liabilities of Norco and caused the latter to be dissolved before the end of

1929. The profit of $2,755,300 realized by Bataafsche upon its sale of the Norco shares to Shell Union was allocated by the Commissioner to Asiatic by applying to the foregoing facts the provisions of section 45 of the Revenue Act of 1928. This produced the deficiency complained of, which the Board of Tax Appeals confirmed.

The statute under which the Commissioner purported to act reads as follows:

"SEC. 45. *Allocation of income and deductions.*—In any case of two or more trades or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Commissioner is authorized to distribute, apportion, or allocate gross income or deductions between or among such trades or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such trades or businesses."

The petitioner contends that section 45, properly interpreted, is inapplicable to the facts of this case, and, if applied, is unconstitutional.

Section 45 authorizes the Commissioner to make an allocation of gross income among businesses controlled by the same interests in order (1) to prevent evasion of taxes, or (2) clearly to reflect the income of any of such businesses. The substance of the two contemporaneous sales above described was to transfer the Norco stock to Shell Union at a price of $6,755,000, and it can scarcely be doubted that the intermediate sale to Bataafsche, made abroad and at the cost basis of the stock to Asiatic, was devised for the purpose of avoiding income taxes on the profit of $2,755,300, to which Asiatic would concededly have been subject had it sold direct to Shell Union at the price which the latter paid. Since the parent corporations had the same stock ownership in both Asiatic and Bataafsche, it would be a matter of indifference to the beneficial owners of the profit whether it was realized by the one subsidiary or the other. But the petitioner contends that, assuming a purpose to avoid taxes, the Commissioner can not justify his allocation to Asiatic of the profit realized by Bataafsche on the ground of preventing an "evasion of taxes," because that phrase is not the same as avoidance of taxes. It is argued that "avoidance" connotes escape from taxation by avoidance of the receipt of income, while "evasion" connotes an effort to escape taxation by one who has received taxable income, and is conduct criminally punishable under section 146(b) of the Revenue Act of 1928. By selling to Bataafsche at cost what it might have sold to Shell Union at a profit, Asiatic avoided the receipt of income; hence, it is urged, it did not evade any tax, and section 45 is inapplicable on the basis of tax evasion. We can not accept so narrow a construction. Asiatic had an actual profit (excess of value over cost) before the sale to Bataafsche, though as yet unrealized for income taxation. The phrase "evasion of taxes" is broad enough to include the avoidance of the realization for taxation of such a profit through its transfer to another branch of the same business enterprise in a way which only changes its place in the business set-up. That such was the meaning ascribed to it during the progress of the bill through Congress is evident from the committee reports which explain that evasion may be attempted "by the shifting of profits, the making of fictitious sales, and other methods frequently adopted for the purpose of 'milking.'" (H. Rept. No. 2, Seventieth Congress, first session, page 16; S. Rept. No. 960, Seventieth Congress, first session, page 24; see also 69 Congressional Record, part 2, page 1068.)

Section 45, although it has no exact counterpart in earlier legislation, is based on the consolidated return provisions of section 240(d) of the Revenue Acts of 1921 and 1924 and section 240(f) of the Revenue Act of 1926. Upon the fact that the committee reports explaining section 240(d) of the 1921 Act (H. Rept. No. 350, Sixty-seventh Congress, first session, page 14; Report No. 275, Sixty-seventh Congress, first session, page 20) refer to foreign subsidiaries as a frequently employed method of "milking" the parent company or otherwise improperly manipulating its financial accounts, and that the committee reports regarding section 45 also mention "milking," the petitioner bases an argument that the "milking" at which the legislation was aimed, is only that of a domestic parent by a foreign subsidiary, so that section 45 has no application when the parent is a foreign corporation or, as in the present case, two such corporations. But we see nothing in the language or in the purpose of the statute to justify giving it so restricted a meaning. An evasion or avoidance of taxes may be accomplished when a foreign subsidiary "milks" a domestic subsidiary of the common foreign parent as well as when it "milks" a domestic parent. The statute is designed to frustrate the one abuse no less than the other.

A more substantial contention with respect to interpreting section 45 turns on the meaning of the words "gross income." The Commissioner is authorized to allocate gross income among trades or businesses under the specified statutory conditions. If there is no gross income, there is nothing to allocate. It is argued that the profit realized by Bataafsche on the sale of the Norco stock to Shell Union was not "gross income" within the definition of that term contained in the Revenue Act of 1928, since section 231(a) provides that "In the case of a foreign corporation gross income includes only the gross income from sources within the United States," and under section 119(e) Bataafsche's profit was income from sources without the United States. It is true that for the purpose of imposing taxes on a foreign corporation "gross income" has a more limited meaning than is given it in the general definition contained in section 22, and it is likewise true that Bataafsche realized no taxable profit. But Bataafsche did realize a profit which falls within the general definition of gross income in section 22. Bearing in mind the abuses at which section 45 was directed, we agree with the Board that "gross income" should be given its broader meaning whether the income to be allocated be received by a foreign or a domestic corporation. Section 45 is not concerned with whether the recipient of gross income is a corporation or whether, if it be, it is a domestic or a foreign corporation. It speaks in terms of two or more trades or businesses, "whether or not incorporated" and "whether or not organized in the United States," and the implication is clear that "gross income" means the same whether it be received by a business organized within or without the United States. The legislative purpose was to prevent the avoidance of taxes or the distortion of income by the shifting of profits from one business to another by means of such transactions as this record presents.

The final argument against the applicability of the statute is that Asiatic is purely a holding company and so not engaged in a trade or business. This is based upon the stipulation in the agreed statement of facts that "the petitioner is and always has been a holding company, engaged in holding the stocks of various subsidiary corporations." It is not clear from this language that Asiatic is solely a holding company and does nothing else. In its 1929 return its "kind of business" is stated to be "petroleum and petroleum products." But if it be assumed that it was purely a holding company and conducted the business of dealing in petroleum products solely through subsidiaries, we think this was a "business" within the meaning of section 45. It can hardly be thought that Congress intended to leave holding companies free to avoid taxes and subjected only their subsidiaries to the terms of the statute. The cases relied upon by the petitioner are quite beside the mark since they deal with statutes of very different import.

For the foregoing reasons we are satisfied that section 45 is applicable to the facts at bar. It remains to consider the contention that, so applied, it is unconstitutional.

The argument is that the profit was Bataafsche's, and that to allocate it to Asiatic is nothing more than an effort to tax one person on the income of another, which results in a deprivation of property without due process of law. (*Hoeper* v. *Tax Commissioner*, 284 U. S., 206; *Heiner* v. *Donnan*, 285 U. S., 312 [Ct. D. 473, C. B. XI–1, 324].) The Hoeper case held invalid a State statute which required the income of the wife to be added to the income of the husband and taxed the latter upon the aggregate income. The Heiner case held invalid a provision of the Federal estate tax law which requires that gifts by the decedent within two years of his death must be deemed transfers made in contemplation of death. This was unconstitutional because in effect it measured the decedent's estate tax by the property of his donee. We do not regard either case as opposite to the situation now before the court. Here Asiatic had potential income, the value in excess of cost of the Norco stock. True, it was not taxable income until realized in money. In order to avoid the receipt by Asiatic of taxable income, the potential income was transferred without consideration to Bataafsche, a foreign corporation, in whose hands the realized profit would not be taxable. The transferee and the transferor had the same stockholders so that it was immaterial to the beneficial owners of the potential income whether it was realized by one business or the other. Legislation which declares that under such circumstances the transferor shall be taxed just as though the potential income had been realized by it, does not, in our opinion, deprive the taxpayer of property without due process of law. Such a statute seems as appropriate a provision for enforcing a general scheme of lawful taxation, and no more difficult to sustain against constitutional attack, than the legislation under consideration in *Taft* v. *Bowers* (278 U. S., 470 [Ct. D. 49, C. B. VIII-1, 226]). It does not measure the tax of one person by the income of another, as in *Hoeper* v. *Tax Commissioner*, supra; rather, it looks through form to reality, and recognizes that the appreciation in value during the transferor's ownership of the property (when realized for the benefit of the real owners, the stockholders) should be ascribed to the transferor rather than to the transferee. Even without such a statute as section 45, many cases have gone very far in disregarding formal transfers introduced into corporate transactions for the purpose of escaping taxation. (See *S. A. Macqueen Co.* v. *Commissioner*, 67 F. (2d), 857 (C. C. A. 3) [Ct. D. 830, C. B. XIII-1, 266]; *Penn. Indemnity Co.* v. *Commissioner*, 77 F. (2d), 92 (C. C. A. 3); *Helvering* v. *Gen. Utilities & Operating Co.*, 74 F. (2d), 972 (C. C. A. 4); *Taylor Oil & Gas Co.* v. *Commissioner*, 47 F. (2d), 108 (C. C. A. 5); *Hellebush* v. *Commissioner*, 65 F. (2d), 902 (C. C. A. 6) [Ct. D. 776, C. B. XIII-1, 268].) If anticipatory arrangements intended to circumvent taxes may be disregarded by the courts without the aid of statutory authority, a statute authorizing the Commissioner to disregard them under similar circumstances can not be unconstitutional. It is true, as the Supreme Court recently stated in *Gregory* v. *Helvering* (293 U. S., 465 [Ct. D. 911, C. B. XIV-1, 193]), that a taxpayer is privileged "to decrease the amount of what would otherwise be his taxes, or altogether avoid them, by means which the law permits." But there is no suggestion in that opinion, or in the authorities upon which it relies, that a statute would be unconstitutional which took away this privilege. At least under the conditions specified in section 45, we are satisfied that it may be taken away. Order affirmed.

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## PART V.—RETURNS AND PAYMENT OF TAX.

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## SECTION 55.—PUBLICITY OF RETURNS.

### ARTICLE 421: Inspection of returns.

REVENUE ACT OF 1928.

Special Committee Investigating Old Age Pension Organizations, House of Representatives. (See T. D. 4637, page 310.)

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## SECTION 56.—PAYMENT OF TAX.

### ARTICLE 432: Extension of time for payment of the tax or installment thereof.

XV-7-7954
Ct. D. 1078

INCOME TAX—REVENUE ACT OF 1928—DECISION OF COURT.

SUIT—BOND—EXTENSION OF TIME FOR PAYMENT OF TAX—AUTHORITY OF COLLECTOR—ESTOPPEL.

Where, at the taxpayer's request, the collector granted an extension of time for payment of overdue installments of tax, in consideration of the execution of a bond, running to the United States, to secure payment within the extended period, the surety company is estopped, in an action on the bond after the taxpayer's failure to pay, to claim that the bond was invalid on the ground that the collector had no authority, under section 56(c) of the Revenue Act of 1928, to grant the extension.

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UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

*The United States of America, appellant, v. Fidelity & Deposit Co. of Maryland, a Corporation, appellee.*

Upon appeal from the District Court of the United States for the Southern District of California, Central Division.

[October 23, 1935.]

OPINION.

WILBUR, Circuit Judge: This is an action by the United States on a bond given on February 24, 1931, by the Fidelity & Deposit Co. of Maryland to the collector of internal revenue to secure the payment of two overdue installments of the internal revenue tax on income due from the Hellman Investment Co. for the calendar year 1929, the tax not having been paid. Judgment was rendered for the defendant on demurrer from which the Government appeals.

The total tax was $235,920.30, the third installment of $58,980.07 was due September 15, 1930, and the fourth installment of the tax was due December 15, 1930. The collector was demanding payment and the taxpayer requested an extension of time to September 15, 1931. This extension was granted in consideration of the execution of the bond in question for the sum of $135,000, running to the United States as obligee, wherein it was agreed that the appellee, hereinafter called the "Surety company," would pay the tax in the event that the Hellman Investment Co. failed to do so. Having thus secured the desired extension the taxpayer has failed to pay the tax and the Surety company defends upon the ground that the collector had no authority to grant the extension, and therefore that the extension was not effective, and consequently that there was no consideration for the bond although the collector in fact refrained from any attempt to enforce the tax until after September 15, 1931. The complaint herein was filed August 22, 1932.

The contention of the Surety company, sustained by the trial court, is based upon section 56(c) of the Revenue Act of 1928 (ch. 852, 45 Stat., 791), which authorizes the Commissioner of Internal Revenue to "extend the time of payment of the amount determined as the tax by the taxpayer, or any installment thereof, for a period not to exceed six months from the date prescribed for the payment thereof." That this provision limits the power of the Commissioner in the granting of extensions is not questioned. The appellee contends that this limitation also applies to the collector of internal revenue who is charged with the duty of collecting the tax after the tax roll leaves the hands of the Commissioner, or rather, its contention is that the collector has no power to extend the time for the collection of the tax because he is charged with the duty of immediate collection, citing 26 U. S. C. A., sections 2, 14, 34, 102, 103, 104, and 2056, in support of this contention. Appellee states: "The underlying fallacy in appellant's entire position as set forth in its brief * * * is that the collector of internal revenue has the power in the exercise of his own discretion to grant extensions of time for the payment of income taxes for such period as he may determine."

The validity of a bond given to a collector of internal revenue to secure the payment of a tax then due in consideration of further time to pay the tax has been repeatedly sustained. In a late case by this court we sustained such a bond. (*Hughson* v. *United States*, 59 F. (2d), 17, citing *Roberts Sash & Door Co.* v. *United States*, 38 F. (2d), 716, 717, affirmed, 282 U. S., 812 [Ct. D. 177, C. B. IX-1, 227]; *United States* v. *John Barth Co.*, 279 U. S., 370 [Ct. D. 65, C. B. VIII-1, 189].) It is contended by the appellant and conceded by the appellee that officers of the United States may take bonds voluntarily given, and that such bonds are valid common law obligations. We quote from appellee's brief as follows: "We are entirely in accord with the first statement that the United States, or an officer thereof, may, notwithstanding the absence of statutory authority, take a bond voluntarily given, as a common law obligation," subject, it contends, to the exception that the act guaranteed must not be "contrary to law or public policy." The rule is of course subject to this limitation and the controversy is thus narrowed to the question of whether the extension is violative of law or public policy. (See *Moses* v. *United States*, 166 U. S., 571.) It is contended by appellee that the duty of the tax collector to collect the tax and the restriction upon the Commissioner in the matter of extensions (section 56(c), Revenue Act 1928, supra) establish the fact that the extensions granted by the collector were both violative of his legal duty and of the policy declared by Congress in regard to extensions. The power of the collector to take a bond running to the United States to secure the payment of a tax he is charged with the duty of collecting in consideration for delay in collecting the tax is well established, regardless of whether or not the tax is immediately due and collectible. See discussion of Supreme Court in *Graham* v. *Foster* (282 U. S., 409, 422 [Ct. D. 287, C. B. X-1, 191]) as to a "voluntary stay" granted by the collector and recognized by Congress. In a recent well considered case by District Judge Lindley (*United States* v. *Converse Cooperage Co.*, 42 F. (2d), 227 [Ct. D. 244, C. B. IX-2, 398]) an action on such a bond was sustained. No such bond was authorized by the Revenue Act of 1918. The applicable rule is thus stated by Judge Lindley:

"The conclusion is that Congress has tacitly approved of the exercise of discretionary administrative power in the collection and abatement of taxes. Just as the Secretary of the Treasury in the case of *United States* v. *Tingey*, and the Secretary of War in the case of *Moses* v. *United States*, were held to be representatives of the sovereign, who might in the administration of their office properly accept bonds, for which there was no statutory authority, so the Secretary of the Treasury and the Commissioner of Internal Revenue in this case charged with the collection, abatement, and refunding of revenue, and impliedly, at least, vested by Congress with wide discretion in the procedure of performing his administrative duties as a representative of the Government, had the right to accept with the claim for abatement a bond conditioned for the payment of the tax if the claim should thereafter be denied and the tax assessed."

This rule was followed by District Judge Gibson in *United States* v. *Clark* (3 F. Supp., 375), where it was claimed that under the Revenue Act of 1921 the extension of time that could be granted by the collector was 18 months from November 23, 1921.

District Judge Strum in *Coleman* v. *United States* (5 F. Supp., 548) sustained the validity of such a bond given by the taxpayer to avoid a sale of property seized by the collector under distraint warrant. A very recent case by the Circuit Court of Appeals for the Fifth Circuit, written by Judge Sibley (*Maryland Casualty Co.* v. *United States*, 76 F. (2d), 626), holds that a bond given to the Commissioner of Internal Revenue for an extension of time to pay a tax is a good common law bond, although the time given was beyond that authorized by statute, and the bond was not authorized by statute, except in case of a deficiency assessment (and for the purpose of the decision it was assumed that the tax was not a deficiency tax).

The appellee cites a number of decisions by State courts dealing with bonds given to various State officers such as tax collector: *Hardesty* v. *Price* (3 Colo., 556); *Packard* v. *Tisdale* (50 Me., 376); *Co. Treas. Cass Co.* v. *Beck & Co.* (76 Ia., 487); *Sheriff Renfro* v. *Heard* (14 Ala., 23); *Hodsdon* v. *Wilkins* (7 Me., 91); *Prewitt* v. *Garrett* (6 Ala., 128); *Cole, Adm'r.*, v. *Parker* (7 Ia., 167); *Tobacco Inspector Wright* v. *Gardner* (98 Ky., 454); *Jailor, Moore*, v. *Allen and Grant* (26 Ky., 410). These bonds were held illegal upon the ground that they were predicated upon an agreement of the officer in question to violate his duty in the premises. While a contract of a Federal officer to shirk his duty in consideration of a bond might be held void on the same principle, the Federal courts from an early date have assumed that an officer in the exercise of his duties might exact a bond in favor of the United States not required by statute and that such a bond was valid. Over 100 years ago (1831) the Supreme Court said: "It has been the constant practice of the Government to take such bonds without express legislative authority, and it has been the understanding of Congress that such bonds were regular. * * * If the United States are competent to become parties to such a bond without legislative requisitions, it is equally true that the right to direct or require such a bond belongs to the Executive. It is a part of its constitutional power." A bond to pay taxes is a new obligation. (See *United States* v. *John Barth Co.*, supra, and cases cited therein with approval; *United States* v. *Onken*, 23 F. (2d), 367 [T. D. 4108, C. B. VI-2, 270]; *Gray Motor Co.* v. *United States*, 16 F. (2d), 357 [T. D. 3994, C. B. VI-1, 149]; *United States* v. *Reynolds*, 27 F. (2d), 902; *McCaughn* v. *Phila Barge Co.*, 27 F. (2d), 628 [T. D. 4199, C. B. VII-2, 168]. Note *United States* v. *U. S. F. & G. Co.*, 221 F., 27; *Raymond* v. *United States*, Fed. Cas. 11, 596. See, also, *Gulf States Steel Co.* v. *United States*, 287 U. S., 32 [Ct. D. 608, C. B. XI-2, 314]; *United States* v. *Wyoming Central Assn.*, 70 F. (2d), 869 [Ct. D. 864, C. B. XIII-2, 323]; *United States* v. *Calumet Steel Co.*, 74 F. (2d), 429.) These considerations point with equal force to the estoppel of the Surety company. (See also as to estoppel, *Florsheim Bros. Dry Goods Co., Ltd.*, v. *United States*, 280 U. S., 453, 464 [Ct. D.

167, C. B. IX-1, 260], and *Magee* v. *United States*, 282 U. S., 432 [Ct. D. 285, C. B. X-1, 189].) The Surety company is estopped to claim the invalidity of the bond.

Judgment reversed.

# SUBTITLE C.—SUPPLEMENTAL PROVISIONS.

## SUPPLEMENT B.—COMPUTATION OF NET INCOME.

## SECTION 111.—DETERMINATION OF AMOUNT OF GAIN OR LOSS.

ARTICLE 561: Determination of the amount of gain or loss.

REVENUE ACT OF 1928.

Redemption of preferred stock, dividends thereon paid in common stock. (See Ct. D. 1124, page 219.)

## SECTION 112.—RECOGNITION OF GAIN OR LOSS.

ARTICLE 577: Definitions.

XV-2-7900
Ct. D. 1059

INCOME TAX—REVENUE ACT OF 1928—DECISION OF SUPREME COURT.

1. GAIN OR LOSS—REORGANIZATION.

If the taxpayer corporation in November, 1929, transferred substantially all of its assets to another corporation in exchange for $200,000 in cash and 17,250 shares of stock of the purchaser, but retained stock of certain subsidiary corporations and some other property of undisclosed value, and thereafter remained in existence and continued to do business, the transaction amounted to a reorganization within the meaning of section 112(i)1(A) of the Revenue Act of 1928, in that the taxpayer acquired a substantial and continuing interest in the affairs of the purchaser corporation. The facts in respect of this not being found by the Board of Tax Appeals, the case must be remanded. The mere fact that the taxpayer and its subsidiaries continued actively in business does not defeat the claim of reorganization.

2. DECISION REVERSED.

Decision of the Circuit Court of Appeals, Fourth Circuit (76 Fed. (2d), 454), reversed.

SUPREME COURT OF THE UNITED STATES.

*The G. & K. Manufacturing Co., petitioner,* v. *Guy T. Helvering, Commissioner of Internal Revenue.*

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

[December 16, 1935.]

OPINION.

Mr. Justice MCREYNOLDS delivered the opinion of the Court.

The petitioner contests the validity of a deficiency assessment for 1929 income taxes. It maintains that the transaction out of which the alleged gains arose amounted to a reorganization within the intendment of section 112(i)1(A), Revenue Act, 1928.

The court below was of opinion that the transaction involved amounted to a sale of the assets and business of the taxpayer. In November, 1929, petitioner transferred what the Board of Tax Appeals seems to have assumed was substantially all of its assets to the Kraft-Phenix Cheese Corporation and received therefor $200,000 in cash and 17,250 shares common stock of the purchaser, then worth possibly $30 per share. After the transfer, the taxpayer remained in existence and continued to do business. It also retained assets of undisclosed value, namely, shares of certain subsidiary corporations and some other property. If the claim of the taxpayer that the transfer included substantially all its property is correct, then we think what was done amounted to a reorganization within the statute. The facts in respect of this were not found by the Board of Tax Appeals, and the cause must be returned there in order that the omission may be supplied. The mere fact that the taxpayer and its subsidiaries continued actively in business would not defeat the claim of reorganization. The ownership of the stock in the Kraft-Phenix Cheese Corporation gave the taxpayer a substantial and continuing interest in the affairs of that corporation.

The judgment of the court below is reversed. The cause will be remanded to the circuit court of appeals with direction to that court to remand the case to the Board of Tax Appeals for determination of the value of the retained assets and such further proceedings as may be necessary.

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## ARTICLE 577: Definitions. XV–2–7901 Ct. D. 1060

INCOME TAX—REVENUE ACT OF 1928—DECISION OF SUPREME COURT.

1. GAIN OR LOSS—REORGANIZATION—CONSTRUCTION OF STATUTE.

B Corporation organized C Corporation and transferred to it real estate, investments, and miscellaneous assets in exchange for the entire capital stock of C, distributing the shares thus obtained among its three stockholders, and transferred all its remaining assets to D Corporation in exchange for voting trust certificates representing 1,800 shares of stock in D and over $400,000 cash. B retained the certificates but immediately distributed the cash among its stockholders, who agreed to pay outstanding debts of B amounting to approximately $100,000. Under these facts, the latter transaction was not a sale, but partook of the nature of a reorganization within the meaning of section 112(i)1(A) of the Revenue Act of 1928, in that the seller acquired a definite and substantial interest in the purchaser. Treasury regulations long in force support the conclusion that the scope of clause (A) of section 112(i)1 is not narrowed by clause (B), which requires that the transferor obtain control of the transferee. The facts that the relationship of B to the assets conveyed was substantially changed, that a large part of the consideration was cash, and that the transferor corporation was not dissolved, do not render the statute inapplicable.

2. DECISION AFFIRMED.

Decision of the Circuit Court of Appeals, Eighth Circuit (76 Fed. (2d), 797), which reversed the decision of the Board of Tax Appeals (28 B. T. A., 591), affirmed.

SUPREME COURT OF THE UNITED STATES.

174. *Guy T. Helvering, Commissioner of Internal Revenue, petitioner,* v. *Minnesota Tea Co.*

175. *Guy T. Helvering, Commissioner of Internal Revenue, petitioner,* v. *E. C. Peterson.*

176. *Guy T. Helvering, Commissioner of Internal Revenue, petitioner,* v. *L. T. Peterson.*

On writs of certiorari to the United States Circuit Court of Appeals for the Eighth Circuit.

[December 16, 1935.]

OPINION.

Mr. Justice MCREYNOLDS delivered the opinion of the Court.

No. 174. Respondent, a Minnesota corporation with three stockholders, assailed a deficiency assessment for 1928 income tax and prevailed below. The

Commissioner seeks reversal. He claims the transaction out of which the assessment arose was not a reorganization within section 112, paragraph (i)1(A), Revenue Act, 1928 (ch. 852, 45 Stat., 791). "The term 'reorganization' means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation." The circuit court of appeals held otherwise and remanded the cause for determination by the Board whether the whole of the cash received by the Minnesota Tea Co. was in fact distributed as required by the Act. We granted certiorari because of alleged conflicting opinions.

The petition also stated that, as the taxpayer made an earlier conveyance of certain assets, the later one, here in question, of what remained to the Grand Union Co. did not result in acquisition by one corporation of substantially all property of another. This point was not raised prior to the petition for certiorari and, in the circumstances, we do not consider it.

Statutory provisions presently helpful are in the margin.[1]

July 14, 1928, respondent caused Peterson Investment Co. to be organized and transferred to the latter real estate, investments and miscellaneous assets in exchange for the transferee's entire capital stock. The shares thus obtained were immediately distributed among the three stockholders. August 23, 1928, it transferred all remaining assets to Grand Union Co. in exchange for voting trust certificates, representing 1,800 shares of the transferee's common stock, and $426,842.52 cash. It retained the certificates; but immediately distributed the money among the stockholders, who agreed to pay $106,471.73 of its outstanding debts. Although of opinion that there had been reorganization, the Commissioner treated as taxable gain the amount of the assumed debts upon the view that this amount of the cash received by the company was really appropriated to the payment of its debts.

The matter went before the Board of Tax Appeals upon the question whether the Commissioner ruled rightly in respect of this taxable gain. Both parties proceeded upon the view that there had been reorganization. Of its own motion, the Board questioned and denied the existence of one. It then ruled

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[1] Revenue Act, 1918 (ch. 18, 40 Stat., 1060):

SEC. 202. (b) When property is exchanged for other property, the property received in exchange shall for the purpose of determining gain or loss be treated as the equivalent of cash to the amount of its fair market value, if any; but when in connection with the reorganization, merger, or consolidation of a corporation a person receives in place of stock or securities owned by him new stock or securities of no greater aggregate par or face value, no gain or loss shall be deemed to occur from the exchange, and the new stock or securities received shall be treated as taking the place of the stock, securities, or property exchanged.

Revenue Act, 1921 (ch. 136, 42 Stat., 230):

SEC. 202. (c) For the purposes of this title, on an exchange of property, real, personal or mixed, for any other such property, no gain or loss shall be recognized unless the property received in exchange has a readily realizable market value; but even if the property received in exchange has a readily realizable market value, no gain or loss shall be recognized—

* * * * * * *

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

Revenue Act, 1924 (ch. 234, 43 Stat., 256):

SEC. 203. (a) Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 202, shall be recognized, except as hereinafter provided in this section.

* * * * * * *

(b) (2) 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.

(3) No gain or loss shall be recognized if a corporation 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.

(4) No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; but in the case of an exchange by two or more persons this paragraph

that the corporation had realized taxable gain amounting to the difference between cost of the property transferred and the cash received plus the value of the 1,800 shares—$712,195.90.

The circuit court of appeals found there was reorganization within the statute and reversed the Board. It concluded that the words "the acquisition by one corporation of * * * substantially all the property of another corporation" plainly include the transaction under consideration. Also that clause (B), section 112(i)1, first introduced by Revenue Act of 1924, and continued in later statutes, did not narrow the scope of clause (A). Further, that reorganization was not dependent upon dissolution by the conveying corporation. And finally, that its conclusions find support in Treasury regulations long in force.

These conclusions we think are correct.

The Commissioner maintains that the statute presents two definitions of reorganization by transfer of assets. One, clause (B), requires that the transferor obtain control of the transferee. The other, clause (A), is part of the definition of merger or consolidation, and must be narrowly interpreted so as to necessitate something nearly akin to technical merger or consolidation. These clauses have separate legislative histories and were intended to be mutually exclusive. Consequently, he says, clause (A) must be restricted to prevent overlapping and negation of the condition in clause (B). Also, the transaction here involved substantially changed the relation of the taxpayer to its assets; a large amount of cash passed between the parties; there are many attributes of a sale; what was done did not sufficiently resemble merger or consolidation as commonly understood.

With painstaking care, the opinion of the court below gives the history of clauses (A) and (B), section 112(i)1. We need not repeat the story. Clause (A) first appeared in the Act of 1921; (B) was added by the 1924 Act. We find nothing in the history or words employed which indicates an intention to modify the evident meaning of (A) by what appears in (B). Both can have effect, and if one does somewhat overlap the other the taxpayer should not be denied, for that reason, what one paragraph clearly grants him. Treasury regulations long enforced support the taxpayer's position, as the opinion below plainly points out.

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shall apply only if the amount of the stock and securities received by each is substantially in proportion to his interest in the property prior to the exchange.

* * * * * * *

(e) If an exchange would be within the provisions of paragraph (3) of subdivision (b) if it were not for the fact that the property received in exchange consists not only of stock or securities permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then—

(1) If the corporation receiving such other property or money distributes it in pursuance of the plan of reorganization, no gain to the corporation shall be recognized from the exchange, but

(2) If the corporation receiving such other property or money does not distribute it in pursuance of the plan of reorganization, the gain, if any, to the corporation shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property so received, which is not so distributed.

* * * * * * *

(h) As used in this section and sections 201 and 204—

(1) The term "reorganization" means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization, or (D) a mere change in identity, form, or place of organization, however effected.

(2) The term "a party to a reorganization" includes a corporation resulting from a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation.

Revenue Act, 1926 (ch. 27, 44 Stat., 12):

Section 203 (a), (b)(2), (b)(3), (b)(4), (e), (e)(1), (e)(2), (h), (h)(1), and (h)(2) repeat the words of section 203 (a), (b)(2), (b)(3), (b)(4), (e), (e)(1), (e)(2), (h), (h)(1), and (h)(2) of the Act of 1924.

Revenue Act, 1928 (ch. 852, 45 Stat., 816):

Section 112 (a), (b)(3), (b)(4), (b)(5), (d), (d)(1), (d)(2), (i), (i)(1), and (i)(2) repeat the words of section 203 (a), (b)(2), (b)(3), (b)(4), (e), (e)(1), (e)(2), (h), (h)(1), and (h)(2) of the Act of 1924.

Revenue Act, 1932 (ch. 209, 47 Stat., 196):

Section 112 (a), (b)(3), (b)(4), (b)(5), (d), (d)(1), (d)(2), (i), (i)(1), and (i)(2) repeat the words of section 203 (a), (b)(2), (b)(3), (b)(4), (e), (e)(1), (e)(2), (h), (h)(1), and (h)(2) of the Act of 1924.

*Pinellas Ice Co.* v. *Commissioner* (287 U. S., 462, 470 [Ct. D. 630, C. B. XII-1, 161]) considered the language of section 203(h)1(A), Act of 1926, which became section 112(i)1(A), Act of 1928, and held that a sale for money or short-term notes was not within its intendment. We approved the conclusion of the Commissioner, Board of Tax Appeals and Court of Appeals that the transaction there involved was in reality a sale for the equivalent of money—not an exchange for securities. But we disapproved the following assumption and observations of the court: "That in adopting paragraph (h) Congress intended to use the words 'merger' and 'consolidation' in their ordinary and accepted meanings. Giving the matter in parentheses the most liberal construction, it is only when there is an acquisition of substantially all the property of another corporation in connection with a merger or consolidation that a reorganization takes place. Clause (B) of the paragraph removes any doubt as to the intention of Congress on this point." And we said: "The words within the parentheses may not be disregarded. They expand the meaning of 'merger' or 'consolidation' so as to include some things which partake of the nature of a merger or consolidation but are beyond the ordinary and commonly accepted meaning of those words—so as to embrace circumstances difficult to delimit but which in strictness can not be designated as either merger or consolidation. But the mere purchase for money of the assets of one company by another is beyond the evident purpose of the provision, and has no real semblance to a merger or consolidation. Certainly, we think that to be within the exemption the seller must acquire an interest in the affairs of the purchasing company more definite than that incident to ownership of its short-term purchase-money notes." And we now add that this interest must be definite and material; it must represent a substantial part of the value of the thing transferred. This much is necessary in order that the result accomplished may genuinely partake of the nature of merger or consolidation.

*Gregory* v. *Helvering* (293 U. S., 465 [Ct. D. 911, C. B. XIV-1, 193]), revealed a sham—a mere device intended to obscure the character of the transaction. We, of course, disregarded the mask and dealt with realities. The present record discloses no such situation; nothing suggests other than a bona fide business move.

The transaction here was no sale, but partook of the nature of a reorganization in that the seller acquired a definite and substantial interest in the purchaser.

True it is that the relationship of the taxpayer to the assets conveyed was substantially changed, but this is not inhibited by the statute. Also, a large part of the consideration was cash. This, we think, is permissible so long as the taxpayer received an interest in the affairs of the transferee which represented a material part of the value of the transferred assets.

Finally, it is said the transferor was not dissolved and therefore the transaction does not adequately resemble consolidation. But dissolution is not prescribed and we are unable to see that such action is essential to the end in view.

The challenged judgment is affirmed.

Nos. 175 and 176. The respondents in these cases are two of the three stockholders of Minnesota Tea Co. The writs were granted upon the Commissioner's petition which states the question involved is whether the transaction between Minnesota Tea Co. and Grand Union Co., described above—No. 174—resulted in a reorganization within the Revenue Act of 1928. The petition also declared—"The amount of the tax due from the respondents, * * * depends solely upon whether the transfer of the properties of the Minnesota Tea Co. to the Grand Union Co. was a reorganization within the meaning of the Revenue Act."

We think the court below rightly decided there was a reorganization. It reversed the Board of Tax Appeals and remanded the cause for further proceedings, and its judgment must be affirmed.

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ARTICLE 577: Definitions. XV-2-7902
Ct. D. 1061

INCOME TAX—REVENUE ACT OF 1928—DECISION OF SUPREME COURT.

1. GAIN OR LOSS—EXCHANGE OF STOCK FOR STOCK—REORGANIZATION.

Where, under the circumstances stated, certain corporate shares owned by the petitioner corporation were exchanged in 1929 for shares which another corporation owned, the petitioner was not a party to a reorganization within the meaning of section 112(i) of the Revenue Act of 1928, since neither party to the exchange acquired any definite immediate interest in the other. Nothing in the transaction even remotely resembles either merger or reorganization as commonly understood.

2. Decision Affirmed.

Decision of the Circuit Court of Appeals, Third Circuit (79 Fed. (2d), 509), affirmed.

Supreme Court of the United States.

*Bus & Transport Securities Corporation, petitioner*, v. *Guy T. Helvering, Commissioner of Internal Revenue.*

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

[December 16, 1935.]

OPINION.

Mr. Justice McReynolds delivered the opinion of the Court.

Petitioner—Bus & Transport Securities Corporation—challenges a deficiency income tax assessment for 1929, and says that the transaction from which the alleged taxable gain arose was reorganization within section 112, Revenue Act, 1928. Paragraphs (b)(4), (i)(1) and (i)(2) are specially relied upon.

Jacobus owned practically all shares of two corporations, herein designated "A" and "B," which operated bus lines. The Public Service Corporation of New Jersey—the projector—desired to control these lines; and to that end engineered the following plan:

Public Service Coordinated Transport Co., affiliated with the projector, caused the organization of C. Easman Jacobus, Inc., took all the stock and paid therefor by transferring 2,500 of the projector's shares.

Jacobus caused petitioner to be organized and acquired all its stock in exchange for all shares of "A" and "B" corporations. Thereafter petitioner transferred to Public Service Coordinated Transport Co. these "A" and "B" shares and took all shares of C. Easman Jacobus, Inc.

Thus, petitioner, through Jacobus, Inc., came to control 2,500 of the projector's shares. And Public Service Coordinated & Transport Co. became owner of all shares of "A" and "B" corporations. Through these manipulations, the projector obtained indirect control of corporations "A" and "B" and the lines which they operate.

The Commissioner, the Board of Tax Appeals, and the Circuit Court of Appeals all rightly concluded that petitioner was not party to a reorganization within the statute. Certain corporate shares owned by it were exchanged for shares which another corporation owned. Neither party to the exchange acquired any definite immediate interest in the other. Nothing here, we think, even remotely resembles either merger or reorganization as commonly understood. (*Pinellas Ice Co.* v. *Commissioner*, 287 U. S., 462 [Ct. D. 630, C. B. XII-1, 161].)

The challenged judgment must be affirmed.

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Article 577: Definitions. XV-25-8131
Ct. D. 1127

INCOME TAX—REVENUE ACT OF 1928—DECISION OF COURT.

1. Gain or Loss—Exchange of Stock for Stock—Reorganization.

Where an offer by the majority stockholders of a bank, to exchange their stock for cash and stock of a trust company which desired to take over the business of the bank, was never accepted but instead, without the knowledge of the bank stockholders, a different method of transfer was substituted whereby a third corporation acquired all the bank stock, which was then purchased by the trust company, followed by liquidation of the bank and retirement of its stock, the evidence was sufficient to sustain the finding of the Board of Tax Appeals that the third corporation was not acting as agent for the trust company, and the transfers did not amount to a reorganization within the meaning of section 112(b)3 of the Revenue Act of 1928.

2. DECISION AFFIRMED.

Decision of the Board of Tax Appeals (30 B. T. A., 89) affirmed.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

*Charles F. Beech, petitioner, v. Commissioner of Internal Revenue, respondent.*

On petition for review of decision of the United States Board of Tax Appeals.

Before BUFFINGTON and THOMPSON, Circuit Judges, and KIRKPATRICK, District Judge.

[January 30, 1936.]

OPINION.

KIRKPATRICK, District Judge: The question presented by this petition for review of the decision of the Board of Tax Appeals is whether gain arising from an exchange of stock was taxable.

The exemption claimed is under section 112(b)3 which is as follows:

"(3) *Stock for stock on reorganization.*—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."

It will be noted that the exemption depends upon two conditions: first, the corporations whose stock is exchanged must be parties to a reorganization, and second, the exchange must be in pursuance of the plan of reorganization.

It might be thought that a situation could scarcely arise in which one of these conditions would be present without the other, yet this appears to be such a case. There is no real controversy about the fact that a plan of reorganization was formed, that the taxpayer parted with his stock in pursuance of the plan, and that, so far as he knew, the stock which he got in exchange was also delivered in pursuance of the plan. But the Board of Tax Appeals has found as a fact that, unknown to the taxpayer, the plan under which he thought he was exchanging his stock was never carried out but that the stock which he received was owned by a third person who was acting independently of and not as an agent for either corporation involved. Consequently no reorganization within the meaning of that term as used in the Act took place and neither of the corporations whose stock was exchanged was a party to a reorganization.

The facts as found by the Board were as follows: The corporations involved were two banking institutions which may be called the Trust company and the Birmingham bank. The Trust company desired to take over and absorb the Birmingham bank by acquiring its stock and liquidating its business. Negotiations resulted in a written proposal by the holders of 770 shares of stock of the Birmingham bank by which they offered to exchange their stock at the rate of 1 share for 3⅓ shares of the Trust company, with the proviso that the Trust company stock so acquired would be purchased for cash at a figure named within 15 days of the acceptance of the offer. It was provided that the offer should remain open for acceptance for a period of 30 days.

If this arrangement had been carried out it may be assumed that it would have constituted a reorganization as that term is defined in *Pinellas Ice & Cold Storage Co.* v. *Commissioner* (287 U. S., 462 [Ct. D. 630, C. B. XII-1, 161]), and *Cortland Specialty Co.* v. *Commissioner* (60 Fed. (2d), 937 [Ct. D. 668, C. B. XII-1, 164]).

But it was not carried out and, instead, entirely new machinery of transfer was substituted without the knowledge of the stockholders of the Birmingham bank. After the offer had been submitted to the Trust company its officials came to the conclusion that if it were accepted there would be a violation of the rules of the Federal Reserve Board, since permission of that body had not been obtained—a matter which had caused criticism in previous transactions. On the supposition that an application for the consent of the Federal Reserve Board would cause considerable delay, a new method of acquiring the Birmingham bank stock was adopted. The stockholders of the Birmingham bank were not notified of the change.

The offer of June 20 was never accepted and no action was taken upon it by the Trust company. Instead two other corporations, Hillman Investment Co. and Allegheny Bankshares, Inc., were brought into the arrangement. Hillman company bought 763 of the 1,000 outstanding shares of the Birmingham bank for cash for the account of the Trust company but in the name of Bankshares, Inc., financing the transaction with money borrowed by Bankshares partly from the Trust company and partly from another bank. For the remaining 237 shares of stock of the Birmingham bank, Hillman company gave the holders 786 shares of the Trust company stock, of which it owned a very large block. Hillman company thus acquired all the stock of the Birmingham bank (except 70 shares owned by directors) between July 25 and August 9, the certificates being assigned in blank and delivered to Hillman company or Bankshares from whom the bank's stockholders received either cash or certificates of stock of the Trust company. The directors' shares were delivered for cash between November, 1930, and January, 1931. Hillman company thus became the sole stockholder of Birmingham bank.

On January 13, 1931, the Trust company by resolution offered to purchase the assets of the Birmingham bank for $550,000 subject to liabilities. This offer was accepted by the Birmingham bank, now controlled by Hillman company, and duly consummated. The Birmingham bank was liquidated, its shares of stock called for retirement and canceled and its charter surrendered. The $550,000 was paid to Sheets, a director of Hillman company who was the record holder of the stock of the Birmingham bank, who turned it over to Bankshares. Just how the transaction was finally wound up is not material, except that nothing appeared which would amount to bringing in the Hillman company as an agent for the Trust company.

It thus appears that the whole question revolves about the single controverted point, whether or not Hillman company in carrying out the scheme adopted was or was not the agent of the Trust company. If it was, the entire transaction in law would stand as though the Trust company had acquired the stock itself, and at that point a reorganization would be effective and that condition of the statute met. In such case, the subsequent acquisition by the Trust company of the assets of the Birmingham bank would have amounted to little more than an internal readjustment by the Trust company of its own property, and the fact that the plan as previously conceived was not actually carried out would make no practical difference.

However, at this point the appellants' case is met by a finding of fact by the Board of Tax Appeals to the effect that Hillman company was not acting as agent for the Trust company. The Board said "Giving due consideration to all the evidence in the case, we are unable to find that either the Hillman company or Bankshares, Inc., or both, were acting as the agent of the Trust company in acquiring the stock of the Birmingham bank. In order to constitute the agency relationship it must appear that these corporations or at least one of them was acting upon authority from the Trust company or the Trust company ratified the action taken. Clearly the Trust company did not authorize the action to be taken in its behalf, nor did it expressly or impliedly ratify it. Accordingly the contention of the petitioner on this point is denied. * * * The most that can be said of the arrangement between the executive officers of the Trust company and Hillman is that it was a gentleman's agreement, entered into by the officers in their individual capacity. So far as the record shows it was never ratified or adopted either by the directors of the Trust company or by its stockholders."

The existence of a disputed agency may be a question of fact even where the evidence is not conflicting if different conclusions can reasonably be drawn therefrom. That is the situation in this case. The finding of no agency by the Board of Tax Appeals is a determination of fact for administrative purposes, not subject to review. (*Phillips* v. *Commissioner*, 283 U. S., 589 [Ct. D. 350, C. B. X-1, 264].) As to it, the only question for this court is whether the evidence was legally sufficient to sustain it, and upon this point we hold that it was.

From the fact situation thus presented, it follows as a matter of law that, regardless of the question whether or not the petitioner's stock was exchanged in pursuance of a plan of reorganization, the corporations involved were not actually parties to a reorganization. As found by the Board of Tax Appeals, what happened, in simplest terms, was that a stockholder of the bank exchanged his bank stock for Trust company stock (and a small amount of cash) which was owned by a third corporation acting entirely independently without authorization or subsequent ratification by the Trust company. Thereafter this third corporation sold to the Trust company all the stock of the bank which it had thus acquired, the bank was liquidated and the stock retired. It can not be contended that a transfer accomplished in this manner, even though it resulted in a final absorption of the bank by the Trust company, amounted to a reorganization if, as has been found by the Board of Tax Appeals, the action of the intermediary was not by virtue of any agency or binding obligation of any kind to the bank.

The order of the Board is approved.

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## SECTION 113.—BASIS FOR DETERMINING GAIN OR LOSS.

ARTICLE 591: Basis for determining gain or loss from sale. XV-13-8018 Ct. D. 1098

INCOME TAX—REVENUE ACTS OF 1921, 1924, 1926, AND 1928—DECISION OF SUPREME COURT.

1. GAIN OR LOSS—BASIS—LEASE OF PROPERTY WITH OPTION TO BUY—DATE PROPERTY WAS "ACQUIRED."

Where the lessee of land under a 10-year lease, embodying an irrevocable option to buy at the expiration of the lease on November 30, 1916, exercised the option and subsequently transferred the land to its successor under circumstances which do not alter the basis for calculation of gain, and the successor sold portions of the tract during the period 1920 to 1928, inclusive, the property was "acquired," within the meaning of the applicable Revenue Acts, when the option was exercised and conveyance made, rather than when the lease was made, and the cost of the property on November 30, 1916, was the proper basis for determining gain upon the sales.

2. DECISION REVERSED.

Decision of the Circuit Court of Appeals, Ninth Circuit (77 Fed. (2d), 723), reversing decision of the Board of Tax Appeals (28 B. T. A., 395), reversed.

SUPREME COURT OF THE UNITED STATES.

*Guy T. Helvering, Commissioner of Internal Revenue, petitioner,* v. *San Joaquin Fruit & Investment Co.*

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

[March 2, 1936.]

OPINION.

Mr. Justice ROBERTS delivered the opinion of the Court.

Is real property "acquired," within the meaning of the Revenue Acts, when a lease is made containing an option to purchase, or when the option is exercised? The question is presented under the relevant sections of the Revenue Acts of 1921, 1924, 1926, and 1928.[1]

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[1] 42 Stat., 227, 229; 43 Stat., 253, 258; 44 Stat., 9, 14; 45 Stat., 791, 818. The provisions of the Revenue Act of 1924, which are typical, follow:

"SEC. 204. (a) The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; except that * * *.

"(b) The basis for determining the gain or loss from the sale or other disposition of property acquired before March 1, 1913, shall be (A) the cost of such property * * * or (B) the fair market value of such property as of March 1, 1913, whichever is greater. * * *"

Section 202 of the Revenue Act of 1921 speaks of "property, real, personal, or mixed."

October 13, 1906, the Irvine Co. leased to the San Joaquin Fruit Co. 1,000 acres, part of a much larger tract, of bare unirrigated land in California. The lessor was wholly owned by one Irvine, and the lessee was organized by two experienced men who together with Irvine subscribed its capital, in the hope that planting, irrigation, and cultivation would make the land valuable. The lease was for a term of 10 years from December 1, 1906; required the lessee to plant the tract as an orchard within four years, to procure and conduct a specified supply of irrigation water to the tract, and to raise certain field crops in connection with the orchard; and embodied an irrevocable option to buy the whole acreage for $200,000, exercisable November 30, 1916. Before October, 1908, the lessee procured the water, planted, and was successfully working the land; and the taking up of the option at the end of the term was then no longer a matter of doubt. By February 28, 1913, the value of the property had greatly increased. On November 30, 1916, the option was closed and conveyance made to the lessee, which subsequently transferred the land to the respondent under circumstances which do not alter the basis for calculation of gain. During the period 1920 to 1928, inclusive, the respondent sold portions of the tract. In computing the tax liability for these years the petitioner determined the property was acquired November 30, 1916, when the option was exercised, and its cost was the $200,000 paid plus the amounts expended for improvements pursuant to the lease. The respondent appealed to the Board of Tax Appeals, contending the lessee acquired a property in the land—an interest real—prior to March 1, 1913, and the value of the land at that date was the proper basis for calculating gain on sales. The Board sustained the petitioner.[2] The Circuit Court of Appeals reversed the Board's decision.[3] To resolve an asserted conflict[4] we granted certiorari.

We hold that the respondent acquired the property on November 30, 1916. The option itself was property, and doubtless was valuable. If it had been assignable, and the lessee had sold it at a profit, taxable gain would have resulted from the sale. But the option is admittedly not the same property as the land. So conceding, the respondent still insists that ownership of the option created an interest in the land. This would not be true of a bare option unconnected with a lease;[5] but we are told that because embodied in the lease the agreement became a covenant real and gave the lessee a species of interest or property in the land. The weight of authority is to the contrary,[6] and no cited California decision supports the position.[7] But even if we should agree that a lessee-optionee acquires, by virtue of the instrument an equitable interest in the land it would not follow that, within the contemplation of the Revenue Acts, he acquires the property at the date of the option rather than at the date of conveyance. The word "acquired" is not a term of art in the law of property but one in common use. The plain import of the word is "obtained as one's own." Language used in tax statutes should be read in the ordinary and natural sense.[8] In the common and usual meaning of the term the land was acquired when conveyed to the respondent's predecessor.

The Circuit Court of Appeals thought that to avoid serious doubts concerning the constitutional power to tax gains accruing before March 1, 1913, it was important, if possible, to treat the property as acquired when the option was given. The court therefore resorted to the doctrine that the title when acquired relates back to the date of the option. Cited in support of this application of the theory are cases in which the California courts have invoked it to subordinate the rights of assignees or mortgagees who became such with notice of an outstanding option.[9] The fiction of relation, indulged to defeat those dealing with the legal title with knowledge of the option, can give no aid in solving the question of the time of the optionee's acquirement of property under a statute

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[2] 28 B. T. A., 395.

[3] 77 F. (2d), 723.

[4] See *Commissioner* v. *Cummings* (77 F. (2d), 670); *Chisholm* v. *Commissioner* (79 F. (2d), 14).

[5] *Richardson* v. *Hardwick* (106 U. S., 252, 254); *Todd* v. *Citizens Gas Co.* (46 F. (2d), 855, 866).

[6] *Willard* v. *Tayloe* (8 Wall., 557, 564); *Kadish* v. *Lyon* (229 Ill., 35, 40); *Bras* v. *Sheffield* (49 Kan., 702, 710); *Caldwell* v. *Frazier* (65 Kan., 24); *Luigart* v. *Lexington Turf Club* (130 Ky., 473, 480); *Trumbull* v. *Bombard* (171 App. Div. (N. Y.), 700); *Gamble* v. *Garlock* (116 Minn., 59).

[7] Compare *Ludy* v. *Zumwalt* (85 Cal. App., 119); *Hicks* v. *Christeson* (174 Cal., 712).

[8] *Old Colony Railroad Co.* v. *Commissioner* (284 U. S., 552 [Ct. D. 456, C. B. XI–1, 274]); *Reinecke* v. *Smith* (289 U. S., 172 [Ct. D. 664, C. B. XII–1, 256]).

[9] *Smith* v. *Bankham* (156 Cal., 359); *Chapman* v. *Great Western Gypsum Co.* (216 Cal., 420).

taxing gain upon a subsequent sale. And there is no need of the fiction to avoid any constitutional question. The power to tax gains which accrued prior to the adoption of the sixteenth amendment is not here involved. We suppose the amount received by the respondent from a sale includes and is the result of increase in value of the property in the period prior to March 1, 1913. But the gain accruing in that period did not accrue to property owned by the lessee. Neither the land nor the gain so accruing before March 1, 1913, became the lessee's property until 1916 when it took up the option.

An alternative contention is that the exercise of the option and the conveyance on November 30, 1916, constituted merely an exchange of capital assets—a closed transaction—and the basis for calculation of gain was the value of the land and improvements at that date. The capital asset, sale of which resulted in taxable gain, was the land. This was not an asset of the taxpayer prior to the exercise of the option. We think it clear that there was no combination of two capital assets—the option and $200,000 of cash, to form a new capital asset, the land, which was subsequently sold at a profit. The judgment of the circuit court of appeals must be reversed.

So ordered.

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ARTICLE 591: Basis for determining gain or loss from sale. (Also Section 23(a), Article 121.) XV-14-8030 Ct. D. 1099

INCOME TAX—REVENUE ACT OF 1928—DECISION OF COURT.

1. DEDUCTION—LOSS—SALE OF BUSINESS—BROKERAGE FEES—ORGANIZATION EXPENSES—COST OF ACQUIRING ASSETS OF ANOTHER COMPANY.

Where the taxpayer, a fire insurance company which acquired all the assets and liabilities of an Indiana company in 1922, sold its business and assets to another company in 1929, it was not entitled to deduct as a loss on such sale the amount of fees paid to brokers for effecting reinsurance of a portion of the risks on which the Indiana company had issued policies, such fees not being a part of the cost of the assets of the taxpayer. Other expenses incurred and paid in 1922 in connection with the merger, in the nature of organization expenses, were deductible as a loss if they were part of the cost of acquiring the assets of the Indiana company.

2. GAIN OR LOSS—SALE OF BUSINESS—GOOD WILL.

A company owned and controlled by Catholics and specializing in writing fire insurance on property owned by Catholics, which was authorized to and did begin business as a corporation on March 1, 1913, and which had secured pledges of insurance in large amounts prior to that date, was not entitled to any allowance for good will, in determining gain or loss upon the sale of its assets in 1929, in the absence of satisfactory evidence as to the value of the pledge contracts above the commissions paid to agents and the cost of carrying the risks, or as to the value of the good will, if any, at March 1, 1913, attributable to the pledges obtained and to the nature and appeal of the organization.

3. DEDUCTION—COMMISSIONS ON SALE OF STOCK—ORGANIZATION EXPENSE—ORDINARY AND NECESSARY EXPENSE—AMORTIZATION—STATUTE AND REGULATIONS.

Commissions paid by a corporation on the sale of its stock at or near the time of organization are not deductible as an organization expense or as an ordinary and necessary expense within the meaning of the tax law, and can not be amortized over the period of organization as a part of the cost of obtaining capital. Longstanding Treasury regulations denying any deduction on account of such commissions have been approved by the Board of Tax Appeals and by the courts, and Congress has not changed the statute in respect thereto, although numerous Revenue Acts have been enacted since the regulations were first promulgated.

COURT OF CLAIMS OF THE UNITED STATES.

*The Columbian National Fire Insurance Co., a Michigan Corporation, v. The United States.*

[February 4, 1935.]

OPINION.

GREEN, Judge, delivered the opinion of the court.

Plaintiff seeks to recover $33,429.07, with interest, on account of income taxes alleged to have been overpaid by it for the year 1929 under the Revenue Act of 1928. A timely and proper claim for refund was filed and rejected.

It appears that the plaintiff is a fire insurance company organized under the laws of Michigan in 1911, began business in March, 1913, and its first policy was issued in that month. On November 1, 1922, the plaintiff took over the Columbian Fire Insurance Co. of Indiana, and the assets and liabilities of that company were transferred to plaintiff's books as of the last day of that year. On August 19, 1929, a group of Cleveland bankers organized the Monarch Fire Insurance Co. for the specific purpose of acquiring the business and assets of the plaintiff as the nucleus in a new company. The Monarch company, acting through its brokers, in September and October, 1929, purchased 18,488 41/60 shares (out of a total of 26,000) of plaintiff's stock at the rate of $43 per share, paying therefor a total of $795,013.40. Having thus acquired the ownership of over 70 per cent of plaintiff's stock, the Monarch company obtained control of the plaintiff corporation, the same individual serving as president of both companies, and an agreement was made on behalf of plaintiff to sell all of its "property and assets, of whatsoever kind" to the Monarch company in consideration of the payment to plaintiff of $1,118,000 and the assumption by the Monarch company of all of plaintiff's liabilities. The plaintiff received this sum and caused it to be distributed to its stockholders, and all outstanding stock of the plaintiff corporation was retired and canceled, having been redeemed at $43 per share.

The plaintiff filed its income tax return for 1929 which disclosed a taxable net income of $310,941.27 and a tax liability of $34,203.54, which was duly paid. Included in its gross income was an item of $379,252.78 shown as "profit from sales of assets." The return set out the sale of its assets and business, as above stated, charged plaintiff with the $1,118,000 received in cash, and offset against the same the cost of the assets less the liabilities assumed. The amount of the net assets was stated in the return at $738,747.22, and this deducted from the price paid by the Monarch company made the profit from the sale $379,252.78. The cost of the assets as shown in the return and used by the Commissioner in computing the tax did not include any amount for the value of good will on March 1, 1913.

The plaintiff filed a claim for refund of the entire tax for 1929 and interest thereon. This claim was based on several grounds as shown in finding 3. The first ground mentioned may be summarized by saying that it claimed that the return for the year 1929 in place of showing a profit of $379,252.78 should have set out a total loss of $589,601.34 composed of certain items to which we shall hereinafter refer. Amendments were filed to this claim alleging alternatively that in 1929 plaintiff sold its entire capital stock to Monarch Fire Insurance Co. of Cleveland, Ohio, for the sum of $1,118,000, and that as of that date the cost of the capital stock so sold was $1,640,640.09; and as a further alternative the plaintiff claimed that good will was sold at the same time to the Monarch Fire Insurance Co., which had a market value as of March 1, 1913, of not less than $500,000, for which the plaintiff was entitled to a credit as an asset.

Subsequently, a further amendment was filed to the original claim stating alternatively that the Monarch Fire Insurance Co. in 1929 purchased from the stockholders of the plaintiff all of its capital stock for the sum of $1,118,000, that by reason thereof there was no sale of assets by the taxpayer, and no profit which should have been reported in its income tax return.

In addition to the matters stated above, the plaintiff included in its refund claim as a part of its net loss an item of "Consolidated expense 1922, $15,101.98." In the consideration of the claim for refund this last item will be first taken up.

The evidence shows that in 1922 plaintiff acquired all the assets and liabilities of the Columbian Fire Insurance Co. of Indiana including its obligations on fire insurance policies which it had issued. After the plaintiff had taken over the business of the Indiana company, it was considered advisable, for certain reasons not necessary to mention here, to reinsure a portion of the risks upon which the Indiana company had issued policies, and an insurance broker was paid $10,000 for effecting the reinsurance thereof with other companies. Plaintiff claims that in addition to this brokerage other expenses were incurred and paid during 1922 in connection with the so-called merger amounting to $5,101.98. The testimony in the case shows that this amount was made up of a number of smaller items some of which in the first instance may have been paid by the Indiana company. The evidence is not as clear as it might have been made with reference to this matter, but on the whole we are satisfied that plaintiff incurred expense in acquiring the assets of the Indiana company in the amount of $5,101.98 in addition to the brokerage fee which was incurred. The two items of expense, however, were of a very different nature. Without going into details we may say that the items which made up the $5,101.98 were somewhat in the nature of organization expenses. They were costs which plaintiff was obliged to pay in order to carry out the transactions by which it acquired the assets of the Indiana company. The brokerage fee was paid for effecting the reinsurance of a portion of the insurance contracts acquired from the Indiana company evidenced by policies issued; it being considered that they belonged to a class which it was not desirable for the plaintiff to carry. The brokerage fee, being paid in order to get plaintiff's business in more satisfactory condition, was either an ordinary and necessary expense or it was a capital expenditure. We are inclined to think it was a capital expenditure, as the benefits obtained through it were permanent; but in either event we do not think it was part of the cost of the assets of plaintiff. If it was an ordinary expense, it should have been deducted in 1922. If it was a capital expenditure, no deduction can be allowed therefor. We are satisfied that the brokerage fee was not deductible as a loss on the sale of plaintiff's assets. On the other hand, if we are right in concluding that the item of $5,101.98 was a part of the cost of the assets acquired from the Indiana company it becomes properly deductible as a loss at the time the plaintiff finally sold all of its assets to the Monarch company.

Of the other items of plaintiff's claim for refund only two are presented in argument. One relates to good will and the other to commissions on the sale of stock.

It is urged on the part of plaintiff that the evidence shows that when plaintiff's assets were sold there was included a good will which on March 1, 1913, was worth not less than $250,000, and that the amount of this good will should have been included by the Commissioner in plaintiff's assets and considered in determining the gain or loss on the final sale thereof to the Indiana company. In this connection it should be said that although there is some mention in the claim for refund of an alternative claim that instead of a sale of the assets there was a sale of the stock of plaintiff to the Indiana company, this claim seems to have been abandoned and the plaintiff's counsel now practically concede that the transactions between the plaintiff and the Monarch company amounted to a sale of all of the plaintiff's assets to that concern which assumed all of plaintiff's liabilities to the stockholders for the proceeds of the sale.

It will be observed that it is claimed that this good will existed on March 1, 1913, which was the date on which the plaintiff was authorized to commence business and the date when it did begin business as a corporation.

The evidence shows that a special feature of the plan on which plaintiff was organized was that of having an insurance company which would be owned and controlled by individuals with Catholic faith and would specialize in writing insurance on property owned by Catholics. A response to the idea was found among Catholics, both lay and clergy, and on July 26, 1911, plaintiff was organized with prominent Catholics as its officers and directors. The promoters of the company in selling its stock presented an appeal to Catholics generally, referring to the amount of insurance taken out by Catholics and the nature of the organization as showing certain advantages which would accrue to the company, and in the stock selling campaigns it was the practice of the salesmen to secure pledges of insurance to be taken out with the plaintiff. Between $30,000,000 and $40,000,000 worth of insurance was pledged prior to December 31, 1913, and from one-half to two-thirds of that amount was pledged prior to March 1, 1913, during the sale of the first issue of the stock. These pledges were generally fulfilled. The stock salesmen in addition to being paid a commission on the sale of the stock received a commission on the pledges taken.

It is urged on behalf of plaintiff not only that the good will was acquired through these pledges so obtained, but that from the nature of the organization of the company and the appeal which it would naturally make to people of the Catholic faith, that a valuable good will existed on March 1, 1913.

On behalf of the defendant it is contended that plaintiff acquired no good will and that if any was acquired the evidence entirely fails to show the value thereof.

There is much discussion in the arguments of respective counsel as to what may or may not constitute good will. We shall not undertake to set out the controlling features of good will when viewed as constituting an asset further than may be necessary to determine whether there is any evidence which shows the value thereof to the plaintiff on March 1, 1913, the date when the company was organized and when it is claimed it existed.

It will be remembered that prior to this date the company had done no business although parties soliciting subscriptions for stock had obtained contracts which provided for taking out policies when the company came into existence. While these contracts may have had some value above the commissions paid to agents for obtaining them and the cost to the company of carrying the insurance risk, the amount thereof, if there was any such value, is not shown by the evidence. It was quite probable that the stockholders were moved to make these contracts by reason of the particular nature of the organization of the company, but the fact that they held stock in the company may have influenced them as much or more in agreeing to take out the insurance. However this may be, there is nothing here upon which any value was placed by the evidence, nor do we think any could be placed as a matter of good will. It may be argued that as soon as the company was organized it had certain advantages in acquiring the business of Catholics, and if we understand plaintiff's argument correctly this constituted good will of a very considerable value. Without determining whether such advantage in fact constituted good will in a legal sense with reference to the tax statutes, we must again say that there is no satisfactory evidence of its value.

It should also be said in this connection that the fact that surrounding conditions make it likely that a new corporation will be able to secure a profitable business is not of itself sufficient to show that it possessed a valuable good will at the time it entered upon the transaction of business. Corporations are seldom formed unless those organizing them believe that the business to be carried on will be profitable and that the time is favorable for creating a new corporation. Sometimes the anticipated results follow and the corporation is successful from the outset. If the judgment of the promoters be wrong, a loss or failure will result, but if successful, the success alone is not sufficient to prove the existence of good will. We have entered a finding to the effect that there is no satisfactory evidence of the good will, if any, that the plaintiff possessed, and therefore hold that the Commissioner was correct in refusing to make any allowance or deduction therefor in computing the tax upon the sale of plaintiff's assets.

The evidence shows that plaintiff paid commissions to the amount of $525,000 on the sale of its stock on two different occasions, one of which was before or at the time of its organization and the other a short period later. It is contended on behalf of the plaintiff that this expense is a part of the cost of organization of the company and should be amortized over the period of the organization thereof.

If the question thus raised were new and original, we think it might present an interesting problem. The Board of Tax Appeals and the courts, whenever the question has arisen of making a deduction by amortization or the discount on the sale of bonds or commissions paid for the allowance thereof, seem to have uniformly held in favor of the taxpayer. It would seem there was as much reason for allowing a commission upon the sale of stock sold for the purpose of obtaining capital as in allowing a commission on the sale of bonds for the same purpose where the length of time the capital so obtained by sale of stock is known as it was in this case. If there is a distinction it is because the issuance of bonds created an absolute liability, but the sale of stock did not. In each instance it may seem that the commissions were the cost of obtaining capital, and if the rule with reference to commissions on bonds is followed this cost should be amortized over the period that the capital was used. But the decisions of the Board of Tax Appeals and of the courts which have considered the question, so far as they have decided it either directly or indirectly, all appear to be against the taxpayer. It is true that in most of these cases the corporation was still in existence and there was no way of determining for what length of time the capital which had been obtained by the sale of stock would be used and therefore no way of determining the amount of amortization for any particular year. But this fact was not given as a reason for any of these decisions. On the contrary they were based upon grounds which are entirely inconsistent with the allowance of the deduction claimed by plaintiff. In *Simmons Co.* v. *Commissioner* (33 Fed. (2d), 75 [Ct. D. 96, C. B. VIII-2, 317]), it was held, in effect, that commissions paid to bankers for sales of stock were not organization expenses nor "ordinary and necessary expenses" within the meaning of the tax law, and, further, that "commissions paid for marketing stock simply diminish the net return from the stock issue" and are equivalent to an issue of stock at a discount. This decision was rendered in 1929, and was based upon the Treasury regulations. The court gave as a reason for upholding the regulations the fact that they had existed and had been in force for a long time without any change in the law by Congress.

In *Corning Glass Works* v. *Lucas* (37 Fed. (2d), 798), the rules laid down in the Simmons Co. case, supra, were approved, and the court again called attention to the fact that its decision was supported by Treasury regulations promulgated under the Revenue Acts of 1921, 1924, 1926, and 1928, and also called attention to a Treasury decision promulgated in 1922 to the effect that a commission paid for marketing preferred stock was a capital expenditure, and said that this interpretation of section 234(a)1 of the Revenue Act of 1921 was impliedly approved by Congress through the reenactment of the section in unchanged form in the Revenue Act of 1924. If the commission so paid was a capital expenditure, it is obvious that it is not an ordinary and necessary expense of business, and that it can not be amortized as a part of the cost of obtaining capital, or treated as organization expense for the purpose of allowing a deduction therefor. In the Revenue Acts of 1926 and 1928, section 234 was reenacted, and as the Revenue Acts enacted since have made no change in it the reasoning of the decisions in the two cases cited above applies with increased force. Plaintiff cites the cases of *Hershey Manufacturing Co.* v. *Commissioner* (14 B. T. A., 867, 43 Fed. (2d), 298) and *Malta Temple Association* v. *Commissioner* (16 B. T. A., 409), but it is not necessary to review the decisions therein. Neither of the cases involved any question with respect to commissions paid or discounts allowed on the sale of corporate stock, but dealt only with organization expenses, and we are of the opinion that the commissions in question in the case now before us can not be held to be organization expenses.

It thus appears that for more than 13 years Treasury regulations have been promulgated denying any deduction on account of commissions paid for sales of stock, and from time to time the courts and the Board of Tax Appeals have approved these regulations. Although numerous Revenue Acts have been enacted since these regulations were first promulgated, Congress has not seen fit to take any action changing the statute. Under these circumstances, we think the law must be considered settled, and that no deduction can be allowed plaintiff on account of this matter.

In this connection we think it ought to be said that even if plaintiff's contention for amortization of the commissions involved were sustained, there does not appear to be any rule of law under which we could allow the plaintiff any further deduction than the *pro rata* part of such expenses for the last year. In other words, there does not seem to be any method of giving the plaintiff a complete and logical remedy under the theory that the commissions were part of cost of capital.

The plaintiff is entitled to recover the amount of improper excess in its taxes arising from the failure to allow as a deduction expenses incurred in acquiring the assets of the Columbian Fire Insurance Co. of Indiana. Before judgment is entered, counsel for the respective parties may submit to the court a stipulation as to the amount of judgment which should be entered in accordance with this opinion if they can agree thereon. If not, they may submit computations of this amount as they respectively consider it should be determined, and upon consideration thereof the court will enter final judgment.

WHALEY, Judge; WILLIAMS, Judge; LITTLETON, Judge; and BOOTH, Chief Justice, concur.

**Article 591: Basis for determining gain or loss from sale.** XV-22-8103 Ct. D. 1121

INCOME TAX—REVENUE ACT OF 1928—DECISION OF COURT.

1. Income—Liquidation of Contracts—Valuation—Evidence—Burden of Proof.

In January, 1929, the taxpayer corporation acquired, in exchange for some of its stock, certain contracts owned by former stockholders of a corporation which had sold its assets to another, one of the contracts providing for an option to pay the consideration either in a lump sum or in an agreed percentage of the profits of operations for three years thereafter. In December, 1929, the option was exercised and the contracts liquidated by the payment of the agreed sum of money. In determining the tax liability for 1929, the amount realized in connection with the liquidation of the contracts constituted gross income and the excess of such amount over the cost represented taxable profit. The burden of proof which rests upon the taxpayer in an attack upon the Commissioner's valuation of the contracts, which valuation is presumptively correct, was not sustained by the evidence submitted.

2. Decision Affirmed.

Decision of the Board of Tax Appeals (30 B. T. A., 491) affirmed.

United States Circuit Court of Appeals for the Ninth Circuit.

*Peerless Investment Co., an Oregon Corporation, petitioner,* v. *Commissioner of Internal Revenue, respondent.*

Upon petition to review an order of the United States Board of Tax Appeals.

Before Wilbur, Denman, and Mathews, Circuit Judges.

[December 17, 1935.]

OPINION.

Denman, Circuit Judge: The petitioner herein seeks a review of a decision of the United States Board of Tax Appeals finding a deficiency in petitioner's 1929 income tax of $2,728.92 and denying his claim for refund of $5,688.91, the tax already paid for the year in question.

In 1928 one William L. James, acting on behalf of the Pacific Stages Co., an Oregon corporation, and on behalf of all its stockholders, of which he was one, sold to the Southern Pacific Motor Transport Co., a competitor, an option to purchase the entire stock of Pacific Stages. The consideration for the sale was to be the sum resulting from an appraisal of all the assets of Pacific Stages at the time of the sale, plus one-half the profits of its operations for three years thereafter.

In October, 1928, a supplemental agreement was concluded between James and the Transport company whereby it was provided that the latter should have the privilege of paying the sum of $90,000 in lieu of one-half the profits for three years.

In December, 1928, the Transport company exercised its option to purchase. The immediate consideration, based on appraisal of the assets of Pacific Stages, was $116,487.54. Of this sum the Transport company at that time paid all but $10,356.24 which it retained to meet contingent claims against the assets. It was uncertain, at this time, whether the vendee would render the remainder of the consideration in payments of half the profits over a period of three years, or in a lump sum of $90,000 as it was privileged, under the supplemental agreement, to do.

After the sale, seven former stockholders of Pacific Stages, including James, owning 705 of the 1,908½ outstanding shares of that corporation (which stock had by this time, of course, passed to the Transport company), purchased from the other former stockholders their entire rights under the contract with the Transport company, at the rate of $80 per share of their former holdings. These obligations were satisfied out of the $106,131.27 already paid by the buyer, leaving in the hands of James a balance of $9,851.27. Also due James as representative of the seven former stockholders was so much of the $10,356.24, retained by the Transport company to meet contingent obligations of Pacific Stages, as was not required for that purpose, and the stated percentage of profits or the $90,000, whichever the Transport company should choose to pay.

In January, 1929, James and his six associates, former stockholders of Pacific Stages, incorporated the Peerless Investment Co., petitioner herein, under the laws of Oregon. The new corporation had an authorized capital stock of 1,000 shares at the par value of $100 each. Seven hundred and five shares were issued to the seven associates in like proportion as they had held stock in Pacific Stages. The consideration for these 705 shares consisted of all rights under the Transport company contract held by the associates, including the rights they had taken over from the remaining former Pacific Stages stockholders, plus the $9,851.27 still retained by James out of the original payment made to him by the Transport company.

In May and August of 1929, the Transport company paid to petitioner the $10,356.24 which it had retained out of the original payment on the sale contract to meet contingent claims. In December, 1929, it exercised the supplemental option to pay $90,000 in lieu of half the profits for three years and paid petitioner $30,000 in cash and $60,000 in promissory notes.

In its original income return for 1929, petitioner showed a profit of $39,069.27, at which it arrived by subtracting the value of the Transport company contracts when received from the amounts realized thereon. In computing the amounts realized, petitioner added the $30,000 cash and $59,361.76 discounted value of the notes, both cash and notes received in December, 1929, to the $10,356.24 paid over in May and August, the sum which had been retained by the Transport company to meet contingent claims. These items made a total realized of $99,718. The subtracted value of the contracts when received was estimated by the petitioner to be $60,648.73.

The Commissioner, in his redetermination of the tax liability for 1929, did not treat the $10,356.24 item as income, but listed it together with the $9,851.27 cash paid in by James at organization on both sides of the ledger, that is, as a portion of the amounts realized on the contracts and as value paid in at the time of organization.

This left for computation the value of the Transport company's optional obligation to pay either the stated percentage of the profits for three years or $90,000. The Commissioner valued this contract at $36,192.49 at the time it was received by the petitioner. Petitioner produced no evidence to refute this valuation found by the Commissioner other than an opinion by James that, because competition had been removed, the profit should increase, and the exercise of the option to pay the $90,000 in lieu of the profits 11 months after the acquisition of the contract by petitioners. We can not disturb the finding of the Board that such evidence is insufficient to overcome the presumption of the correctness of the Commissioner's valuation of $36,192.49. (*Wickwire* v. *Reinecke*, 275 U. S., 101, 105 [T. D. 4126, C. B. VII-1, 316]; *Welch* v. *Helvering*, 290 U. S., 111, 115 [Ct. D. 755, C. B. XII-2, 112].)

After the exercise of the option the amount realized was $89,361.76 in cash and discounted notes. The differential was $53,169.27, a taxable gain. The Board of Tax Appeals sustained the Commissioner, decreed a deficiency, and rejected petitioner's claim for a refund of taxes already paid.

The decision is clearly correct. That a taxpayer who acquires an asset for $36,000 in January and realizes $89,000 on that asset in December has realized a taxable gain seems too obvious for argument. Petitioner's arguments for a contrary result in this case are somewhat confused and unilluminated by the citation of a single case. For example, the petitioner contends that, "There was no sale or exchange, but a mere realization by the corporation of the amounts due upon the capital asset."

If this is an assertion that an increment in capital assets is not taxable income, the assertion is completely denied by *Eisner* v. *Macomber* (252 U. S., 189, 207 [T. D. 3010, C. B. 3, 25]) and *United States* v. *Kirby Lumber Co.* (284 U. S., 1, 3 [Ct. D. 420, C. B. X-2, 356]). If it is intended to be argued that taxable gain may not result from the *discharge* of a contract obligation at an enhanced valuation, as distinguished from the *sale* of such obligation, the argument is without merit. (*Ruth Iron Co.* v. *Commissioner* (C. C. A.), 26 Fed. (2d), 30, 33; *Eldredge* v. *United States* (C. C. A.), 31 Fed. (2d), 924, 928; *Wells Amusement Co.* v. *Commissioner* (C. C. A.), 70 Fed. (2d), 209, 212.)

We take this argument to be in effect, as are other points urged by petitioner, that the value of the contract with the Transport company was substantially greater than the Commissioner's estimate of $36,192.49. But, as we have pointed out, the burden of proof in an attack on the Commissioner's valuation rests upon the taxpayer, and the Board found that the burden in this case was not sustained.

Affirmed.

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ARTICLE 591: Basis for determining gain or loss from sale. XV-26-8143 Ct. D. 1130

INCOME TAX—REVENUE ACT OF 1928—DECISION OF COURT.

1. DEDUCTION—LOSS—SURRENDER OF LIFE INSURANCE POLICY.

A corporation which took out insurance upon the life of one of its principal officers for its own benefit is not entitled, upon surrender of the policy, to deduct as a loss the excess of the net cost of the insurance over the cash surrender value. In the absence of proof as to what part of the premiums was paid for protection and what part for investment, it is presumed that the cash surrender value corresponds with the amount of the reserve and hence no loss was established, since the cost was approximately reflected in the cash surrender value. The portion of the premiums not used to build up the reserve was paid to obtain the protection afforded.

2. CERTIORARI DENIED.

Petition for certiorari denied April 27, 1936.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

*London Shoe Co., Inc., petitioner,* v. *Commissioner of Internal Revenue, respondent.*

Appeal from the United States Board of Tax Appeals.

Before MANTON, AUGUSTUS N. HAND, and CHASE, Circuit Judges.

[December 9, 1935.]

OPINION.

From an order of the Board of Tax Appeals determining that there was a deficiency of $3,713.48 in income taxes of London Shoe Co., Inc., for the year 1931, the taxpayer appeals. Affirmed.

AUGUSTUS N. HAND, Circuit Judge: This appeal involves income taxes of London Shoe Co., Inc., for the year 1931, and the sum in controversy is $3,115.44.

In 1924 that company insured the life of Marcus Weingarten, one of its principal officers, for $100,000. Under the terms of the policy the taxpayer was designated as the beneficiary and a gross annual premium of $9,097 was required to be paid so long as Weingarten was alive unless the policy was to determine other than by reason of the death of the insured. Between 1924 and 1931, the taxpayer paid for premiums the aggregate sum of $63,679 and received as dividends $13,117, leaving $50,562 as the net amount expended for the insurance. The premiums were not deducted as an expense during any of the taxable years. The policy was surrendered and canceled in 1931 and the taxpayer received $24,600 as the cash surrender value of the policy. In its income tax return for that year it claimed a deductible loss of $25,962 based upon the difference between $50,562, the net cost of the insurance, and the cash surrender value of $24,600. In assessing the tax for the year 1931, the Commissioner rejected the deduction claimed. Upon an appeal by the taxpayer to the Board of Tax Appeals the Board likewise disallowed the deduction and because of this determined a deficiency in taxes of $3,713.48.

A life insurance policy ordinarily combines investment with insurance protection. The decision in *Lovell* v. *St. Louis Mutual Life Insurance Co.* (111 U. S., 264, 274), where the contract was terminated by the act of the company and the policyholder demanded a return of all premiums paid, with interest, less the amount of his premium note, illustrates this double feature. The court there said:

"But we do not think that he is entitled to a return of the full amount of his premiums paid. He had the benefit of insurance upon his life for five years, and the value of that insurance should be deducted from the aggregate amount of his payments. In other words, the amount to which the complainant is entitled is, what is called and known in the life insurance business as the value of his policy at the time it was surrendered, with interest, less the amount of his premium note, which should be surrendered and canceled."

In the earlier years of a policy, the annual life premium is in excess of the amount required to pay the current cost of insurance protection and such excess is retained by the insurance company as a reserve and increased at compound interest at an agreed rate for the purpose of making good the deficiency in later years when the annual premium is no longer sufficient to pay for the actual cost of insurance. The fund accumulated out of the excess premiums is known as the "reserve" on the policy and represents the investment portion of the premium payments held for the benefit of the policyholder. In case the policy is surrendered or allowed to lapse the holder may receive the reserve held for his benefits known as the "cash surrender value" which represents the equity of the insured in the policy above the amounts paid for protection. The nature of a "surrender value" was described by the Florida District Court in *In re Morgan* (282 Fed., 650), substantially as above. In order to determine whether there was any loss in the present case, the taxpayer would have to show what portion of the premiums was attributable to investments and whether the cash surrender value was less than such portion. It may be assumed in the absence of any proof to the contrary that the cash surrender corresponds with the amount of the reserve, that is to say, with the excess of premiums over what was required for protection.

It is argued that in *Lucas* v. *Alexander* (279 U. S., 573 [Ct. D. 76, C. B. VIII-2, 273]), the Supreme Court applied another rule and held where, upon the surrender of the policies, the amount received was in excess of the premiums paid the difference was taxable gain within the provisions of section 213 of the Revenue Act of 1918 which provided:

"A. That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property * * * the basis shall be:

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

In other words, it is said that the difference between the amount received as a surrender value and the premiums paid is the measure of the tax "against the profits and income derived from any source whatever." We think, however, that such was not the effect of the decision. It is true that Justice Stone at one place in his opinion (page 576) said:

"By the expenditure of $78,100 in premiums, the insured secured a return of $120,797, resulting in an economic and realized money gain to him of $42,697."

But he neither said, nor did the Court hold, that the difference was a taxable gain. In that case the policies were taken out in 1899, the premiums had been fully paid in 1908 and in 1919 the policyholder was given the option of receiving on each policy the sum of $50,000 plus the cash dividend then apportioned by the company. The question of the cost of the capital asset was not before the Court but only the fair market value as of March 1, 1913, and the gain realized after that date. It was held that the gain was the difference between the cash surrender value of the policy on March 1, 1913, plus dividends then collectible and the cash surrender value plus dividends received when the policy was surrendered. The Court was not dealing with the cost of the policy but its value on March 1, 1913.

It was the failure to take into account the two factors of investment and insurance protection which are inherent in the ordinary life policy that explains the decision in *Forbes Lithograph Mfg. Co.* v. *White* (42 Fed. (2d), 287), with which, with all respect, we must differ. The precise question we have to determine was before the Circuit Court of Appeals of the Third Circuit in *Century Wood Preserving Co.* v. *Commissioner* (69 Fed. (2d), 967). That court declined to follow *Forbes Lithograph Mfg. Co.* v. *White*, supra, and held that a corporate taxpayer was not entitled to deduct as a business loss the difference between the cash surrender value of a life insurance policy and the amount of premiums paid. The holding of the third circuit that cost is approximately reflected in the cash surrender value of a policy and consequently that there could be no loss though the premiums exceeded the value seems to us correct and applicable to the facts before us.

Section 22(b)2 of the Revenue Act of 1928 exempts from taxable income:

"Amounts received (other than amounts paid by reason of the death of the insured and interest payments on such amounts) under a life insurance, endowment, or annuity contract, but if such amounts (when added to amounts received before the taxable year under such contract) exceed the aggregate premiums or consideration paid (whether or not paid during the taxable year) then the excess shall be included in gross income."

It is argued that, because the foregoing subdivision provides that gain shall be ascertained by taking the total amount paid in on one side from the total amount received upon the closing out of the transaction, a similar rule ought to be applied where there is a loss. But there is no special statutory provision for computing deductible losses in cases where the premiums paid for a life insurance policy exceed the amount of the reserve or the cash surrender value. The subdivision dealing with the computation of taxable gains somewhat favors the taxpayer at the expense of the Government because it allows the deduction of the full amount of the premiums paid from the total amount received, though the premiums are in excess of what would normally be required for insurance protection, and thus lessens the amount of the taxable gain. It does not necessarily result that such statutory indulgence will be given the taxpayer in computing losses especially where there is no statutory provision that contains language that will justify it.

Section 113 of the Act of 1928 contains a general clause for computing loss which states the law applicable to the present situation. It provides that:

"The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property."

Here the cost of the proceeds which the taxpayer received upon the surrender of the policy seems to have been approximately the amount of excess premiums set apart from year to year as a reserve. Section 22(b)2 which is a specific statute dealing with gains has nothing to do with the mode of calculating the losses that may be deducted when the cash surrender value of a life insurance policy is paid. They are governed by the general provisions of section 23 (f) (g) and section 113. Losses, if any, would be represented by the amount by which the premiums so far as they are paid toward the reserve exceed the cash surrender value of the policy.

We can see no escape from the conclusion reached by the Board that no loss was established in this case for the reason that the cost was approximately reflected in the cash surrender value. The portion of the premiums not used to build up the reserve was paid to obtain the insurance protection which was for many years afforded. (*Century Wood Preserving Co.* v. *Commissioner*, 69 Fed. (2d), 967; *Keystone Consolidated Publishing Co.*, 26 B. T. A., 1210; *Standard Brewing Co.*, 6 B. T. A., 980.)

The order of the Board of Tax Appeals is affirmed.

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## ARTICLE 597: Property acquired upon an exchange. XV-6-7940 Ct. D. 1075

INCOME TAX—REVENUE ACT OF 1928—DECISION OF SUPREME COURT.

1. CAPITAL GAIN—SALE OR EXCHANGE OF STOCK—BASIS—VALUATION OF OPTIONED STOCK.

The taxpayer acquired stock of a corporation in December, 1922, at much less than its market value, agreeing to refrain from competing business and to give the corporation an option to repurchase at par a part of the stock. Later in 1922 he exchanged all the stock so acquired for common and redeemable preferred stock of the corporation, and in 1929 the preferred stock was redeemed at $110 per share. Under these facts, the basis for determining capital gain derived from redemption of the stock was the fair market value in 1922 of the shares then held, and, considering the outstanding option to repurchase at par, the fair market value did not exceed $100 per share.

2. JURISDICTION OF CIRCUIT COURT OF APPEALS—QUESTION OF ESTOPPEL.

Where the question whether the taxpayer was estopped, because of failure to report income from purchase of stock at a bargain price in 1922, to claim that the fair market value, and not cost, in 1922 was the basis for determining gain from redemption of the stock in 1929, was not presented to nor considered by the Board of Tax Appeals, the circuit court of appeals has no jurisdiction to pass upon the question. *General Utilities, etc., Co.* v. *Helvering* (Ct. D. 1055, page 214, this Bulletin), decided December 9, 1935, followed.

SUPREME COURT OF THE UNITED STATES.

No. 173. *Guy T. Helvering, Commissioner of Internal Revenue, petitioner,* v. *Samuel A. Salvage.*

No. 280. *Samuel A. Salvage, petitioner,* v. *Guy T. Helvering, Commissioner of Internal Revenue.*

[January 13, 1936.]

OPINION.

Mr. Justice MCREYNOLDS delivered the opinion of the Court.

These cross writs bring up a judgment of the Circuit Court of Appeals, Second Circuit, which disapproved a deficiency assessment for 1929 income; and authorized recovery for overpayment below the taxpayer's claim.

The petition for certiorari in No. 173 asserts: "The question is—Whether the taxpayer is estopped to claim that the difference between the market value of the 1,500 shares as of December 30, 1922, and their cost to him constituted taxable income to him for 1922; and hence that the fair market value of these shares, and not their cost, is the basis to be used in measuring the gain from the disposition of the shares in 1929, no income from the transaction having been reported in 1922."

The points to be urged in No. 280 are stated thus—"The circuit court of appeals erred: (1) In holding that the cost base of the preferred stock of American Viscose Corporation redeemed in 1929 was to be arrived at by taking as the fair market value of the Viscose company stock the sum of $100 per share, in so far as the five-sevenths of said stock which was subject to the option to repurchase was concerned. (2) In making a finding as to the value of said optioned stock."

Prior to 1922, Salvage, the taxpayer, bought 25 shares, Viscose company stock. He paid $166.66 for each one—for all $4,166.66. In December, 1922, he acquired from the corporation 1,500 shares for which he paid $100 per share ($150,000) and entered into an obligation to refrain from competing business, etc. Also, he agreed that during 1923 the corporation might repurchase five-sevenths of 1,500 shares at par; during 1924, four-sevenths, etc. Intrinsically (when unincumbered) a share of the company stock was then worth $1,164.70.

Later during 1922, all these shares (1,525) were exchanged for 6,100 preferred shares, redeemable at $110, and 7,625 common shares, American Viscose Corporation. The basis of exchange was four preferred and five common shares of new stock for one share of old. The taxpayer's return for 1922 (not in evidence) showed no gain from these transactions.

During 1929, American Viscose Corporation redeemed its preferred shares at $110; Salvage received $671,000. His return for that year disclosed as net capital gain the difference between that sum and $154,166.66, total outlay for the 1,525 converted shares. Upon this, he paid the assessed tax. Apparently, he supposed apportionment between preferred and common stock of their total cost was impossible or unnecessary; also that no taxable gain arose before return of his entire outlay.

Upon an audit, the Commissioner ruled that proper apportionment of the total cost—$154,166.66—could be made. He assigned 37+ per cent to the preferred and 62+ per cent to the common shares and made a deficiency assessment of $12,005.38. Thereupon, the taxpayer claimed, first that in 1922 each Viscose company share was fairly worth $1,164.70 and with that as the base, no taxable gain arose upon redemption of the preferred stock. Also that he had overpaid to the extent of $63,750. Second, that apportionment of the cost of both between preferred and common shares was impracticable and no taxable gain could arise prior to recovery of the full outlay.

Upon these conflicting claims, the Board of Tax Appeals took the matter. There the Commissioner asserted correctness of his action; he presented no affirmative defense; set up no claim of estoppel because of the taxpayer's failure properly to report 1922 gain.

The Board held the difference between the true value of Viscose company shares and the price paid by the taxpayer was not compensation for services; also that the deficiency assessment was properly made. Estoppel was neither presented nor considered.

The court below held that the consideration for the Viscose company stock acquired in 1922 was $100 per share, plus the covenants to resell five-sevenths at par, etc., and not to engage in competing business. Also that the base cost for estimating capital gain in 1929 was the fair market value in 1922 of the shares then held. And since the corporation had the right to repurchase at par, the market value of five-sevenths did not exceed $100 per share. Further, that the failure to disclose 1922 taxable gain apparently resulted from innocent mistake of law; there was no false representation of fact; nothing gave support to the claim of estoppel. The cause was remanded for ascertainment of the amount of the overpayment.

We find no reason to disagree with the judgment of the court.

The defense of estoppel was not before the Board. Under what we regard as the correct practice (*General Utilities, etc., Co.* v. *Helvering*, December 9, 1935 [Ct. D. 1055, page 214, this Bulletin]), the court should have passed the point. Furthermore, the facts disclosed give it no support.

Considering the option to repurchase at par, outstanding in 1922, there could be no proper finding of fair market value at that time in excess of $100 per share. In the cirumstances, the court did not err in so holding.

Pertinent Treasury regulations, rulings and judicial opinions are adequately pointed out by the court's opinion.

The judgment is affirmed. The cause will be remanded for further proceedings.

Affirmed.

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## SECTION 114.—BASIS FOR DEPRECIATION AND DEPLETION.

### ARTICLE 611: Basis for allowance of depreciation and depletion.

XV–9–7973
Ct. D. 1084

INCOME TAX—REVENUE ACTS OF 1926 AND 1928—DECISION OF COURT.

1. DEDUCTION—DEPLETION—BASIS—OIL AND GAS WELLS—CASINGHEAD GASOLINE.

Where oil wells produce a mixture known as "wet gas" which is separated in the producer's plant into two merchantable products, casinghead gasoline and dry gas, the market value of the casinghead gasoline content of the wet gas as it emerges from the well, rather than the amount actually received from the sale of the casinghead gasoline after the process of extraction, is to be included in the gross income from the property for the purpose of computing the percentage depletion allowed by section 204(c)2 of the Revenue Act of 1926 and section 114(b)3 of the Revenue Act of 1928.

2. DECISION AFFIRMED.

Decision of the Board of Tax Appeals (29 B. T. A., 1134) affirmed.

3. CERTIORARI DENIED.

Petition for certiorari denied October 14, 1935.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

*Brea Canon Oil Co., a Corporation, petitioner,* v. *Commissioner of Internal Revenue, respondent.*

Upon petition to review an order of the United States Board of Tax Appeals.

Before WILBUR and GARRECHT, Circuit Judges, and CAVANAH, District Judge.

[April 22, 1935.]

OPINION.

WILBUR, Circuit Judge: The petitioner seeks to review an order of the Board of Tax Appeals relating to its income tax for the calendar years 1926 to 1930, inclusive, involving the total tax of $36,625.49. The question involved relates to the depletion allowance upon gross proceeds from oil and gas wells under the Revenue Act of 1926 (section 204(c)2; Revenue Act of 1928, section 114(b)3, which provides that "in case of oil and gas wells the allowance for depletion shall be 27½ per centum of the gross income from the property during the taxable year."

Petitioner's wells produce what is known as casinghead gasoline, that is, a very volatile gasoline which comes from the well in the form of gas mixed with the more stable gas known as natural, or dry, gas. The mixture is called wet gas. After separation the merchantable products consist of casinghead gasoline and dry gas. The respondent contends, and petitioner admits, that the process of extraction of the casinghead gasoline from the wet gas is a manufacturing process. The respondent, in estimating the basis upon which the percentage of 27½ per cent should be allowed for depletion took 40 per cent of the gross receipts from the casinghead gasoline as the market value of the casinghead gasoline content of the wet gas as it emerged from the well, and held that the remaining 60 per cent of the gross receipts from casinghead gasoline was attributable to the manufacturing process and, consequently, did not constitute "income from the property" within the meaning of the Revenue Act of 1926 (section 204(c)2; Revenue Act of 1928, section 114(b)3).

It is conceded by the petitioner that if the gross proceeds derived from the sale of casinghead gasoline should be apportioned at all, the apportionment of 40 per cent of the gross proceeds from casinghead gasoline as the value of the gasoline content of the wet gas is correct. The sole question for our consideration then is whether or not the amount actually received from the sale of casinghead gasoline by the petitioner is subject to the allowance of 27½ per cent for depletion, or whether the depletion should be estimated upon the market value of the gasoline content of the wet gas. The regulations of the Commissioner adopted under this Act are quoted in full in the footnote.[1]

While the Act of Congress and regulations adopted in pursuance thereof must be construed according to their plain import, it should be borne in mind in determining the amount of the depletion allowance that such allowance is

[1] Commissioner's regulations:

Regulations 69—Relating to the Revenue Act of 1926:

ART. 201. * * * When used in these articles (201–237) covering depletion and depreciation—

(*c*) A "mineral property" is the mineral deposit, the development and plant necessary for its extraction, and so much of the surface only as is reasonably expected to be underlaid with the mineral. The value of a mineral property is the combined value of its component parts.

(*d*) A "mineral deposit" refers to minerals only, such as the ores only in the case of a mine, to the oil only in the case of an oil well, and to the gas only in the case of a gas well, and to the oil and gas in the case of a well producing both oil and gas. The value of a mineral deposit is the value of the mineral property, less the value of the plant and equipment, and less the value of the surface of the land for purposes other than mineral production. The cost of a mineral deposit is that proportion of the total cost of the mineral property which the value of the deposit bears to the value of the property at the time of its purchase.

ART. 207. *Determination of fair market value of oil and gas properties.*—* * *

(*b*) To determine the fair market value of an oil and/or gas property by the present value method, the essential factors must be determined for each deposit included in the property. The factors are (1) the total quantity of oil and/or gas in terms of the principal or customary unit (or units) paid for in the product marketed, (2) the quantity of oil and/or gas expected to be recovered during each operating period, (3) the average intended to represent the amount of capital recovered in the product produced by the well, that is the value of the raw product. As stated by the Supreme Court, speaking through Justice Brandeis, in *United States* v. *Ludey* (274 U. S., 295, 302 [T. D. 4046, C. B. VI-2, 157]):

"The depletion charge permitted as a deduction from the gross income in determining the taxable income of mines for any years represents the reduction in the mineral contents of the reserves from which the product is taken. The reserves are recognized as wasting assets. The depletion effected by operation is likened to the using up of raw material in making the product of a manufacturing establishment. As the cost of the raw material must be deducted from the gross income before the net income can be determined, so the estimated cost of the part of the reserve used up is allowed."

Consequently, the Commissioner has provided in his regulations that "if the oil and gas are not sold on the property but are manufactured or converted into a refined product or are transported from the property prior to sale, then the gross income shall be assumed to be equivalent to the market or field price of the oil and gas before conversion or transportation."

The petitioner concedes the validity of these regulations but contends that the plant for the extraction of the casinghead gasoline from the wet gas is a part of the property from which the gasoline is produced, and therefore the extraction plant being erected upon the property and used in connection with the production of the casinghead gasoline that it is the gross income derived from the sale of the gasoline rather than the market value of the wet content of the natural gas which should be used as a basis for the depletion allowance. Petitioner cites Regulations 69, article 201, as follows:

"ART. 201. When used in these articles (201-237) covering depletion and depreciation—

"(*c*) A 'mineral property' is the mineral deposit, the development and plant necessary for its extraction, and so much of the surface only as is reasonably expected to be underlaid with the mineral. The value of a mineral property is the combined value of its component parts."

The petitioner also points to the fact that the Commissioner has treated the process of dehydrating oil as a part of the method of production of the oil and has allowed the 27½ per cent depletion upon the income from the oil sold after dehydration and contends that the process of separating the casinghead gas from the wet gas is essentially the same. There is an obvious difference. In the latter case the wet gas is composed of two marketable products and is salable as such and has a market value, whereas the water content of the oil produced by a well is an impurity like the oil sand which is also sometimes mixed with the oil. Both may be separated by the operation of gravity—a settling process—although more complicated processes have been utilized. However that may be, it is immaterial for the purpose of this case whether or not the Commissioner is correct in ignoring the dehydrating process in estimating the depletable base where the oil produced contained a large water content, if he is correct in limiting the petitioners herein to the market value of the casinghead gasoline content of wet gas produced from the petitioner's property. In the latter case, it is conceded that the process is a manufacturing

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quality or grade of the oil and/or gas reserves, (4) the expected percentage of recovery in each process or operation necessary for the preparation of the oil and gas for market, (5) the probable operating life of the deposit in years, (6) the unit development cost, that is, cost of development exclusive of depreciation and depletion, (7) the unit operating cost, that is, cost of production exclusive of depreciation and depletion, and, (8) the rate of interest commensurate with the risk for the particular deposit. When the deposit has been sufficiently developed these factors may be determined from past operating experience. In the application of factors derived from past experience full allowance should be made for probable future variations in the rate of exhaustion, quality or grade of the oil and/or gas, percentage of recovery, cost of development, production, interest rate, and selling price of the product marketed during the expected operating life of the oil and/or gas deposit.

(*e*) The number of units of oil and/or gas recoverable in marketable form multiplied by the difference between the selling price and the operating cost per unit gives the total expected operating profit. The value of each oil or gas deposit is then the total expected operating profit from that deposit reduced to a present value as of the basic date at the rate of interest commensurate with the risk for the operating life, and further reduced by the value at the basic date of the depreciable assets and of the capital additions, if any, necessary to realize the profits. The degree of risk is generally lowest in cases where the factors of valuation are fully supported by the operating record of the oil and/or gas property prior to the basic date; relatively higher risks attach to appraisals upon any other basis.

process and under the regulations of the Commissioner it is the market value of the net product that constitutes the depletable base. Also, it is immaterial that the manufacturing process is relatively simple, although it appears from the record that a large capital investment is necessary for the separation of the gasoline content of the wet gas.

The rule of the Commissioner is conceded to be lawful. The action of the Commissioner follows the rule and is presumptively correct.

Order affirmed.

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ARTICLE 611: Basis for allowance of depreciation and depletion. XV-9-7974 Ct. D. 1085

INCOME TAX—REVENUE ACT OF 1928—DECISION OF COURT.

1. DEDUCTION—DEPLETION—OIL AND GAS WELL.

The owner of a natural gas well whose business was the production, transportation, and sale of its product to consumers, is entitled to deduction for depletion, under the provisions of section 114(b)3 of the Revenue Act of 1928 and article 221(i) of Regulations 74, computed upon the estimated income representing the value of the gas at the mouth of the well and not upon the income derived from the sale of gas at the meters.

2. DECISION AFFIRMED.

Decision of the Board of Tax Appeals (30 B. T. A., 1263) affirmed.

3. CERTIORARI DENIED.

Petition for certiorari denied October 28, 1935.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

*Consumers Natural Gas Co., petitioner*, v. *Commissioner of Internal Revenue, respondent.*

Petition to review an order of the Board of Tax Appeals, fixing a deficiency in the petitioner's income tax for the year 1929.

Before MANTON, L. HAND, and AUGUSTUS N. HAND, Circuit Judges.

[June 17, 1935.]

OPINION.

L. HAND, Circuit Judge: The question involved in this appeal is of a depreciation allowance denied the taxpayer for the year 1929, and claimed by it under section 114 of the Revenue Act of 1928. It is the owner of a natural gas well in the western part of New York from which it directly supplies consumers in two nearby villages, from 1 to 5 miles away. The decision turns upon the words: "In the case of oil and gas wells the allowance for depletion shall be 27½ per centum of the gross income from the property during the taxable year" (section 114(b)3); and the exact issue is whether this percentage is to be computed upon the income of the taxpayer derived from the sale of gas to consumers at the meter, or upon so much of that income as is estimated to represent the value of the gas at the mouth of the well. The purpose of the section, and of section 23(1) to which it is ancillary, is to allow an annual deduction to amortize the original cost (or value) of a wasting deposit of mineral wealth. (*United States* v. *Ludey*, 274 U. S., 295 [T. D. 4046, C. B. VI-2, 157].) If the volume of the deposit were known, the proper amortization charge would be the quotient of the cost divided by that volume; but as it is unknown, any deduction must depend upon as good a guess as is possible. Originally (section II G (b) of the Revenue Act of 1913), an arbitrary allowance of 5 per cent "of the gross value at the mine of the output for the year," was fixed for metals, and this was extended administratively to oil and gas wells. That proved unsatisfactory, and in 1916 (section

12(a) Second (a) of the Act of 1916), an effort was made at a more flexible formula; "a reasonable allowance for actual reduction in flow and production to be ascertained * * * by the settled production or regular flow." "The fair market value of the property" was substituted as the "basis" in 1918 (section 234(a)9), and continued through 1921 and 1924 and until the Act of 1926, when the law took the form with which we are here concerned, and which once more went back to an arbitrary percentage. However, instead of taking "the gross value at the mine of the output," as in 1913, Congress then adopted the phrase which we have already quoted; "gross income from the property." Did "property" mean the well, or the oil or gas at its sale upon delivery miles away?

It is quite true, as the taxpayer says, that no single formula will give a rational result for all wells. The same percentage will be too much for one deposit and too little for another; that is an inevitable consequence of abandoning any effort to learn its amount; the plan is a makeshift, at best no more than an approximation to the average of many instances. Moreover, instead of fixing an arbitrary proportion of the original cost (or value) it makes the "basis" the yearly value of the product when sold. That is a further irrational factor. But these defects are no excuse for not eliminating whatever else will impair the validity of the solution, so far as it has any validity at all. Because the formula is rude and imperfect we are not justified in injecting into the "basis" the added value imparted to the output by work done upon it after it reaches the surface. That can not fail to make the deviation greater and to introduce a variable which adds a quite unnecessary discrimination to a result arbitrary enough at best. True, its correction involved some computation; the sales price must be broken down into two component parts; the value contributed by the later services, and the remainder of the gross price. But the contributed value is not inaccessible; the apparatus for transportation is known, its cost, its wear and tear, its coefficient of obsolescence; the calculation is like much that is customary in reckoning other taxes, and there is no reason to suppose that Congress would shrink from it. Indeed it can not be avoided in many cases. Article 221(i) of Regulations 74 requires, both when the gas and oil is refined and when it is transported, that the "market or field price * * * before conversion or transportation" shall be the "basis for depletion." The taxpayer concedes, and must concede, that this is the right rule when the product is converted into something else. (*Brea Canon Oil Co.* v. *Commissioner*, 77 Fed. (2d), 67 (C. C. A. 9) [Ct. D. 1084, page 209, this Bulletin].) It is only when oil or gas is transported, that it says that the article is invalid. At least the problem is the same; and if the solution is tolerable in one case, we can not see why it should not be in the other. We are dealing with economic categories, not physical, to say nothing of metaphysical. When does oil for example cease to be oil in the process of refining? We are surely not to engage in such niceties when trying to find a working method of amortizing the original cost of the well. It is inevitable indeed that the owner of a short-lived well should suffer as against that of a long-lived; but it is not inevitable that a man with a pipe line should amortize his investment more quickly than one who sells at the surface. It is probably true that part of the apparatus of transportation has a life coterminous with the well; but in substantial part that is not the case, certainly not as to street mains, meters and the like. In this respect such property is unlike the subsurface apparatus in the well itself, which is largely irrecoverable when the well goes dry. Nor is it relevant that the article grants to the extraction apparatus not only a depletion allowance, but a deduction for wear and obsolescence. (*United States* v. *Dakota-Montana Co.*, 288 U. S., 459 [Ct. D. 655, C. B. XII-1, 243].) Indeed it might theoretically be entitled to each; for even if its life be limited to that of the well, it may not last as long. But whether or not the double allowance be justified is of no moment; the taxpayer can not properly complain, so long as he is not prevented from including in his "basis" all that he should be allowed.

Nothing in the congressional debates throws any light upon the question; *Herring* v. *Commissioner* (293 U. S., 322 [Ct. D. 904, C. B. XIV-1, 303]) perhaps does. A depletion deduction was there allowed against a bonus or dead-rent, which was necessarily income from the well and not from the sale of oil; so far as the decision is pertinent at all it implies that "property" in section 114(b)3 means the well. True, in such cases it is customary to give the lessee a credit to be worked out in oil, and if that happens, the bonus will be only an advance payment. But if the lessee fails to strike oil, this does not hold, or if the strike is short-lived. Finally as to the constitutional objection, put forward rather as a make-weight in interpretation, we are not clear that oil or gas as soon as it is extracted from the ground, can not without more be a "realized" gain, but assuming that it can not, the gain at sale may certainly be divided between the "spot gas" so to say, and the additions due to transportation, and the two parts taxed by separate formulas. Indeed that is inevitable in cases of manufacture or conversion.

The text of the section is in accord. Section 114(b) is in three subdivisions all designed to define the "basis for depletion." The first refers back to section 113 and makes cost (or value) the "basis"; the second is for mines and fixes "fair market value" at "discovery," once the "basis" for oil and gas wells. It ends with a limitation to 50 per cent of the net income "from the property." Consistently the third subdivision should also make the cost or value of the well the "basis." It does not do that, for it uses income; but we should expect the "basis" to be the income from the well, and grammatically that is just what it does. It does not speak of "oil" or "gas," but of "oil and gas wells" as the "property" from which the income is to arise. If calculation is necessary to find that income, calculation is implied. Nor does the second sentence introduce any complications which compromise this interpretation, as the taxpayer would have us understand. It is true that the net income "from the property" can not be found, even after the gross income at the mouth of the well has been computed, without the allocation of the "overhead" or general expenses. Article 221(i) provides for that by a reasonable formula; it is not unduly difficult of application; the implied administrative detail is surely preferable to the inequalities which result from the taxpayer's proposal. Moreover, it is a matter of some importance that this sentence of subdivision 3 was carried over substantially unchanged from the Act of 1924 (section 204(c)). There, at any rate the word "property" meant "well." We can find no reason for change from its present context; it seems to us that the "basis" is income from the wells, not from the oil or gas after it has been carried through perhaps many miles of piping.

Order affirmed.

## SECTION 115.—DISTRIBUTIONS BY CORPORATIONS.

### ARTICLE 627: Dividends paid in property. XV-1-7890 Ct. D. 1055

INCOME TAX—REVENUE ACT OF 1928—DECISION OF SUPREME COURT.

1. GAIN OR LOSS—RECOGNITION—DIVIDEND PAYABLE IN STOCK OF ANOTHER CORPORATION AT A VALUE WHICH EXCEEDED ITS COST.

Where a corporation acquired stock of another corporation in 1927, and in March, 1928, declared a dividend payable in stock of the latter corporation at an agreed value per share, which value was in excess of the cost of the stock, it derived no taxable gain from the distribution among its stockholders of the shares as a dividend.

2. JURISDICTION OF CIRCUIT COURT OF APPEALS.

Upon petition for review of a decision of the Board of Tax Appeals, the Circuit Court of Appeals is without power to make findings of fact or to rule upon a point not presented to or ruled upon by the Board, its function being to decide whether the correct rule of law was applied to the facts found and whether there was substantial evidence before the Board to support the findings made.

3. DECISION REVERSED.

Decision of the Circuit Court of Appeals, Fourth Circuit (74 Fed. (2d), 972), which reversed the decision of the Board of Tax Appeals (29 B. T. A., 934), reversed.

SUPREME COURT OF THE UNITED STATES.

*General Utilities & Operating Co., petitioner, v. Guy T. Helvering, Commissioner of Internal Revenue.*

**On writ of certiorari to the United States Circuit Court of Appeals for the Fourth Circuit.**

[December 9, 1935.]

OPINION.

Mr. Justice MCREYNOLDS delivered the opinion of the Court.

January 1, 1927, petitioner—General Utilities, a Delaware corporation—acquired 20,000 shares (one-half of total outstanding) common stock Islands Edison Co., for which it paid $2,000. Gillet & Co. owned the remainder.

During January, 1928, Whetstone, president of Southern Cities Utilities Co., contemplated acquisition by his company of all Islands Edison common stock. He discussed the matter with Lucas, petitioner's president, also with Gillet & Co. The latter concern agreed to sell its holdings upon terms acceptable to all. But Lucas pointed out that the shares which his company held could only be purchased after distribution of them among stockholders, since a sale by it would subject the realized profit to taxation, and when the proceeds passed to the stockholders there would be further exaction. Lucas had no power to sell, but he, Gillet and Whetstone were in accord concerning the terms and conditions under which purchase of all the stock might become possible—"it being understood and agreed between them that petitioner would make distribution of the stock of the Islands Edison Co. to its stockholders and that counsel would prepare a written agreement embodying the terms and conditions of the said sale, agreement to be submitted for approval to the stockholders of the Islands Edison Co. after the distribution of said stock by the petitioner."

Petitioner's directors, March 22, 1928, considered the disposition of the Islands Edison shares. Officers reported they were worth $1,122,500, and recommended an appreciation on the books to that figure. Thereupon a resolution directed this change; also "that a dividend in the amount of $1,071,426.25 be and it is hereby declared on the common stock of this company payable in common stock of the Islands Edison Co. at a valuation of $56.12½ a share, out of the surplus of the company arising from the appreciation in the value of the common stock of the Islands Edison Co. held by this company, viz, $1,120,500, the payment of the dividend to be made by the delivery to the stockholders of this company, pro rata, of certificates for the common stock of the Islands Edison Co. held by this company at the rate of two shares of such stock for each share of company stock of this corporation."

Accordingly, 19,090 shares were distributed amongst petitioner's 33 stockholders and proper transfers to them were made upon the issuing corporation's books. It retained 910 shares.

After this transfer, all holders of Islands Edison stock, sold to Southern Cities Utilities Co. at $56.12½ per share. Petitioner realized $46,346.30 net profit on 910 shares and this was duly returned for taxation. There was no report of gain upon the 19,090 shares distributed to stockholders.

The Commissioner of Internal Revenue declared a taxable gain upon distribution of the stock in payment of the dividend declared March 22, and made the questioned deficiency assessment. Seeking redetermination by the Board of Tax Appeals, petitioner alleged, "The Commissioner of Internal Revenue has erroneously held that the petitioner corporation made a profit of $1,069,517.25 by distributing to its own stockholders certain capital stock of another corporation which it had theretofore owned." And it asked a ruling that no taxable gain resulted from the appreciation upon its books and subsequent distribution of the shares. Answering, the Commissioner denied that his action was erroneous, but advanced no new basis of support. A stipulation concerning the facts followed; and upon this and the pleadings, the Board heard the cause.

It found "The respondent has determined a deficiency in income tax in the amount of $128,342.07 for the calendar year 1928. The only question presented in this proceeding for redetermination is whether petitioner realized taxable gain in declaring a dividend and paying it in the stock of another company at an agreed value per share, which value was in excess of the cost of the stock to petitioner." Also, "On March 26, 1928, the stockholders of the Islands Edison Co. (one of which was petitioner, owning 910 shares) and the Southern Cities Utilities Co., entered into a written contract of sale of the Islands Edison Co. stock. At no time did petitioner agree with Whetstone or the Southern Cities Utilities Co., verbally or in writing, to make sale to him or to the Southern Cities Utilities Co. of any of said stock except the aforesaid 910 shares of the Islands Edison Co."

The opinion recites—The Commissioner's "theory is that upon the declaration of the dividend on March 22, 1928, petitioner became indebted to its stockholders in the amount of $1,071,426.25, and that the discharge of that liability by the delivery of property costing less than the amount of the debt constituted income, citing *Kirby Lumber Co.* v. *United States* (284 U. S., 1 [Ct. D. 420, C. B. X–2, 356])." "The intent of the directors of petitioner was to declare a dividend payable in Islands Edison stock; their intent was expressed in that way in the resolution formally adopted; and the dividend was paid in the way intended and declared. We so construe the transaction, and on authority of *First Utah Savings Bank*, supra (53 Fed. (2d), 919 [Ct. D. 451, C. B. XI–1, 280]), we hold that the declaration and payment of the dividend resulted in no taxable income."

The Commissioner asked the Circuit Court of Appeals, Fourth Circuit, to review the Board's determination. He alleged, "The only question to be decided is whether the petitioner (taxpayer) realized taxable income in declaring a dividend and paying it in stock of another company at an agreed value per share, which value was in excess of the cost of the stock."

The court stated: "There are two grounds upon which the petitioner urges that the action of the Board of Tax Appeals was wrong: First, that the dividend declared was in effect a cash dividend and that the respondent realized a taxable income by the distribution of the Islands Edison Co. stock to its stockholders equal to the difference between the amount of the dividend declared and the cost of the stock; second, that the sale made of the Islands Edison Co. stock was in reality a sale by the respondent (with all the terms agreed upon before the declaration of the dividend), through its stockholders who were virtually acting as agents of the respondent, the real vendor."

Upon the first ground, it sustained the Board. Concerning the second, it held that, although not raised before the Board, the point should be ruled upon. "When we come to consider the sale of the stock of the Islands Edison Co. we can not escape the conclusion that the transaction was deliberately planned and carried out for the sole purpose of escaping taxation. The purchaser was found by the officers of the respondent; the exact terms of the sale as finally consummated were agreed to by the same officers; the purchaser of the stock stated that the delivery of all the stock was essential and that the delivery of a part thereof would not suffice; the details were worked out for the express and admitted purpose of avoiding the payment of the tax and for the reason that the attorneys for the respondent had advised that unless some such plan was adopted the tax would have to be paid; and a written agreement was to be prepared by counsel for the respondent which was to be submitted to the stockholders; all this without the stockholders, or any of them, who were ostensibly making the sale, being informed, advised or consulted. Such admitted facts plainly constituted a plan, not to use the harsher terms of scheme, artifice or conspiracy, to evade the payment of the tax. For the purposes of this decision it is not necessary to consider whether such a course as is here shown constituted a fraud, it is sufficient if we conclude that the object was to evade the payment of a tax justly due the Government.

"The sale of the stock in question was, in substance, made by the respondent company, through the stockholders as agents or conduits through whom the transfer of the title was effected. The stockholders, even in their character as agents, had little or no option in the matter and in no sense exercised any independent judgment. They automatically ratified the agreement prepared and submitted to them."

A judgment of reversal followed.

Both tribunals below rightly decided that petitioner derived no taxable gain from the distribution among its stockholders of the Islands Edison shares as a dividend. This was no sale; assets were not used to discharge indebtedness.

The second ground of objection, although sustained by the court, was not presented to or ruled upon by the Board. The petition for review relied wholly upon the first point; and, in the circumstances, we think the court should have considered no other. Always a taxpayer is entitled to know with fair certainty the basis of the claim against him. Stipulations concerning facts and any other evidence properly are accommodated to issues adequately raised.

Recently (April, 1935) this Court pointed out—"The Court of Appeals is without power on review of proceedings of the Board of Tax Appeals to make any findings of fact." "The function of the court is to decide whether the correct rule of law was applied to the facts found; and whether there was substantial evidence before the Board to support the findings made." "If the Board has failed to make an essential finding and the record on review is insufficient to provide the basis for a final determination, the proper procedure is to remand the case for further proceedings before the Board." "And the same procedure is appropriate even when the findings omitted by the Board might be supplied from examination of the record." (*Helvering* v. *Rankin*, 295 U. S., 123, 131, 132 [Ct. D. 966, C. B. XIV-1, 160].)

Here the court undertook to decide a question not properly raised. Also it made an inference of fact directly in conflict with the stipulation of the parties and the findings, for which we think the record affords no support whatever. To remand the cause for further findings would be futile. The Board could not properly find anything which would assist the Commissioner's cause.

The judgment of the court below must be reversed. The action of the Board of Tax Appeals is approved.

Reversed.

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## ARTICLE 627: Dividends paid in property. XV-7-7955 Ct. D. 1079

INCOME TAX—REVENUE ACT OF 1928—DECISION OF COURT.

1. INCOME—DIVIDEND—PAID IN STOCK OF ANOTHER CORPORATION.

Where a corporation on January 2, 1929, declared and distributed a dividend of 1 share of stock in another corporation, which it had acquired after February 28, 1913, for each 10 shares of its own stock, the shares so received by a stockholder were taxable as a dividend in an amount measured by their market value at the time of distribution.

2. CERTIORARI DENIED.

Petition for certiorari denied on October 14, 1935.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

*Peter Binzel, Jr., petitioner, v. Commissioner of Internal Revenue, respondent.*

Appeal from United States Board of Tax Appeals.

Before MANTON, SWAN, and AUGUSTUS N. HAND, Circuit Judges.

[March 4, 1935.]

OPINION.

From an order of the Board of Tax Appeals adjudging a deficiency of $9,708.86 in the income taxes of the petitioner, Peter Binzel, Jr., for the year 1929, the latter appeals. Affirmed.

AUGUSTUS N. HAND, Circuit Judge: On January 2, 1929, the taxpayer owned 2,500 shares of the United Cork Cos. and on the same date the latter company declared a dividend of 1 share of National City Bank stock, which it had among its assets, for each 10 shares held by its stockholders in its own stock. It had purchased 1,335 shares of the City Bank stock at various times after February 28, 1913, and distributed 845 shares of the total amount to its stockholders on January 2, 1929. The average cost of this stock to the United

Cork Cos. was $62.98 per share and the market value at the time the dividend was declared was $273 per share. At this valuation the 250 shares which the taxpayer received were worth $68,250. The taxpayer valued the 250 shares at $5,745 in his income tax return for the year 1929, which was at $62.98 per share, the original cost to the United Cork Cos. The Commissioner valued them at $273 per share—the worth of each share when distributed to the taxpayer—assessed his tax upon such a valuation of his shares, and determined a deficiency of $9,708.86 accordingly, which was affirmed by the Board of Tax Appeals.

The taxpayer claims that any amount over $62.98 per share received by him through the distribution of the City Bank stock was not subject to taxation because the excess was unrealized and could not be taxed until it should exceed the basis of his United Cork Cos. stock. The Commissioner claims that the distribution was an ordinary dividend in property and subject to the provision of article 627 of Regulations 74, which provided that:

"Dividends paid in securities or other property (other than its own stock) in which the earnings of a corporation have been invested are income to the recipients to the amount of the market value of such property when receivable by the shareholders. * * *"

Section 115(a) of the Revenue Act of 1928 defines a dividend as:

"* * * any distribution made by a corporation to its shareholders, whether in money or in other property, out of its earnings or profits accumulated after February 28, 1913."

Subdivision (b) of the same section provides that:

"* * * Any earnings or profits accumulated, or increase in value of property accrued, before March 1, 1913, may be distributed exempt from tax, after the earnings and profits accumulated after February 28, 1913, have been distributed, but any such tax-free distribution shall be applied against and reduce the basis of the stock provided in section 113."

As the taxpayer has the burden of proof we must assume that the stock of the City Bank was purchased out of earnings accrued after March 1, 1913. If so, its increase in value resulted from earnings out of which the stock was originally purchased and pro tanto was added to its surplus available for dividends or for any other purpose. It does not follow, because the United Cork Cos. *realized* no taxable profit while it held the shares of the National City Bank, that there was no profit in fact, or that the dividend was not subject to taxes based upon a valuation of the stock that included the increment. That the market value at the time of distribution should be the basis for the income tax is evident from the decisions of the Supreme Court in *United States* v. *Phellis* (257 U. S., 156 [T. D. 3270, C. B. 5, 37]); *Rockefeller* v. *United States* (257 U. S., 176 [T. D. 3271, C. B. 5, 34]), as well as under article 627 of Regulations 74, supra.

It is argued on behalf of the petitioner that the value of the City Bank stock, represented by the increase over its cost, is not taxable as a dividend, but should be applied against and reduce the basis of the stock which the taxpayer held in the United Cork Co., because of the language of section 115(d) of the Revenue Act of 1928. That subdivision reads as follows:

"(d) *Other distributions from capital.*—If any distribution (not in partial or complete liquidation) made by a corporation to its shareholders is not out of increase in value of property accrued before March 1, 1913, and is not out of earnings or profits, then the amount of such distribution shall be applied against and reduce the basis of the stock provided in section 113, and if in excess of such basis, such excess shall be taxable in the same manner as a gain from the sale or exchange of property. * * *"

The foregoing subdivision, however, does not exempt distributions made out of earnings or profits of the United Cork Cos. There is no reason to suppose that the earnings and profits were not sufficient to cover the value of the City Bank stock at the time of distribution, and the burden to prove that they were not was upon the taxpayer. (*Wickwire* v. *Reinecke*, 275 U. S., 101 [T. D. 4126, C. B. VII-1, 316]; *Metcalf's Estate* v. *Commissioner*, 32 Fed. (2d), 192, 195 (C. C. A. 2) [Ct. D. 58, C. B. VIII-1, 219].) Section 115(d), therefore, can not be regarded as requiring that the increase in value of the bank stock over its cost should be applied against and reduce the basis of the taxpayer's holding of stock of the United Cork Cos. If that corporation had earnings or profits from any source, accumulated after February 28, 1913, from which it could have made a distribution equal in amount to the market value of the bank stock received by the taxpayer, the distribution should be regarded as having been made from the most recently accumulated earnings, and should not be applied to reduce the basis of his stock in United Cork Cos. (Section 115(b), supra; *Helvering* v. *Canfield*, 291 U. S., 163 [Ct. D. 783, C. B. XIII-1, 176]; *Leland* v. *Commissioner*, 50 Fed. (2d), 523 (C. C. A. 1) [Ct. D. 387, C. B. X-2, 300].)

Whether we regard the distribution of the bank stock as made out of earnings accrued after February 28, 1913, because it was originally purchased out of them and its increased value originated in that purchase, or whether at the time the taxpayer received the City Bank stock there were earnings and profits accrued after February 28, 1913, that were equivalent to its then market value, in either event the increment would not be exempt from taxes under 115(d), but would be a part of a dividend all of which was subject to taxation as current income of the recipient.

We think that the Board correctly determined that the taxpayer received a dividend in City Bank stock taxable at a value of $273 per share and its order is affirmed accordingly.

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## Article 628: Stock dividends. (Also Section 111, Article 561.)

XV-24-8123
Ct. D. 1124

### INCOME TAX—REVENUE ACTS OF 1926 AND 1928—DECISION OF SUPREME COURT.

Gain or Loss—Redemption of Preferred Stock—Dividends Paid in Common Stock—Whether Income or Return of Capital—Validity of Treasury Regulations.

A taxpayer who purchased cumulative nonvoting preferred shares of stock of a corporation upon which dividends were subsequently paid in common voting shares is not required, upon the redemption of the preferred stock, to apportion its cost between the preferred and common for the purpose of determining gain or loss, notwithstanding that Treasury regulations, long in force, prescribe such allocation. The stock dividends were income and may not be treated as returns of capital. The provisions of the statute are unambiguous and its directions specific that in taxing income arising from capital gain the cost of the asset disposed of shall be the measure of the income, and the Secretary of the Treasury is therefore without power by regulatory amendment to add a provision that income derived from the capital asset shall be used to reduce cost.

Supreme Court of the United States.

*Corinne S. Koshland, petitioner,* v. *Guy T. Helvering, Commissioner of Internal Revenue.*

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

[May 18, 1936.]

OPINION.

Mr. Justice Roberts delivered the opinion of the Court.

The writ of certiorari was granted in this case to resolve a conflict between the decision below [1] and one by the Circuit Court of Appeals for the Sixth Circuit.[2]

The question is whether, under the Revenue Acts of 1926 and 1928, a taxpayer who purchases cumulative nonvoting preferred shares of a corporation upon which a dividend is subsequently paid in common voting shares, must, upon a sale or other disposition of the preferred shares, apportion their cost between preferred and common for the purpose of determining gain or loss.

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[1] *Commissioner* v. *Koshland* (81 F. (2d), 641).
[2] *Commissioner* v. *Tillotson Mfg. Co.* (76 F. (2d), 189).

The petitioner, in 1924 and 1926, purchased preferred stock of Columbia Steel Corporation. The company's articles of incorporation provided that holders of preferred stock should receive annual dividends of $7 a share in cash or, at the company's option, one share of common stock for each share of preferred. Dividends on the preferred were to be paid in full before any could be paid on the common; the common had voting rights, the preferred none. The preferred was redeemable at $105 per share, plus accrued dividends; and upon dissolution or liquidation was entitled to preferential payment of $100 per share, plus accrued dividends, and no more. The common alone was entitled in such event to the assets of the corporation remaining after payment of the preferred.

In each of the years 1925 to 1928, inclusive, the company had a surplus sufficient to pay the preferred dividends in cash, but elected to pay them in common stock. The petitioner received, in each of those years, shares of common stock as dividends on her preferred. In 1930 the corporation redeemed its preferred stock at $105 per share. In computing the profit realized by the petitioner the Commissioner allocated to the common stock so received, in each instance, a proportionate amount of the cost of the preferred stock. He thereby decreased the resulting cost basis per share and increased the gain. The Board of Tax Appeals reversed holding that the dividends were taxable income, were not stock dividends within the meaning of the Revenue Acts,[3] and their receipt did not reduce the cost basis of the preferred stock. The circuit court of appeals reversed the Board and approved the Commissioner's action.

The petitioner contends, first, that the dividends she received were not stock dividends exempted from taxation by the Revenue Acts; and, secondly, if exempted, they were none the less income and can not be treated as returns of capital in computing capital gain or loss. The respondent answers that the distributions were stock dividends because made in the capital stock of the corporation and come within the plain meaning of the provisions exempting stock dividends from income tax; accordingly, the Treasury regulations have consistently and continuously treated them as returns of capital, and required the original cost to be apportioned between the shares originally acquired and those distributed as dividends to obtain the cost basis for the calculation of gain or loss. We hold that the dividends were income and may not be treated as returns of capital.

The Revenue Act of 1913 imposed an income tax on dividends.[4] In *Towne* v. *Eisner* (245 U. S., 418) it was held that where a corporation declared a dividend on its common stock, in the form of common stock, the dividend was not income within the intendment of the Act. The Revenue Act of 1916 provided that a stock dividend should be considered income to the amount of its cash value.[5] In *Eisner* v. *Macomber* (252 U. S., 189 [T. D. 3010, C. B. 3, 25]) it was decided that a dividend in the corporation's common stock paid to the then common stockholders, was not income within the meaning of the sixteenth amendment and therefore the effort to tax such dividends exceeded the power granted by the amendment. It was said that such a dividend was not income because, by its payment, no severance of corporate assets was accomplished and the preexisting proportionate interests of the stockholders remained unaltered. After the decision the Treasury revoked regulations to the effect that a dividend paid in the corporation's stock is income and issued amended regulations, broadly phrased, to exempt all income in the form of stock dividends, whether the dividend shares be of the same class as those theretofore held by the stockholder or of a different class, and prescribing the method of allocating the original cost as between the old and the new stock for purposes of calculating gain or loss upon realization. Subsequently Congress adopted the Revenue Act of 1921 which provided, in section 201(d): "A stock dividend shall not be subject to tax * * *."[6] The reason for the exemption was the decision in *Eisner* v. *Macomber*, supra. The reports of both the House and the Senate committees dealing with the bill state that the Act "modifies the definition of dividends in existing law by exempting stock dividends from the

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[3] Revenue Act of 1928, section 115(f) (ch. 852, 45 Stat., 791, 822); Revenue Act of 1926, section 201(f) (ch. 27, 44 Stat., 9, 11): "A stock dividend shall not be subject to tax."

[4] 38 Stat., 114, 166, 167.

[5] 39 Stat., 756, 757. Compare Revenue Act of 1918 (40 Stat., 1057, 1059).

[6] 42 Stat., 227, 228. The same provision was repeated in all subsequent Revenue Acts; Revenue Acts of 1924 and 1926, section 201(f); Revenue Acts of 1928, 1932, and 1934, section 115(f).

income tax, as required by the decision of the Supreme Court in *Eisner* v. *Macomber* (252 U. S., 189)." [7]

Although *Eisner* v. *Macomber* affected only the taxation of dividends declared in the same stock as that presently held by the taxpayer, the Treasury gave the decision a broader interpretation which Congress followed in the Act of 1921. Soon after the passage of that Act, this Court pointed out the distinction between a stock dividend which worked no change in the corporate entity, the same interest in the same corporation being represented after the distribution by more shares of precisely the same character, and such a dividend where there had either been changes of corporate identity or a change in the nature of the shares issued as dividends whereby the proportional interest of the stockholder after the distribution was essentially different from his former interest.[8] Nevertheless the successive statutes and Treasury regulations respecting taxation of stock dividends remained unaltered.[9] We give great weight to an administrative interpretation long and consistently followed, particularly when the Congress, presumably with that construction in mind, has reenacted the statute without change.[10] The question here, however, is not merely of our adopting the administrative construction but whether it should be adopted if in effect it converts an income tax into a capital levy.

We are dealing solely with an income tax Act. Under our decisions the payment of a dividend of new common shares, conferring no different rights or interests than did the old—the new certificates, plus the old, representing the same proportionate interest in the net assets of the corporation as did the old—does not constitute the receipt of income by the stockholder. On the other hand, where a stock dividend gives the stockholder an interest different from that which his former stock holdings represented he receives income. The latter type of dividend is taxable as income under the sixteenth amendment. Whether Congress has taxed it as of the time of its receipt, is immaterial for present purposes.

The relevant capital gains provisions of the Revenue Act of 1928 are section 111(a):

"* * * the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the basis provided in section 113 * * *." [11]

And section 113:

"The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; * * *" (with exceptions having no relevancy here).[12]

The property disposed of was the petitioner's preferred stock. In plain terms the statute directs the subtraction of its cost from the proceeds of its redemption, if the latter sum be the greater. But we are told that Treasury regulations [13] long in force require an allocation of the original cost between the preferred stock purchased and the common stock received as dividend. And it is said that while no provision of the statute authorizes a specific regulation respecting this matter, the general power conferred by the law to make appropriate regulations comprehends the subject. Where the Act uses ambiguous terms, or is of doubtful construction, a clarifying regulation or one indicating the method of its application to specific cases not only is permissible but is to be given great weight by the courts. And the same principle governs where the statute merely expresses a general rule and invests the Secretary of the Treasury with authority to promulgate regulations appropriate to its enforcement. But where, as in this case, the provisions of the Act are unambiguous, and its directions specific, there is no power to amend it by regulation.[14] Congress

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[7] H. R. 350, Sixty-seventh Congress, first session, page 8. Senate Report No. 275, Sixty-seventh Congress, first session, page 9.

[8] *United States* v. *Phellis* (257 U. S., 156 [Ct. D. 19, C. B. 5, 37]) ; *Rockefeller* v. *United States* (257 U. S., 176 [Ct. D. 18, C. B. 5, 34]; *Cullinan* v. *Walker* (262 U. S., 134 [Ct. D. 82, C. B. II–2, 55]) ; *Marr* v. *United States* (268 U. S., 536 [T. D. 3755, C. B. IV–2, 116]).

[9] See Regulations 65 and 69, articles 1547, 1548; Regulations 74 and 77, articles 627, 628; Regulations 86, articles 115–7, 115–8.

[10] *Poe* v. *Seaborn* (282 U. S., 101, 116 [Ct. D. 259, C. B. IX–2, 202]) ; *McCaughn* v. *Hershey* (283 U. S., 488, 492 [Ct. D. 345, C. B. X–1, 444]) ; *McFeely* v. *Commissioner* (296 U. S., 102, 108).

[11] 45 Stat., 815.

[12] 45 Stat., 818.

[13] Regulations 74, articles 58, 628, and 600.

[14] *Manhattan General Equipment Co.* v. *Commissioner of Internal Revenue*, No. 226, October Term, 1935, and cases cited.

having clearly and specifically declared that in taxing income arising from capital gain the cost of the asset disposed of shall be the measure of the income, the Secretary of the Treasury is without power by regulatory amendment to add a provision that income derived from the capital asset shall be used to reduce cost.

The judgment is reversed.

## ARTICLE 629: Distribution in redemption or cancellation of stock taxable as a dividend. XV-15-8036 Ct. D. 1102

INCOME TAX—REVENUE ACT OF 1928—DECISION OF COURT.

INCOME—DIVIDEND—CANCELLATION OR REDEMPTION OF STOCK.

Where a corporation in 1930 redeemed and canceled a portion of the stock held by its principal stockholder, the payment being made out of surplus, and immediately thereafter increased its capital stock by declaring a stock dividend, and continued in business, the amount received by the stockholder, though in form a stock redemption, was in fact a distribution of earnings and substantially equivalent to a cash dividend, taxable under the provisions of section 115(g) of the Revenue Act of 1928.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

*William T. Brown, Jr., petitioner,* v. *Commissioner of Internal Revenue, respondent.*

Upon petition for review from the United States Board of Tax Appeals.

Before BUFFINGTON and THOMPSON, Circuit Judges, and JOHNSON, District Judge.

[July 31, 1935.]

OPINION.

THOMPSON, Circuit Judge: This is a petition for review of a decision of the Board of Tax Appeals. In 1927, the Electro Construction Co., a corporation, had outstanding 1,000 shares of capital stock, of which the petitioner, William T. Brown, Jr., owned 550 shares, Joseph F. McCarthy 445 shares and John A. McCarthy 5 shares. Joseph F. McCarthy died testate and under his will John A. McCarthy became the owner of his shares. The corporation declined John A. McCarthy's request to redeem those shares at their book value of $205 per share, for, although at that time it had $154,000 cash on hand, it needed all of its available cash to execute a number of contracts then pending. The petitioner, however, agreed to and did in fact, buy the 445 shares for $91,225 and paid for them out of his own personal funds. The petitioner thereupon sold 5 shares to his secretary and retained 990 shares. In 1927 and 1928, the corporation declared a 100 per cent cash dividend, but in 1929, no dividend was declared, although the company's earnings were high. The cash on hand had increased from $154,000 in 1927 to approximately $241,000 near the close of 1930. December 16, 1930, the corporation redeemed and canceled 440 of the shares which the petitioner had purchased from John A. McCarthy and paid the petitioner $280 per share or $123,200, using funds out of its surplus with which to pay for the difference between the par value and the book value. One day later the corporation declared a 400 per cent stock dividend on its capital stock, whereby the petitioner received 2,200 shares, his secretary 20 shares and John A. McCarthy 20 shares. In his income tax return for 1930, the petitioner reported $31,975 as profit resulting from the sale of his stock to the corporation. The Commissioner assessed a deficiency and was sustained by the Board of Tax Appeals.

The petitioner contends that the transaction was in partial liquidation of the corporation under section 115(c) of the Revenue Act of 1928 and that only the liquidated profit of $31,975 was taxable. The Commissioner, on the other hand, contends that the transaction was essentially equivalent to the distribution of a taxable dividend under section 115(g) of the Revenue Act of 1928 and that the entire $123,200 should be reported in the petitioner's income tax return as dividend subject to tax.

The applicable statute is section 115 of the Revenue Act of 1928 (26 U. S. C. A., 2115) which provides:

(a) "The term 'dividend' when used in this title (except in section 203(a)4 and section 208(c)1, relating to insurance companies) means any distribution made by a corporation to its shareholders, whether in money or in other property, out of its earnings or profits accumulated after February 28, 1913.

* * * * * * *

(c) "Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under section 111, but shall be recognized only to the extent provided in section 112. In the case of amounts distributed in partial liquidation (other than a distribution within the provisions of section 112(h) of stock or securities in connection with a reorganization) the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits within the meaning of subsection (b) of this section for the purpose of determining the taxability of subsequent distributions by the corporation.

* * * * * * *

(g) "If a corporation cancels or redeems its stock (whether or not such stock was issued as a stock dividend) at such time and in such manner as to make the distribution and cancellation or redemption in whole or in part essentially equivalent to the distribution of a taxable dividend, the amount so distributed in redemption or cancellation of the stock, to the extent that it represents a distribution of earnings or profits accumulated after February 28, 1913, shall be treated as a taxable dividend. In the case of the cancellation or redemption of stock not issued as a stock dividend this subsection shall apply only if the cancellation or redemption is made after January 1, 1926.

(h) "As used in this section the term 'amounts distributed in partial liquidation' means a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock."

The question is whether the payment by the corporation for the redemption of the petitioner's stock was essentially equivalent to the distribution to him of a taxable dividend. It is for the Board of Tax Appeals to determine from the facts before it whether the particular transaction is essentially equivalent to a taxable dividend. (*Commissioner* v. *Babson*, 70 Fed. (2d), 304, certiorari denied, 293 U. S., 571.) We think the Board had sufficient evidence upon which to base its findings. The money with which the corporation paid the petitioner came from its profits and earnings. Prior to the sale to the corporation of 440 shares of capital stock, the petitioner held 99 per cent of the stock. Notwithstanding the fact that the corporation paid him $123,200 for less than one-half of the stock which he held, the petitioner, after the sale, continued to hold 98 per cent of its stock. The reduction of the capital stock did not amount to a liquidation, for it is to be noted that the following day the capital stock was increased and the business of the corporation was continued at a profit.

In *Hyman* v. *Commissioner* (71 Fed. (2d), 342 [Ct. D. 920, C. B. XIV-1, 213], certiorari denied, 293 U. S., 570), the court, speaking of section 115(g) of the Revenue Act of 1928 said:

"The purpose of Congress in the inclusion of (g) was to narrow the distinction to the end that corporations might not by resort to the device of stock redemption or cancellation make a distribution to its shareholders essentially resulting in a division of profits. In both the House and Senate reports, and in the conference reports, an illustration is given showing the congressional purpose. The illustration supposes, under the tax laws prior to the amendment involved here, the case of two men holding practically the entire stock of a corporation for which each paid $50,000. The corporation having accumulated a surplus of $50,000 above its cash capital, buys from the stockholders for cash one-half of the stock held by them and cancels it, and the payment is nontaxable because it is a partial redemption of stock. To change this result and make it taxable (g) was written and incorporated into the law. Granted the illustration is an apt one and the object sought accomplished, it will be seen how nearly it fits the facts of this case, for here we have a corporation with large accumulated earnings, which, by means of a purchase of a part of its stock, it transfers to its single stockholder, leaving the corporation precisely in the condition in which it was prior to the transfer, except that its earnings have been distributed to its stockholder without having disturbed his ownership and control of the corporation."

In the instant case, our conclusion is that the transaction, though in form a stock redemption, was, in fact, a distribution of earnings substantially equivalent to a cash dividend. We find no error in the findings of fact and conclusions of law of the Board of Tax Appeals.

The decision of the Board of Tax Appeals is affirmed.

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## SECTION 116.—EXCLUSIONS FROM GROSS INCOME.

### ARTICLE 642: Income of States.

XV-11-7998
Ct. D. 1090

INCOME TAX—REVENUE ACT OF 1928—DECISION OF COURT.

1. EXEMPTION—INCOME—RENTS RECEIVED BY LESSEE OF STATE LANDS.

Where a State leased land, held and used for the sole benefit of the State university, to a lessee which invested a large amount of capital and labor in the erection of buildings upon the leased land, the lessee's income from the rents received was not immune from tax. The tax was not imposed upon the State, nor upon the lease, but upon a private corporation holding the lease, and its imposition placed no substantial burden upon the exercise of any essential function of government.

2. DECISIONS DISTINGUISHED.

*Gillespie* v. *The State of Oklahoma* (257 U. S., 501) and *Burnet* v. *Coronado Oil & Gas Co.* (285 U. S., 393 [Ct. D. 485, C. B. XI-1, 265]) distinguished.

3. CERTIORARI DENIED.

Petition for certiorari denied March 2, 1936.

COURT OF CLAIMS OF THE UNITED STATES.

*Metropolitan Building Co.* v. *The United States.*

[November 4, 1935.]

OPINION.

WILLIAMS, Judge, delivered the opinion of the court.

The plaintiff seeks recovery of $16,646.31, together with interest, income tax paid for the period, February 1, 1929, to November 13, 1929. The facts have been stipulated by the parties, the sole controversy being whether the income upon which the tax was imposed is subject to taxation by the United States.

The land, the subject of the lease, is located in the city of Seattle, Wash., and is commonly designated as "University Tract." It is owned by the State of Washington and is held and used for the sole benefit of the University of Washington. The income to the State under the lease is paid direct to the university and is used exclusively for educational purposes.

The Supreme Court of the State of Washington, in the case of *State of Washington* v. *The City of Seattle et al.* (57 Wash., 602; 107 Pacific, 827), where the direct issue presented was whether the land in question was owned and held by the State in its private capacity as a proprietor or in its governmental capacity, held that the tract was acquired by the State in trust for the sole use of upbuilding its university according to the purpose and spirit of the grant by which it was acquired, to the extent and in the same manner in which the State had accepted the grant of public land from the United States for public school purposes. The land being owned and held by the State of Washington in its governmental capacity under an express trust to use the land and all the income arising therefrom in support of the university, the lease in question is an instrumentality of the State.

The plaintiff contends that the tax in question is in effect a tax upon the lease itself, and that as such is void under the rule laid down by the Supreme Court in *Gillespie* v. *The State of Oklahoma* (257 U. S., 501), *Burnet* v. *Coronado Oil & Gas Co.* (285 U. S., 393), and other cases, and by this court in *Marland* v. *United States* (78 C. Cls., 69, 53 Fed. (2d), 907).

The principle of immunity from taxation by the Federal Government of instrumentalities of a State and the corresponding immunity of Federal instrumentalities from taxation by a State is well settled. However, it is recognized that "just what instrumentalities of either a State or the Federal Government are exempt from taxation by the other can not be stated in terms of universal application." (*Metcalf & Eddy* v. *Mitchell*, 269 U. S., 514 [T. D. 3824, C. B. V-1, 218].) The established principle "has its inherent limitations." (*Fox Film Corporation* v. *Doyal et al.*, 286 U. S., 123.) "The reasons underlying the principle mark the limits of its range." (*Indian Motocycle Co.* v. *United States*, 283 U. S., 570 [Ct. D. 354, C. B. X-1, 439].) The immunity does not exist "where no direct burden is laid upon the governmental instrumentality, and there is only a remote, if any influence upon the exercise of the functions of government." (*Willcuts* v. *Bunn*, 282 U. S., 216 [Ct. D. 280, C. B. X-1, 309].)

The rule of *Gillespie* v. *Oklahoma* and *Burnet* v. *Coronado Oil & Gas Co.* must be considered in the light of the limitations placed upon it in the decisions just cited, and, as stated by the court in the Coronado case, is to be applied "strictly and only in circumstances closely analogous" to those which they disclose.

The circumstances of the present case in our opinion are not closely analogous to the circumstances disclosed in the Gillespie and the Coronado cases. The facts are clearly and fundamentally distinguishable. In both the Gillespie and the Coronado cases the taxed income came from profits realized on the sale of oil abstracted from the lands leased. The income came directly and wholly from the thing leased—the land itself. That is not the situation here. The plaintiff's income was not derived directly from the lands leased but came wholly from rents received from buildings which the plaintiff had erected on the premises. It came from more than a thousand tenants to whom the plaintiff had rented storerooms and offices. Except for plaintiff's large investment in buildings, amounting to almost $5,000,000, and the labor incident to the successful management of the properties represented by such investment, the income could not have been realized. The fact that the buildings were erected in conformity with the terms of the lease and that title to the buildings vested immediately in the State upon their erection is not important and does not change the situation. The income upon which the tax was imposed was realized primarily from the plaintiff's large investment of capital and labor and did not come directly from the premises leased, as in the cases relied upon. These facts remove the case from the rule announced in the Gillespie and Coronado cases. (*Eckstein* v. *United States*, 80 C. Cls., 725, 10 Fed. Supp., 231.)

The challenged tax is not imposed upon the State of Washington, nor upon the lease, the instrumentality of the State, but upon the plaintiff, a private corporation holding the lease. The immunity claimed, therefore, exists only if the effect of the tax is to place a substantial burden upon the exercise of the State's essential functions of government, and as stated in *Willcuts* v. *Bunn*, supra, "it must appear that the burden is real, not imaginary; substantial, not negligible." "The application of the doctrine of implied immunity must be practical (*Railroad Co.* v. *Peniston*, 18 Wall., 5, 31, 36) and should have regard to the circumstances disclosed." (*Burnet* v. *A. T. Jergins Trust*, 288 U. S., 508 [Ct. D. 653, C. B. XII-1, 214].)

The amount of rental paid to the State under the lease is definitely fixed by the terms of the lease, and is paid at stated intervals unaffected by whether or not the plaintiff is taxed on the profits of its business. Theoretically the tax may have some effect upon the amount of rental reserved in the lease but, if so, its influence is so remote and indirect as to be imaginary rather than real. As a practical matter, therefore, the imposition of the tax against plaintiff places no substantial burden upon the State's exercise of any essential function of government. It follows that the petition must be dismissed, and it is so ordered.

WHALEY, Judge; LITTLETON, Judge; GREEN, Judge; and BOOTH, Chief Justice, concur.

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## ARTICLE 643: Compensation of State officers and employees.

REVENUE ACT OF 1928.

Taxability of compensation received by officers and employees of a State or political subdivision. (See Mim. 3838, revised, page 130.)

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## ARTICLE 643: Compensation of State officers and employees.

XV-19-8077
Ct. D. 1114

INCOME TAX—REVENUE ACTS OF 1926 AND 1928—DECISION OF COURT.

EXEMPTION—COMPENSATION FOR SERVICES—OFFICER OR EMPLOYEE OF STATE—INDEPENDENT CONTRACTOR.

Compensation received by the taxpayer as attorney and chief counsel for the Imperial irrigation district of the State of California was not exempt from Federal income tax. The taxpayer was not an officer or employee of the State, but was an independent contractor who entered into the ordinary relation of attorney and client with a public corporation.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

*Charles L. Childers, petitioner,* v. *Commissioner of Internal Revenue, respondent.*

Upon petition to review orders of the United States Board of Tax Appeals.

Before WILBUR, GARRECHT, and DENMAN, Circuit Judges.

[November 4, 1935.]

OPINION.

*Per curiam:* This is a petition to review simultaneous decisions of the United States Board of Tax Appeals entered January 11, 1934, and involves the Federal income tax liability of the petitioner, formerly a resident of El Centro, Calif., and now residing in Los Angeles, Calif.

The petitioner claims that the respondent has erroneously included in the petitioner's taxable income the amounts of $11,588.23 and $10,055 for the years 1927 and 1928, respectively, representing compensation received by the petitioner "for services as an officer or employee" of the Imperial irrigation district of the State of California. The taxpayer contends that the irrigation district is a public agency of the State, exercising "essential governmental functions," and that he devoted "practically all of his business hours to the business of said district."

It is the petitioner's contention that the amounts received by him from the district are not subject to Federal income taxes under the general principle of law that the Federal Government can not tax the means and instrumentalities of the States. He also invokes the revenue laws of the United States and Treasury regulations issued pursuant thereto.

The Board held in effect that the Imperial irrigation district could not be classified as an essential governmental function of the State of California and that, therefore, the petitioner's income derived therefrom was not exempted from Federal income taxation.

The matter in dispute was submitted upon an agreed statement of facts, from which the Board found the following:

In 1923, the petitioner was engaged as attorney and chief counsel of the irrigation district, and was so engaged during the years in controversy, namely, 1927 and 1928.

The authority for the petitioner's connection with the district is contained in the following resolution adopted by the board of directors of the district:

"*Resolved*, That Chas. L. Childers, of El Centro, Calif., be employed as attorney for Imperial irrigation district, at a retainer of $350, which retainer shall include all services rendered by him, excepting the trial of cases and any services requiring his absence from the county of Imperial, and when engaged in the trial of cases on behalf of the district or absent from Imperial County on behalf of the district in addition to said retainer he shall receive the sum of $25 per day."

The petitioner maintained his own law office and during the years 1927 and 1928 "he was free to and did accept some other minor concurrent work." He also operated a farm for profit, which operation resulted in a net loss for the year 1927 of $66.06, and net profit of $439.13 for the year 1928.

Practically all of his ordinary business hours were devoted to the affairs of the said Imperial irrigation district. Because of the volume of district work, it was necessary for the petitioner to employ an assistant, whose compensation was paid by the petitioner.

The expenses incurred by the petitioner in connection with earning the compensation received from the district, which have been allowed by the respondent as deductions from gross income, included office rent, supplies, the salary of the assistant, taxes and depreciation.

The letterhead of the Imperial irrigation district lists the petitioner as attorney, under the heading of officers.

The Imperial irrigation district was formed and exists under the California irrigation district act, and the acts amendatory thereof and supplementary thereto.

The petitioner asks this court to review the decision of the Board approving deficiencies in Federal income taxes of $145.96 and $73.22 for the years 1927 and 1928, respectively.

The primary question here presented is whether the compensation received by the petitioner as attorney for the irrigation district is exempt from the Federal income tax. This depends upon the question as to whether the petitioner was an officer or employee of the State of California.

Article 37 of Regulations 69, promulgated under the Revenue Act of 1926, reads in part as follows:

"*State contracts.*—The profit of an independent contractor from a contract with a State or political subdivision thereof must be included in gross income. * * *"

Article 88 of the same regulations is in part as follows:

"*Compensation of State officers and employees.*—Compensation paid to its officers and employees by a State or political subdivision thereof for services rendered in connection with the exercise of an essential governmental function of the State or political subdivision, including fees received by notaries public commissioned by States and the commissions of receivers appointed by State courts, is not taxable. Compensation received for services rendered to a State or political subdivision thereof is included in gross income unless (*a*) the person receives such compensation as an officer or employee of a State or political subdivision, and (*b*) the services are rendered in connection with the exercise of an essential governmental function. * * *

"An officer is a person who occupies a position in the service of the State or political subdivision, the tenure of which is continuous and not temporary and the duties of which are established by law or regulations and not by agreement. An employee is one whose duties consist in the rendition of prescribed services and not the accomplishment of specific objects, and whose services are continuous, not occasional or temporary. * * *"

Articles 56 and 643 of Regulations 74, promulgated under the Revenue Act of 1928, contain provisions identical, in all material respects, with those quoted above.

The petitioner contends that, "From the probative facts found by the Board, the ultimate fact must necessarily be that the petitioner is an officer or an employee" of the irrigation district. The respondent insists that the petitioner was an independent contractor in his relationship to the district.

Under this heading, the petitioner asserts that "Since the Board did not find that the petitioner *was not* an officer or employee, but based its decision wholly upon other grounds, the decision of the Board of Tax Appeals can not be sustained on the ground that the Board might have found that the petitioner was not an officer or an employee."

Though the Board's findings do not contain a statement of the ultimate fact that the petitioner was not an employee or an officer, the findings contain sufficient facts to enable us to determine that question as a matter of law. It is well settled that an appellate court may base an affirmance upon grounds other than those relied upon below.

In support of his contention that he was an "employee" of the irrigation district, the petitioner quotes section 1965 of the Civil Code of California, which reads as follows:

"The contract of employment is a contract by which one, who is called the employer, engages another, who is called the employee, to do something for the benefit of the employer, or of a third person."

This section, however, must be read in connection with section 2009, which provides:

"A servant is one who is employed to render personal service to his employer, otherwise than in the pursuit of an independent calling, and who in such service remains entirely under the control and direction of the latter, who is called his master."

The Supreme Court of California has held that "The word 'servant' is generally synonymous with the word 'employee.'" (*Western Indemnity Co.* v. *Pillsbury*, 172 Cal., 807, 810–811.)

The petitioner also lays considerable stress upon the fact that the Board expressly found that he had been "engaged" as attorney and chief counsel, and upon the fact that the board of directors of the district, in its resolution, stated that he be "employed" as attorney, etc.

Again the Supreme Court of California has ruled against the petitioner's contention, and with specific reference to contracts between attorney and client. In *Fidelity & C. Co.* v. *Industrial Acc. Com.* (191 Cal., 404, 410), the court said:

"The circumstance that under the contract decedent was to render nondelegable personal services may be persuasive, but it is in no sense conclusive or determinative. Contracts for the rendition of nondelegable personal services are of common occurrence which do not constitute the contractor an employee. For example, the ordinary contracts between attorney and client. The same may be said of the use of the phrase 'engages and employs.'"

Indeed, it has been held that even when the word "employee" is used in a statute, such usage is not conclusive in establishing the relationship of employer and employee. (*Burnet* v. *Livezey* (C. C. A. 4), 48 F. (2d), 159, 161.)

The books are replete with instances where the term "employer" or "employ" is used in connection with the hiring of an independent contractor. We need cite only a few such decisions: *Western Indemnity Co.* v. *Pillsbury*, supra, at page 813; *Fidelity & C. Co.* v. *Industrial Acc. Com.*, supra, at page 410, quoting Shearman and Redfield on Negligence, 6th ed., section 164; *Metcalf & Eddy* v. *Mitchell*, at pages 518 and 520 [T. D. 3824, C. B. V-1, 218]; *Register* v. *Commissioner of Internal Revenue* (C. C. A. 6) (69 F. (2d), 607, 608 [Ct. D. 863, C. B. XIII-2, 284].)

In California, as elsewhere, "The chief consideration which determines one to be an independent contractor is the fact that the employer has no right of control as to the mode of doing the work contracted for * * *" (*Green* v. *Soule*, 145 Cal., 96, 99, quoting 16 Am. & Eng. Encyc. of Law, 2d ed., page 187; *Western Indemnity Co.* v. *Pillsbury*, supra, at page 811.)

To render one an employee, the employer's right of control must be complete, and extend to the details of the work.

In *Western Indemnity Co.* v. *Pillsbury*, supra, at page 811, the court said:

"It is true that many authorities specify 'control' of the person performing the work as the means of differentiating service from independent employment. The test of 'control,' however, means '*complete* control.'"

And in *Fidelity & C. Co.* v. *Industrial Acc. Com.*, supra, at page 407:

"He is deemed to be the master who has the supreme choice, control, and direction of the servant, and whose will the servant represents, not merely in the ultimate results of the work, but in all the details."

The test to which we refer was recognized in the case of *Haight* v. *Commissioner of Internal Revenue* (C. C. A. 7) (52 F (2d), 779, 781, certiorari denied, 285 U. S., 537–538), in which the court said:

"The record in this case shows that Adcock, in rendering his services to the sanitary district, was under the general direction and supervision of its general attorney. This was required by the rules and regulations of the board of trustees. All this amounts to is that Adcock would report to the general attorney from time to time as to what had been done, and consulted with him. It does not show that the general attorney exercised any detailed control as to what should be done, and how it should be done, which is essential to the relationship of employer and employee."

In the leading case of *Metcalf & Eddy* v. *Mitchell*, supra, the plaintiffs were consulting engineers, who, either as individuals or as copartners, were professionally "employed" to advise States or subdivisions of States with reference to proposed water supply and sewage disposal systems. In that case, at pages 520–521 of its opinion, the Supreme Court of the United States said:

"Nor do the facts stated in the bill of exceptions establish that the plaintiffs were 'employees' within the meaning of the statute. So far as appears, they were in the position of independent contractors. The record does not reveal to what extent, if at all, their services were subject to the direction of the public boards or officers engaging them. In each instance the performance of their contract involved the use of judgment and discretion on their part and they were required to use their best professional skill to bring about the desired result. This permitted to them liberty of action which excludes the idea of that control or right of control by the employer which characterizes the relation of employer and employee and differentiates the employee or servant from the independent contractor. [Cases cited.]"

So here, there is nothing in the record to establish that the petitioner was an "employee" within the meaning of the constitutional limitation. Neither in the resolution of the board of directors, upon which the petitioner relies, nor in the findings of the Board of Tax Appeals can there be found any statement which would justify the assumption that the contract between the petitioner and the district was other than an ordinary contract between attorney and client, so far as supervision and control by the client are concerned.

Of a similar contract with a drainage district, in *Burnet* v. *Jones* (C. C. A. 8) (50 F. (2d), 14, 15), the court said:

"While his employment was authorized by statute, the statute itself does not fix the status of the attorney as an employee. It does not fix his duties, his salary, nor his tenure of office. He had no fixed office hours, but rendered legal services pursuant to specific contract.

* * * * * * *

"The lawyer who is retained in the affairs of his client is not properly designated an employee. He is an officer of the court. As counselor and advisor to his clients and as an advocate before the court, whatever action he takes is upon independent judgment illuminated by his learning, his skill, his experience, and his ethics. The relationship of attorney and client is entered into and maintained with regard to these considerations, and is not that of employer and employee."

(See also 13 Cal. Jur., 1019–1020; 3 Cal. Jur., 654–656; *Singer Manufacturing Co.* v. *Rahn*, 132 U. S., 518, 523–524; *Chi., Rock Isld. & Pac. Ry.* v. *Bond*, 240 U. S., 449, 455–457; *Burnet* v. *McDonough* (C. C. A. 8), 46 F. (2d), 944, 945–946 [Ct. D. 338, C. B. X–1, 367]; *Brown* v. *Commissioner of Internal Revenue*, 19 B. T. A., 568, 573–574, petition for review denied, 55 F. (2d), 1076, certiorari denied, 287 U. S., 602; *Kreipke* v. *Commissioner of Internal Revenue* (C. C. A. 8), 32 F. (2d), 594, 596 [Ct. D. 114, C. B. VIII–2, 287]; *Roberts* v. *Commissioner* (C. C. A. 5), 44 F. (2d), 168; *Haight* v. *Commissioner*, supra, at page 781; *Underwood* v. *Commissioner* (C. C. A. 4), 56 F. (2d), 67, 71–72; *Norcross* v. *Helvering* (C. A. D. C.), 75 F. (2d), 679, 680.)

Nor could the petitioner be considered an "officer" of the district. He cites to us no statute creating the office of attorney for an irrigation district, nor have we been able to discover any. Sections 7 and 19 of the California irrigation district act provide for the election of officers, and section 19c provides for the appointment of officers, but no mention is made of an attorney.

Section 15 of the act empowers the board of directors to "employ and appoint such agents, officers and employees as may be required, and prescribe their duties." We assume that the petitioner was appointed as attorney under this provision.

Nor does the fact that the petitioner's name appears as attorney under the heading of officers, on the letterhead of the district conclude the matter; for, as we have repeatedly held, and as we have already pointed out herein, legal relationships are determined not by labels but by contractual provisions, interpreted according to law. "We do not regard that question as answered by mere terminology." (*Helvering* v. *Powers*, 293 U. S., 214, 224 [Ct. D. 900, C. B. XIII–2, 213].)

Extremely apposite to the instant case is the language of the court in *Metcalf & Eddy* v. *Mitchell*, supra, at page 520:

"An office is a public station conferred by the appointment of government. The term embraces the idea of tenure, duration, emolument, and duties fixed by law. Where an office is created, the law usually fixes its incidents, including its terms, its duties, and its compensation. [Case cited.] The term 'officer' is one inseparably connected with an office; but there was no office of sewage or water supply expert or sanitary engineer, to which either of the plaintiffs was appointed. The contracts with them, although entered into by authority of law and prescribing their duties, could not operate to create an office or give to plaintiffs the status of officers. [Cases cited.] There were lacking in each instance the essential elements of a public station, permanent in character, created by law, whose incidents and duties were prescribed by law. [Cases cited.]"

(See also *Helvering* v. *Powers*, supra, at pages 222–223; *Blair* v. *Byers* (C. C. A. 8), 35 F. (2d), 326, 328 [Ct. D. 146, C. B. IX–1, 247]; *Haight* v. *Commissioner*, supra, at pages 780–781; *Register* v. *Commissioner*, supra; *Commissioner* v. *Modjeski* (C. C. A. 2), 75 F. (2d), 468, 470.)

Applying the principles announced in the foregoing decisions, we conclude that the petitioner was neither an employee nor an officer, but was an independent contractor who entered into the ordinary relation of attorney and client with a public corporation.

The petitioner has not brought himself either substantially or "exactly within the exception he claims." (*Register* v. *Commissioner*, supra, at page 607.)

Inquiring into the effect of the particular tax, we do not find that it impairs in any substantial manner the ability of the petitioner to discharge his "obligations to the State or the ability of a State or its subdivisions to procure the services of private individuals to aid them in their undertakings." (*Metcalf & Eddy* v. *Mitchell*, supra, at page 526. See also *Tirrell* v. *Johnston*, 86 N. H., 530, 171 A, 641, 654, affirmed, 293 U. S., 533.)

The petition is denied, and the decisions of the Board of Tax Appeals are affirmed.

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## ARTICLE 643: Compensation of State officers and employees. XV–25–8132 Ct. D. 1128

INCOME TAX—REVENUE ACT OF 1928—DECISION OF COURT.

1. EXEMPTION—COMPENSATION FOR SERVICES—EMPLOYEE OF STATE—INDEPENDENT CONTRACTOR.

Compensation received by the taxpayer as chief counsel for an investigation committee created by the legislature of the State of New Jersey was not exempt from Federal income tax, where the taxpayer continued to engage in private practice, was under no supervision by the committee as to his hours, and exercised his own judgment and discretion in the conduct of the investigation. He was an independent contractor and not an employee of the State.

2. DECISION AFFIRMED.

Decision of the Board of Tax Appeals (31 B. T. A., 1097) affirmed.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

*Russell E. Watson, petitioner,* v. *Commissioner of Internal Revenue, respondent.*

Upon petition for review from the United States Board of Tax Appeals.

Before DAVIS and THOMPSON, Circuit Judges, and FORMAN, District Judge.

[January 20, 1936.]

OPINION.

THOMPSON, Circuit Judge: This is a petition for review of a decision of the Board of Tax Appeals. The petitioner is a lawyer engaged in general practice in New Jersey. In 1928, by a joint resolution, the New Jersey Legislature created a committee charged with the duty—

"To make a survey of all questions of public interest; to investigate violations of law and the conduct of any State, county, or municipal official, State, county or municipal department, State, county or municipal commission, State, county or municipal board, or State, county or municipal body, to report whether the functions of such officials, departments, commissions, boards, and bodies, have been or are being lawfully and properly discharged, for the purpose of obtaining information relative thereto as a basis for such legislative action as the senate and general assembly may deem necessary and proper; to ascertain what departments or activities of the State, county, or municipal governments may be curtailed, consolidated, or eliminated, and report those findings as a basis for such legislative action as the senate and general assembly may deem necessary and proper; to make a general survey of the finances of the State, counties, municipalities, and to report its findings as a basis for such legislative action as the senate and general assembly may deem necessary and proper, excluding, however, any investigation of the department of banking and insurance."

Section 2 of the resolution provided:

"* * * The committee shall select a chairman and secretary, and shall have the power to employ the necessary legal, clerical and other assistance."

The petitioner served as chief counsel for the committee from June, 1928, until January, 1930, and for the services thus rendered, he was paid $18,000 in 1929 by the State of New Jersey. He did not include this amount in his income tax return. The Commissioner assessed a deficiency and was sustained by the Board of Tax Appeals. The petitioner claims that as to this sum he was an instrumentality of the State. The Commissioner disputes the claim. Although there is no express provision in the Constitution of the United States which prohibits the imposition of Federal income taxes upon agencies and instrumentalities of a State, the Supreme Court has held that the tax prohibition is necessarily implied. (*The Collector* v. *Day*, 11 Wallace, 113; *United States* v. *Railroad Company*, 17 Wallace, 322.) The sixteenth amendment to the Constitution has not altered this exemption from taxation. (*Bowers* v. *Kerbaugh-Empire Co.*, 271 U. S., 170 [T. D. 3881, C. B. V-1, 199].) In accordance with this doctrine Congress has enacted 26 U. S. C. A., 1065b, which provides:

"Any taxes imposed by the Revenue Act of 1924 or prior Revenue Acts upon any individual in respect of amounts received by him as compensation for personal services as an officer or employee of any State or political subdivision thereof (except to the extent that such compensation is paid by the United States Government directly or indirectly), shall, subject to the statutory period of limitations properly applicable thereto, be abated, credited, or refunded."

The petitioner does not claim to be an officer of the State, but does claim to be an employee of the State and contends that his income so derived is tax exempt. The Commissioner maintains that the petitioner was not an employee but was an independent contractor. The distinction is tersely made by the Supreme Court in *Metcalf & Eddy* v. *Mitchell* (269 U. S., 514, 520 [T. D. 3824, C. B. V-1, 218]), where it is said:

"Nor do the facts stated in the bill of exceptions establish that the plaintiffs were 'employees' within the meaning of the statute. So far as appears, they were in the position of independent contractors. The record does not reveal to what extent, if at all, their services were subject to the direction or control of the public boards or officers engaging them. In each instance the performance of their contract involved the use of judgment and discretion on their part and they were required to use their best professional skill to bring about the desired result. This permitted to them liberty of action which excludes the idea that control or right of control by the employer which characterizes the relation of employer and employee and differentiates the employee or servant from the independent contractor."

We apply this test to the instant case. As evidence that the petitioner was an employee are the facts that the resolution used the word "employ," that the petitioner took an oath of office (although the same was not required by the legislature), that he could be discharged by the committee at any time and that he was paid out of the State treasury under authority of the joint resolution. As evidence that he was independent contractor are the facts that the committee exercised no supervision over his hours, that he continued to engage in his private practice, and that he exercised his own judgment and discretion in the conduct of the investigation authorized by the joint resolution. In *Lucas, Commissioner of Internal Revenue,* v. *Reed* (281 U. S., 699), the Supreme Court, upon authority of *Metcalf & Eddy* v. *Mitchell,* supra, reversed the decision of this court reported in 34 F. (2d), 263. In that case the taxpayer was employed as special counsel to represent the Commonwealth in certain inheritance tax cases. The State legislature had appropriated funds for the services of attorneys to be employed in such cases. The Commissioner refused to allow the taxpayer exemption for compensation received from the State on the ground that he was an independent contractor and not an employee of the State. The Supreme Court upheld the Commissioner. Judged by the test developed in the discussion in *Metcalf & Eddy* v. *Mitchell,* supra, and by the ruling of the Supreme Court in *Lucas, Commissioner of Internal Revenue,* v. *Reed,* supra, we think the Board in the instant case had before it sufficient evidence to establish its conclusion that the petitioner was an independent contractor and not an employee. We think the decision of the Board of Tax Appeals is amply supported by the evidence and its conclusions sustained by the authorities. It is, accordingly, affirmed.

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## SECTION 117.—NET LOSSES.

ARTICLE 651: Net losses, definition and computation. XV-20-8088 Ct. D. 1116

INCOME TAX—REVENUE ACT OF 1928—DECISION OF COURT.

1. DEDUCTION—NET LOSS—SEPARATE AND JOINT RETURNS.

Where separate returns were filed by a husband and wife for 1929, that of the husband showing a net business loss, and a joint return was filed for 1930 disclosing net income of the wife and net business loss sustained by the husband, the net loss of the husband for 1929 can not be carried over and taken as a deduction from the aggregate income of the husband and wife for 1930.

2. DECISION AFFIRMED.

Decision of the Board of Tax Appeals (31 B. T. A., 433) affirmed.

3. CERTIORARI DENIED.

Petition for certiorari denied April 6, 1936.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

*Charles E. Van Vleck and Natalie J. Van Vleck, petitioners,* v. *Commissioner of Internal Revenue, respondent.*

*Charles E. Van Vleck, petitioner,* v. *Commissioner of Internal Revenue, respondent.*

Petitions to review decisions of the Board of Tax Appeals. Affirmed.

Before MANTON, AUGUSTUS N. HAND, and CHASE, Circuit Judges.

[December 9, 1935.]

OPINION.

The petitioners in one case are a husband and wife who filed a joint return of income for the calendar year 1930; and in the other the husband alone is the petitioner. As the same issue is raised in each case, they were consolidated for hearing.

CHASE, Circuit Judge: During the calendar years 1929 and 1930 Charles E. Van Vleck, one of the petitioners, was regularly engaged in the business of buying and selling securities. He sustained a net business loss of $58,165.37 in 1929 and filed a separate return for that calendar year which showed the loss sustained.

During the calendar year 1930, he had gross income amounting to $77,996.56 and a capital net gain of $12,679.36; but his allowable deductions for that period alone were $110,814.58, so that a computation of his income tax status for the period, figured on the basis of a separate return, left him with another net loss and with no opportunity then to carry over and use as a deduction the statutory net loss he had sustained in the previous year.

Mr. Van Vleck, however, did not file a separate return for the calendar year 1930. Instead, he and his wife, the other petitioner, who were living together and had aggregate income sufficient to entitle them so to do, filed a joint return for 1930. Mrs. Van Vleck had net income for that period which exceeded the total net losses her husband had sustained both in 1929 and 1930. In that joint return the husband's 1930 net loss was deducted from the aggregate gross income of both and the right to take that deduction has not been questioned.

What has given rise to the issue raised by these petitioners is the fact that the net loss he sustained in 1929 was also deducted. That is to say, $39,418.16 of it was taken as a deduction in the joint return, and later the petitioners filed a claim for refund based upon a recomputation in which the remainder of his 1929 loss was claimed to be deductible. That claim for refund is still pending before the Commissioner and is, strictly, not here involved although it is inevitable that the decision here will supply the basis for deciding the refund claim.

From the above, it will be seen that the sole question presented is whether, when a husband and wife filed, as they might, a joint return for the year 1930 which showed no taxable net income except that of the wife, such taxable net may be reduced by carrying over and deducting a net loss sustained by the husband in the previous year. The right to file a joint return under the circumstances already outlined flows from the provisions of section 51 of the Revenue Act of 1928. The statute provides that where a husband and wife may, and do, file a single joint return "the tax shall be computed on the aggregate income." And article 381 of Treasury Regulations 74 in so far as here applicable provides that, "* * * Where the income of each is included in a single joint return, the tax is computed on the aggregate income and all deductions and credits to which either is entitled shall be taken from such income. * * *"

In the light of the above statute and regulation no objection was made to the deduction by the husband of his 1930 statutory net loss from the net income of his wife. Simply stated, the position of the petitioners is that there is the same right to carry over and deduct his 1929 net loss.

This claim of right to take such a deduction fails adequately to take into account a basic limitation upon the right to carry over a net loss for purposes of deduction in a subsequent year. We agree that once either husband or wife can establish in his or her own right that a loss is deductible it may be taken from the aggregate income shown by the joint return. But in the case of a loss sustained in a previous year the right to any deduction at all depends upon the right to carry the loss over and into the computation of the current year for the purpose of determining gain or loss for the taxable year. The right to carry over a loss is an incident of the right to deduct and equally depends upon legislative grace. The enactments of Congress upon this subject disclose a general policy to limit the right to deduct losses to the taxpayer who sustained them and when the right to make them available to another is claimed it must be supported by an applicable statute. (See *New Colonial Co.* v. *Helvering*, 292 U. S., 435 [Ct. D. 841, C. B. XIII-1, 194]; *Woolford Realty Co.* v. *Rose*, 286 U. S., 319 [Ct. D. 493, C. B. XI-1, 154]; *Planters Cotton Oil Co.* v. *Hopkins*, 286 U. S., 332 [Ct. D. 492, C. B. XI-1, 153].)

Although the petitioners filed a joint return in 1930, each of them remained a separate and distinct taxpayer. (*Woolford Realty Co.* v. *Rose*, supra.) In the case just mentioned the taxpayers were corporations but the principle applies with equal force to individual taxpayers. As two corporate taxpayers who file a consolidated return remain two separate taxpayers so do a husband and wife who file a joint return.

The right to carry over and deduct a previous net loss rests upon section 117(b) of the 1928 Revenue Act. The right to carry over is expressly limited to "any taxpayer (who) has sustained a net loss" and the right to use the deduction is as expressly limited to "computing the net income of the taxpayer" for the succeeding year or years. It follows that the only taxpayer who could use the husband's 1929 net loss in computing net income for 1930 was the taxpayer who sustained the loss, i. e., the husband himself. But it so happens that his right to take it into the computation is so restricted that he could not even do this. Section 117(a)6 of the Revenue Act of 1928 provided that: "In computing the net loss for any taxable year a net loss for a prior year shall not be allowed as a deduction." As the husband sustained a net loss in 1930 he could not in his own right carry his 1929 net loss into the 1930 computation. (See *Bowers* v. *Commissioner*, 80 Fed. (2d), 215 (decided to-day).) As the wife did not sustain the 1930 net loss she could not carry it into the 1930 computation either. And, of course, as neither could carry it into the 1930 computation of taxable income it could have no place at all in the 1930 joint return.

Affirmed.

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**SUPPLEMENT C.—CREDITS AGAINST TAX.**

## SECTION 131.—TAXES OF FOREIGN COUNTRIES AND POSSESSIONS OF UNITED STATES.

### Article 691: Analysis of credit for taxes.

REVENUE ACT OF 1928.

Taxes assessed by German Government for 1916 and paid during next four years. (See Ct. D. 1100, page 172.)

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### Article 695: Countries which do or do not satisfy the similar credit requirement.

REVENUE ACT OF 1928.

Netherlands Government. (See I. T. 2980, page 140.)

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**SUPPLEMENT D.—RETURNS AND PAYMENT OF TAX.**

## SECTION 141.—CONSOLIDATED RETURNS OF CORPORATIONS—1929 AND SUBSEQUENT TAXABLE YEARS.

### Article 41, Regulations 75: Net losses.

XV–13–8019
Ct. D. 1096

INCOME TAX—REVENUE ACT OF 1928—DECISION OF COURT.

1. Consolidated Returns—Change From Calendar to Fiscal Year Basis—"Taxable Year"—Net Loss of Subsidiary.

Where the parent of two corporations which became affiliated in 1929 secured the permission of the Commissioner to change its accounting period for 1929 from the calendar year basis to the fiscal year ending June 30, provided it filed its 1929 return for the period from January 1 to June 30, and also secured the consent of the subsidiary, which had previously filed returns upon the basis of a fiscal year ending October 31, to the filing of a consolidated return, the 2-month period of November–December, 1928, which was not included in the taxable year of the parent, constituted a "taxable year" for which the subsidiary was obligated to file a separate return, under the provisions of section 141 (a) and (b) of the Revenue Act of 1928 and Regulations 75, and a statutory net loss sustained by the subsidiary for the fiscal year ending October 31, 1927, was allowable only against income allocated to the 2-month separate return period and not against income for the period from January to July, 1929, for which consolidated return was filed.

2. Former Opinion Adhered to.

Opinion of March 12, 1934 (Ct. D. 880, C. B. XIII–2, 217; 77 Fed. (2d), 774) adhered to.

3. Decision Distinguished.

*Helvering* v. *Morgan's, Inc.* (68 Fed. (2d), 325; 293 U. S., 121), distinguished.

4. Certiorari Denied.

Petition for certiorari denied October 21, 1935.

United States Court of Appeals for the District of Columbia.

*Wishnick-Tumpeer, Inc., petitioner,* v. *Guy T. Helvering, Commissioner of Internal Revenue, respondent.*

On rehearing.

[June 10, 1935.]

OPINION.

Groner, J.: Our former opinion was filed March 12, 1934. Shortly thereafter, and before our mandate had gone down, the Government applied to the Supreme Court for certiorari in *Helvering* v. *Morgan's, Inc.* (68 F. (2d), 325). The petition assigned as the reason for granting the writ that:

"The decision below is in direct conflict with the decision of the United States Court of Appeals for the District of Columbia in *Wishnick-Tumpeer, Inc.*, v. *Commissioner*, decided March 12, 1934 [Ct. D. 880, C. B. XIII–2, 217]. Although the Wishnick-Tumpeer case arose under the Revenue Act of 1928, and invoked the provisions of Regulations 75, there is, we submit, no basis of distinction between the two cases on this ground. In each case the ultimate question is the meaning of the words 'taxable year' as used in the applicable section of the statute."

Certiorari was granted, and the decision of the First Circuit Court of Appeals affirmed November 5, 1934 (293 U. S., 121 [Ct. D. 888, C. B. XIII–2, 267]).

We granted a rehearing. On rehearing the Government reversed its former position and now insists there *is* a distinction between the two cases. This Laodicean policy does not commend itself to us, but we doubt if it can be made to justify a refusal to examine the question for ourselves.

In Morgan's case that corporation, on June 1, 1925, acquired the voting stock of Haines Corporation. Both corporations were previously on the calendar year basis, and in filing their 1926 returns Haines filed a separate return for the first five months of 1925 and the two corporations filed consolidated returns for the last seven months of that year and for the years 1926 and 1927. In 1925 and in 1926 Haines sustained net losses. In 1927 it made a net profit. Its net loss in the first five months of 1925 (before affiliation) was shown in a separate return for that period. Its net losses for the last seven months of 1925 and for the year 1926 were shown in the consolidated returns of the two corporations for those periods. In the consolidated return for 1927 Haines brought forward its loss for the first five months of 1925 and deducted it from its net income in 1927. The Commissioner disallowed the deduction on the ground that the separate return covering the first five months of 1925 and the consolidated return for the last seven months of 1925 covered two separate taxable years within the meaning of the statute—resulting in making the third year carry-over expire in 1926.

In our case the two corporations in question were affiliated, in the sense that Tumpeer owned 95 per cent of Pioneer for a period prior to the time in question, but both companies had during that period filed separate tax returns. Tumpeer's tax period was the calendar year, and Pioneer's the fiscal year ending October 31. Tumpeer in 1929 was granted permission by the Commissioner to change its taxable year from calendar year to a fiscal year ending June 30, provided it filed its return for that year (1929) on or before September 15, covering the period of January 1 to June 30, 1929. Tumpeer, with the consent of Pioneer, then filed a consolidated return. The return included the net income of Tumpeer from January 1 to June 30, 1929, and the net income of Pioneer for the 8-month period November 1, 1928, to June 30, 1929. In Pioneer's return there was deducted a loss sustained in 1927, no portion of which had been used to offset its income in the year ending October 31, 1928. The Commissioner held that this was not permissible, treated Pioneer's return as a separate return for the period November 1 to December 31, 1928, and allowed the 1927 net loss against the net income allocated to the November-December period, but denied the right to offset the remainder against the income for the period January to July, 1929; and this result was accomplished, as in Morgan's case, by treating the period November and December, 1928, as a separate taxable year.

The statement of facts in Morgan's case and this case, to the extent we have gone, shows the cases are identical.

In Morgan's case the Supreme Court held the Commissioner's decision wrong on the ground that the "taxable year" in the carry-over statute was a 12-month period, and that a return made, under the circumstances of that case, for a shorter period did not constitute such period a separate taxable year.

And if this were all, it would be manifestly our duty to recall our former opinion and to conform it to the view of the Supreme Court. But in the view we take there are other facts and considerations, to which we shall refer, which when fairly weighed distinguished the two cases and made the rule in the one inapplicable in the other; and this, we think, was the view of the Supreme Court as indicated by the only two references to this case in the opinion in Morgan's case.

Morgan's case arose under the Revenue Act of 1926; our case under the Revenue Act of 1928. There is no substantial difference in the two Acts in definition of taxable year, or loss carry-over, but in other respects there are material differences both in the Acts and in the Treasury regulations made pursuant to statutory authority.

Section 141 (Act of 1928, ch. 852; 45 Stat., 791) is new. It provides as follows:

"(a) An affiliated group of corporations shall, subject to the provisions of this section, have the privilege of making a consolidated return for the taxable year 1929 or any subsequent taxable year, in lieu of separate returns. The making of a consolidated return shall be upon the condition that all the corporations which have been members of the affiliated group at any time during the taxable year for which the return is made consent to all the regulations under subsection (b) prescribed prior to the making of such return; and the making of a consolidated return shall be considered as such consent. In the case of a corporation which is a member of the affiliated group for a fractional part of the year the consolidated return shall include the income of such corporation for such part of the year as it is a member of the affiliated group.

"(b) The Commissioner, with the approval of the Secretary, shall prescribe such regulations as he may deem necessary in order that the tax liability of an affiliated group of corporations making a consolidated return and of each corporation in the group, both during and after the period of affiliation, may be determined, computed, assessed, collected, and adjusted in such manner as clearly to reflect the income and to prevent avoidance of tax liability."

Pursuant to this authority, the Commissioner promulgated Regulations 75. We quote the applicable sections, as follows:

"Art. 13. (*g*) If a corporation, during its taxable year, becomes a member of an affiliated group, its income for the portion of such taxable year not included in the consolidated return of such group must be included in a separate return * * *.

"Art. 14. The taxable year of the parent corporation shall be considered as the taxable year of an affiliated group which makes a consolidated return, and the consolidated net income must be computed on the basis of the taxable year of the parent corporation.

"ART. 41. (*d*) Any period of less than 12 months for which either a separate return or a consolidated return is filed, under the provisions of article 13, shall be considered as a taxable year."

By reference to the above it will be seen that Congress, in the 1928 Act, authorized the Commissioner to prescribe specific regulations to determine the tax liability of an affiliated group of corporations seeking permission to make a consolidated return, and made the acceptance of the regulations by the applicant corporations a condition precedent to the right to file consolidated returns. And it will also be seen that the Commissioner's regulations, made pursuant to this authority, provide that where there is affiliation for the purpose of filing consolidated returns, and such returns are filed during the taxable year of one of the corporations, its return for the period of the year not included in the consolidated return shall be made separately; also that the taxable year of the parent shall be the taxable year of the affiliate; and that any period of less than 12 months for which either a separate or consolidated return is filed shall be a taxable year. These conditions, in their entirety, exactly fit the case of petitioner here. Tumpeer and Pioneer became affiliated for the purpose of consolidated taxation in the year 1929. Tumpeer is the parent. It duly applied to the Commissioner for permission to change its taxable year from calendar year to fiscal year. With the consent of Pioneer, it filed a consolidated return. By the terms of the Commissioner's permit, its taxable year for its 1929 return was January 1 to June 30. Pioneer, in order to conform to the regulations, was obligated to file a separate return to cover the last two months of 1928—the months not included in the taxable year of its parent. Under article 41(*d*) of the regulations, this separate period return embraced a taxable year.

It therefore follows that, if the Commissioner's regulations are to be given the force of law, the Government's position is, as we formerly held, in all respects correct.

Is there, then, anything in Morgan's case to negative this conclusion? We think not. That case turned upon the construction of section 200(a) of the 1926 Act. The section defines the term "taxable year" to include a fractional part of a year for which a return is made. The Supreme Court construed the word "includes," not as synonymous with "means," but as the equivalent of "comprehends" or "embraces," and found support in other provisions of the Act for this construction; but it is perfectly obvious that if the Court had construed the word "includes" as "means," the conclusion reached would have been different. The ambiguity which the Supreme Court found in the 1926 Act, and resolved in favor of the taxpayer, is wholly absent in the 1928 Act and Treasury regulations, when considered together; for in the latter there is the express and positive command that the fractional part of the year for which the return is made "shall be considered as a taxable year." And if Congress had the right to limit or restrict the carry-over privilege, as to which there can be but one answer, it had the same right to confer that power on the Commissioner. Congress unquestionably inserted the new provisions in the 1928 Act to clarify administrative procedure under the former Act and to substitute, in place of a definite provision, rules to be made by the Commissioner which would be optional in the case of corporations changing from separate to consolidated returns and, sometimes, involving in the change wholly different tax periods; and, in this view, petitioner's case is brought precisely within the scope of the purpose. In Morgan's case the taxpayers' taxable year (parent and affiliate), both before and after the year of affiliation, was the calendar year, and the filing of returns for fractional parts of the year did not involve any change in either of the taxpayers' accounting years and, so far as the question here involved is concerned, had no effect upon the actual net income, or the amount of tax. In the instant case, Tumpeer's previous taxable year was the calendar year, and Pioneer's the fiscal year ending October 31.

The application of Tumpeer involved a complete change in accounting periods of both parent and affiliate. The consent was a concession for which the Commissioner had the right to demand terms. The conditions were that Pioneer should file a separate return for the period prior to affiliation and that such return should be considered as covering a tax year. In effect, he said to petitioner—If the returns of Pioneer for the two months prior to affiliation and the six months of affiliation be considered as a single return, the result will be to permit its entire loss carry-over to be set off against earnings of only eight months; and this will not correctly reflect its tax for the reason that a return for that period will not correctly reflect its income. True, to this it may be said—neither does the regulation; but, since the regulation must apply generally, it is not enough to say that in a particular case—where it is optional and not coercive—it is invalid because it deprives a taxpayer of something which otherwise he would be entitled to. An occasional hardship is inescapable. It was the recognition of this fact, doubtless, which induced Congress in 1928 to enlarge the power of the Commissioner to make specific rules to apply when a change of accounting period like that involved here is asked as a matter of grace. It is true that in this case, as was true in Morgan's case, if Pioneer had not taken advantage of the provision authorizing consolidated returns, it would have been permitted to carry over its net loss of 1927 for the next two succeeding years; but, even in that event—the two succeeding years would have embraced two full years and not, as in the present case, a materially shorter time.

All of this we mention as giving substance to our assumption that Congress, in the 1928 provisions, had a definite purpose in view. The regulations authorized to carry out the purpose were intentionally made optional. An affiliated corporation could take them or leave them, as appeared to it advantageous. This was as nearly a fair and equitable arrangement as the difficulties inherent in the situation made possible; and we can think of no reason, and certainly can find none in Morgan's case, to justify our saying that the regulations so made are invalid.

Petitioner, having exercised its option and consented to be bound, will not now be heard to complain, and in this view we have no other course than to adhere to our former opinion.

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## SECTION 142.—CONSOLIDATED RETURNS OF CORPORATIONS—TAXABLE YEAR 1928.

ARTICLE 731: Consolidated returns of affiliated corporations for 1928. XV-12-8008 Ct. D. 1093

INCOME TAX—REVENUE ACT OF 1928—DECISION OF COURT.

1. AFFILIATED CORPORATION—ELECTION TO FILE SEPARATE RETURNS—CHANGE OF BASIS—ADDITION OF NEW CORPORATION TO AFFILIATED GROUP.

Where two affiliated corporations elected to file separate returns for the years 1926 and 1927, the addition to the group, in 1928, of a newly formed subsidiary, carved out of the parent and wholly owned by it, and which brought in neither new capital nor business, did not create a new right of election so as to permit the filing of a consolidated return for 1928, without the permission of the Commissioner as provided in section 142(a) of the Revenue Act of 1928, since the identity of the group remained the same and the integrity of a single business was not destroyed.

2. DECISION AFFIRMED.

Decision of the Board of Tax Appeals (31 B. T. A., 161) affirmed.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT.

*Braden Steel Corporation, petitioner,* v. *Commissioner of Internal Revenue, appellee.*

On petition to review the decision of the United States Board of Tax Appeals.

Before LEWIS, PHILLIPS, and BRATTON, Circuit Judges.

[July 8, 1935.]

OPINION.

PHILLIPS, Circuit Judge, delivered the opinion of the court.

The Braden Co., an express trust, was organized in 1923 and has at all times since been taxed as a corporation. On January 1, 1926, the Braden Co. organized the Braden Steel & Winch Co. and transferred to it a part of its business in return for all of the issued stock. On January 1, 1928, the Braden Co. organized the Braden Steel Corporation and transferred another portion of its business and in return received all the issued stock. It has at all times continued to own all of the outstanding stock of its two subsidiaries.

The Braden Co. and the Braden Steel & Winch Co. made separate income tax returns for the years 1926 and 1927. Those two companies each sustained a loss in 1928, while the Braden Steel Corporation earned a net income of $24,939.75. Without requesting or securing permission of the Commissioner to change the basis of filing returns, the Braden Co. filed a consolidated return for the year 1928 for itself and its two wholly owned subsidiaries.

The Commissioner determined that the three companies, although affiliated, were not entitled to file a consolidated return for the year 1928, under section 142, Revenue Act, 1928,[1] and thereupon proposed to assess a deficiency against the Braden Steel Corporation of $2,632.77.

The Board of Tax Appeals affirmed the determination of the Commissioner.

The only question presented here is whether the three affiliated corporations had the right to file a consolidated return of income for the year 1928, without first obtaining permission from the Commissioner.

Section 142, supra, grants to affiliated corporations the option of filing separate returns or a consolidated return, but it is expressly provided that if an election was made in 1927, the method elected could not be changed in 1928 without the consent of the Commissioner. The statute requires a definite and permanent election, and once made, it must be adhered to by the taxpayer in the absence of permission of the Commissioner to change the basis.

It is argued that, even though separate returns were filed in 1927 by the Braden Co. and the Braden Steel & Winch Co., a new right of election arose in 1928, because of the addition of the Braden Steel Corporation to the group.

The addition of a new member to a group does not create a new right of election, where the group remains substantially constant and such addition does not destroy the integrity of a single business. (*Export Leaf Tobacco Co.* v. *Commissioner* (C. C. A. 2), — F. (2d), — [Ct. D. 1094, page 240, this Bulletin]; *Sweets Co. of America* v. *Commissioner* (C. C. A. 2), 40 F. (2d), 436; *Swift & Co.* v. *United States* (C. Cl.), 38 F. (2d), 365.)

When the change is so fundamental that a new and different group is created, a new right of election arises. (*Albert Leon & Son, Inc.*, v. *Commissioner*, 29 B. T. A., 251.) Whether such a substantial change is brought about by such addition is a question of fact. Some of the cases hold that a change which gives rise to a new right of election does not occur if the dominant parent of all the affiliates remains the same. (*Huntington Beach, Inc.*, v. *Commissioner*, 30 B. T. A., 731; *Marvel Equipment Co.* v. *Commissioner* (C. C. A. 3), 67 F. (2d), 354, 355; *Export Leaf Tobacco Co.* v. *Commissioner* (C. C. A. 2), — F. (2d), —. Compare *Stonega Coke & Coal Co.* v. *Commissioner* (C. C. A. 3), 57 F. (2d), 1030.)

Although the dominant parent was the same here during the years 1927 and 1928, it is not necessary for us to rest our decision upon that basis, since the facts clearly disclose that the identity of the group was the same in 1928 as it was in 1927. There is no sound basis for the contention advanced that a newly formed subsidiary, which was carved out of the parent corporation and wholly owned by it and which brought neither new capital nor business into the group, changed the identity of the affiliation and empowered it to change the method of reporting income from that adopted in 1927. If such a situation gave rise to a new right of election, it would be a simple matter for an affiliation to establish a new right of election by carving out a part of the business of one member of the group and organizing a new member, or by one of the members absorbing another member, despite the Commissioner's nonpermission or even express disapproval. It is not to be assumed that Congress would have imposed this express restriction upon the voluntary election given cor-

[1] Section 142(a), Revenue Act, 1928 (45 St., 832), which in substance reenacted section 240(a), Revenue Act, 1926, provides in part as follows:

"(a) *Consolidated returns permitted.*—Corporations which are affiliated within the meaning of this section may, for the taxable year 1928, make separate returns or, under regulations prescribed by the Commissioner with the approval of the Secretary, make a consolidated return of net income for the purpose of this title, in which case the taxes thereunder shall be computed and determined upon the basis of such return. If return for the taxable year 1927 was made upon either of such bases, return for the taxable year 1928 shall be upon the same basis unless permission to change the basis is granted by the Commissioner."

porate taxpayers, and yet leave open such an obvious means of its circumvention and frustration.

The decision of the Board of Tax Appeals is affirmed.

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## ARTICLE 731: Consolidated returns of affiliated corporations for 1928.

XV-12-8009
Ct. D. 1094

INCOME TAX—REVENUE ACT OF 1928—DECISION OF COURT.

1. AFFILIATED CORPORATIONS—ELECTION TO FILE SEPARATE RETURNS—ADDITION OF NEW AFFILIATES—CHANGE IN BASIS.

Where affiliated corporations filed separate returns for 1926 and no proper consolidated return was made for 1927 (when one member filed a separate return and the group failed to file a consolidated return on behalf of all its members), an election to file separate returns for both years had been exercised, and the addition of new affiliates in 1927 and 1928 did not entitle the group to a new election and to change to a consolidated return basis for 1928, since there had been no substantial change in the continuity of the business and the dominant parent remained the same, and the permission of the Commissioner to change the basis had not been requested or granted.

2. CLOSING AGREEMENT—INTENTION TO CHANGE STATUS OF AFFILIATED GROUP.

By the execution of a closing agreement, pursuant to section 606 of the Revenue Act of 1928, settling the tax liability of two of the affiliates upon the basis of their consolidated returns for 1927, such returns did not become proper and lawful and did not authorize the filing of a consolidated return by the affiliated group for 1928. The Commissioner did not intend thereby to change the status of the corporations as to future returns or in such an indirect way to afford them a new election.

3. DECISION AFFIRMED.

Decision of the Board of Tax Appeals (31 B. T. A., 28) affirmed.

4. CERTIORARI DENIED.

Petition for certiorari denied October 21, 1935.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

*Export Leaf Tobacco Co., petitioner, v. Commissioner of Internal Revenue, respondent.*

*T. C. Williams Co., petitioner, v. Commissioner of Internal Revenue, respondent.*

*The Smith Paper Co., petitioner, v. Commissioner of Internal Revenue, respondent.*

Before MANTON, L. HAND and AUGUSTUS N. HAND, Circuit Judges.

[June 17, 1935.]

OPINION.

The foregoing three cases, which were consolidated for hearing before the United States Board of Tax Appeals, involve deficiencies in income taxes for the year 1928, arising solely out of the fact that the Commissioner of Internal Revenue required the several petitioners to compute their income upon the basis of separate returns. From orders of the Board, adjudging deficiencies in income taxes against the several taxpayers, the latter have appealed. Affirmed.

AUGUSTUS N. HAND, Circuit Judge: The deficiencies of the above corporate taxpayers arise out of the fact that the Commissioner required each of them to compute its income upon the basis of a separate return. The only question before us is whether, under the circumstances presented, these taxpayers were entitled to report on a consolidated basis. The taxes affected are those for the year 1928.

Section 142(a) of the Revenue Act of 1928, which in substance reenacted section 240(a) of the Act of 1926, provided that:

"Corporations which are affiliated within the meaning of this section may, for the taxable year 1928, make separate returns or, under regulations prescribed by the Commissioner with the approval of the Secretary, make a consolidated return of net income for the purpose of this title, in which case the taxes thereunder shall be computed and determined upon the basis of such return. If return for the taxable year 1927 was made upon either of such bases, return for the taxable year 1928 shall be upon the same basis unless permission to change the basis is granted by the Commissioner."

Under section 142(c) of the Act of 1928 domestic corporations are "deemed to be affiliated (1) if one corporation owns at least 95 per centum of the stock of the other or others, or (2) if at least 95 per centum of the stock of two or more corporations is owned by the same interests."

In 1927 a foreign corporation known as British-American Tobacco Co., Ltd., became owner of 99 per cent of the stock of Export Leaf Tobacco Co. of Delaware. The latter company had succeeded to the business and property of a New Jersey company of the same name, 99 per cent of the stock of which was owned by the British-American company in 1926. In 1926 the British-American company also acquired all the stock of the T. C. Williams Co., a Virginia corporation, which conducted a tobacco business. In March, 1927, the Brown & Williamson Tobacco Corporation was organized and 95 per cent of its stock was owned by the British-American company. Brown & Williamson Tobacco Corporation likewise owned all of the stock of Brown & Williamson Tobacco Sales Corporation, which was organized June 5, 1928. On October 8, 1928, the Export Leaf Tobacco Co. of Delaware acquired 95 per cent of the stock of the Smith Paper Co., a Massachusetts corporation engaged in manufacturing cigarette papers.

From the foregoing, it is evident that before the end of 1928, Export Leaf Tobacco Co., T. C. Williams Co., Brown & Williamson Tobacco Corporation, Brown & Williamson Tobacco Sales Corporation and the Smith Paper Co. were all affiliated within the meaning of section 142(c) of the Act of 1928, unless the fact that the British company was a foreign corporation made a difference. See section 238 of that Act.

Export Leaf Tobacco Co. of New Jersey and T. C. Williams Co. filed separate income tax returns for the year 1926. Export of New Jersey, and Brown & Williamson filed a consolidated return for the period from January 1, 1927, to November 30, 1927, the date of dissolution of Export of New Jersey, and the latter's successor, Export of Delaware, and Brown & Williamson filed a consolidated return for the balance of 1927, while the T. C. Williams Co. filed a separate return for that entire year. For the year 1928 Export of Delaware, T. C. Williams Co., Brown & Williamson, Brown & Williamson Sales Corporation and the Smith Paper Co. filed consolidated returns.

It appears from the foregoing that for 1926 the group, of which the British company was the parent, filed separate returns, and that for 1927 the group consisting of Export of New Jersey, its successor Export of Delaware, Brown & Williamson and T. C. Williams, did not file a proper consolidated return for the reason that T. C. Williams filed a separate return. The election allowed by the statute had been exercised by filing separate returns for 1926 and by in effect continuing the same method of reporting in 1927, when one of the affiliates filed a separate return and the group neglected to file a consolidated return on behalf of all its members. Where one member of a group files a separate return, it has been generally held that all are bound by that return and must file separately. (*Duke Power Co.* v. *Commissioner*, 44 Fed. (2d), 543 (C. C. A. 4), certiorari denied, 282 U. S., 903; *Dr. Pepper Bottling Co.* v. *Commissioner*, 69 Fed. (2d), 768; *Pictorial Review Co.* v. *Helvering*, 68 Fed. (2d), 766, 769; *Safety Electric Products Co.* v. *Helvering*, 70 Fed. (2d), 439.) In section 240(a) of the Act of 1926, and 142(a) of the Act of 1928, it is said that, if "return" is made upon either a separate or consolidated basis, the subsequent return "shall be upon the same basis unless permission to change the basis is granted by the Commissioner." We think that the "return" referred to in those sections evidently is a proper and lawful return and that some of the affiliates can not file a consolidated return in disregard of others who neglect or refuse to join and thus leave the method of reporting to the choice not of the group, but of any members of it that may happen to find the method adopted temporarily advantageous. Such a method is quite out of keeping with the limited election afforded by the statute and would leave the basis for the imposition of income taxes to the caprice of the taxpayer though the statute requires a definitive and permanent election which the taxpayers must adhere to in the absence of permission of the Commissioner to change the basis.

It is argued that every addition of an affiliate changes the group and gives rise to a new right of election. But this is not so where the group remains substantially constant and the new member can not fairly be said to destroy the integrity of a single business. Whether that happens in any particular case is a question of fact to be determined by how substantial is the change in the continuity of the business and whether two groups having little common relation are consolidated. Here the British company was the parent and controlling head and it from time to time absorbed other corporations into its business. Export, T. C. Williams and Brown & Williamson owned property of the value of more than $19,000,000 having a gross income of about $36,670,000, while the Smith Paper Co., which was added to the group in 1928, had a probable gross business of about $2,400,000. There can be no doubt that the group had a continuity from 1926 to 1927, inclusive, and when it acquired the Smith Paper Co. in 1928 absorbed a relatively small concern with a good business and made it in every sense a subsidiary. In *Sweets Co. of America* v. *Commissioner* (40 Fed. (2d), 436 (C. C. A. 2)), and in *Swift & Co.* v. *United States* (38 Fed. (2d), 365 (C. Cls.)), it was held that the mere entry into or withdrawal from a group of a new affiliate did not terminate the group or create a new tax-computing unit. Doubtless a change may be so fundamental as to create a new and different group (*Albert Leon & Son, Inc.*, v. *Commissioner*, 29 B. T. A., 251), but such a change will not occur if the dominant parent of all the affiliates remains the same (*Huntington Beach, Inc.*, v. *Commissioner*, 30 B. T. A., 731, 735). It is this distinction that is mentioned in *Marvel Equipment Co.* v. *Commissioner* (67 Fed. (2d), 354, 355 (C. C. A. 3)), and we think renders the earlier decision by the same court in *Stonega Coke & Coal Co.* v. *Commissioner* (57 Fed. (2d), 1030 (C. C. A. 3)) subject to the limitations imposed by the general current of authority.

Inasmuch as individual returns were made by the members of the group for the year 1926 and no proper consolidated return was made by the group for the year 1927, we hold that an election to file separate returns for both of those years had been exercised. Consequently there was no right to change to a consolidated return for the year 1928 without the permission of the Commissioner, which was neither requested nor granted.

We have not overlooked the difficulty of treating affiliation as possible among the members of a group bound together in one business through the medium of a foreign corporation. (Section 238, Revenue Act of 1928.) But inasmuch as the Commissioner raised no objection to the filing of a consolidated return on this ground, we have assumed for the sake of argument that it alone would not render such a return unlawful and have only discussed the issues raised on the appeal. If affiliation was impossible either (1) because the members of the group had elected to file separate returns for 1926 and 1927, or (2) because the parent company was a foreign corporation, the result would be the same and the action of the Board would be right in either event. We have held it impossible upon the first ground.

Finally the taxpayers contend that because the Commissioner executed closing agreements, pursuant to section 606 of the Act of 1928, settling the income tax liability of Export and Brown & Williamson for 1927 upon the basis of their consolidated returns, the consolidated returns which they attempted to make for the year 1927 became proper and lawful returns on the consolidated basis and authorized the filing of consolidated returns for 1928. But the closing agreement was a mere arrangement to settle the amount of their taxes for 1927 and there is not the slightest reason to suppose that the Commissioner intended by it to change the status of the taxpayers as to future returns or in such an indirect way to afford them a new election. His consent was not to a consolidated return for 1927, because none in law had been filed. He merely compromised a claim and admitted nothing in law or in fact.

Orders affirmed.

**Article 734: Consolidated net income of affiliated corporations for 1928.** XV-13-8020 Ct. D. 1097

INCOME TAX—REVENUE ACT OF 1928—DECISION OF COURT.

1. Deduction—Loss—Affiliated Corporations—Consolidated Returns—Liquidation of Subsidiary.

Where a corporation acquired the capital stock of another in 1924, and thereafter, in consolidated returns, reported a profit of the subsidiary in 1925 and operating losses in 1926, 1927, and 1928, the loss deductible by the parent in 1928, upon the dissolution of the subsidiary, was the excess of its investment loss (the difference between the total cost of the subsidiary and the value of its assets taken over upon dissolution) over the operating losses of the subsidiary previously deducted, without reducing the latter by the amount of profit reported in 1925.

2. Decision Reversed.

Decision of the Board of Tax Appeals (29 B. T. A., 139) reversed.

United States Circuit Court of Appeals for the Third Circuit.

*Commissioner of Internal Revenue, petitioner,* v. *National Casket Co., Inc., respondent.*

Upon petition for review from the decision of the United States Board of Tax Appeals.

Before Buffington and Thompson, Circuit Judges, and Johnson, District Judge.

[July 31, 1935.]

OPINION.

Thompson, Circuit Judge: This is a petition for review of a decision of the Board of Tax Appeals. In 1924, the respondent acquired all of the capital stock of Hornthal & Co., a subsidiary. In 1925, the subsidiary operated at a gain, but in 1926, 1927, and 1928, it sustained operating losses. Throughout the period of affiliation, the respondent filed consolidated income tax returns. In 1928 the respondent dissolved the subsidiary and took over its assets, applying part to repay itself for advances made to the subsidiary and the balance towards its investment in the capital stock of that company. In its 1928 income tax return the respondent claimed a deductible loss of $105,355.07, incurred through its investment in the subsidiary. The Commissioner reduced the deductible loss to $4,995.70 and assessed a deficiency. The Board of Tax Appeals reversed the Commissioner in part, allowed a deductible loss of $48,087.67, and found that there was an overpayment for 1928. The Commissioner has taken this appeal. The following summary sets forth the methods used by the respondent, the Commissioner, and the Board of Tax Appeals, respectively, in arriving at the amount to be allowed the respondent as a deductible loss by reason of its investment in the subsidiary:

Calculation of deductible loss by:

RESPONDENT.

| | |
|---|---|
| Paid by respondent for capital stock of Hornthal & Co | $163, 515. 29 |
| Advanced by respondent to Hornthal & Co | 485, 551. 26 |
| Total cost to respondent | 649, 066. 55 |
| Assets of Hornthal & Co | 543, 711. 48 |
| Investment loss claimed as deductible loss by respondent | 105, 355. 07 |

COMMISSIONER.

| | |
|---|---|
| Investment loss of respondent | $105, 355. 07 |
| Operating losses of Hornthal & Co. previously deducted by respondent in consolidated income tax returns for 1926, 1927, and 1928 | 100, 359. 37 |
| Deductible loss allowed by Commissioner | 4 995. 70 |

| | |
|---|---|
| Operating loss of Hornthal & Co. for 1926, previously deducted by respondent in consolidated income tax return | $10, 993. 44 |
| Operating loss of Hornthal & Co. for 1927, previously deducted by respondent in consolidated income tax return | 78, 087. 51 |
| Operating loss of Hornthal & Co. for 1928, deducted by respondent in consolidated income tax return | 11, 278. 42 |
| Gross operating loss of Hornthal & Co | 100, 359. 37 |
| Profit of Hornthal & Co. for 1925 | 43, 091. 97 |
| Net operating loss of Hornthal & Co | 57, 267. 40 |
| Investment loss of respondent | 105, 355. 07 |
| Net operating loss of Hornthal & Co | 57, 267. 40 |
| Deductible loss allowed by Board of Tax Appeals | 48, 087. 67 |

The Commissioner asserts error in that portion of the Board's ruling which allows the gross operating losses to be diminished by the profit reported by the respondent for the subsidiary in 1925, one of the years of affiliation. He relies upon the principle enunciated by the Supreme Court that, except where Act and regulation so provide, double deduction of the same losses, first as subsidiary company losses in consolidated returns for earlier years, and again in stating the eventual loss to the parent company from its investment in the subsidiary, is not permissible. (*Ilfeld Co.* v. *Hernandez*, 292 U. S., 62 [Ct. D. 819, C. B. XIII–1, 139]; *McLaughlin* v. *Pacific Lumber Co.*, 293 U. S., 351 [Ct. D. 907, C. B. XIV–1, 335]. Compare *Burnet* v. *Aluminum Goods Mfg. Co.*, 287 U. S., 544 [Ct. D. 631, C. B. XII–1, 283].) We think none of those cases entirely dispositive of the issue in the instant case, inasmuch as in each of the cited cases the net operating losses of the subsidiary exceeded the liquidating losses of the parent company, so that when the operating losses were set off against the liquidating losses, there was no allowable deduction. There was, therefore, no need in those cases to determine whether profits of the subsidiary should be applied to diminish the gross operating losses. In spite of the absence of direct authority, we do have an indication as to the views of the Supreme Court on this issue. In *Ilfeld Co.* v. *Hernandez*, supra, the Supreme Court said:

"Where all the members gain, total taxable income is the same on a consolidated return as upon separate ones. But where as in the case before us the subsidiaries lose and the parent gains, the losses of the former go in reduction of the taxable income of the latter. Considerations that justify inclusion of the profits made by all the members do not support the double deduction claimed."

We paraphrase this statement and apply it to the instant case: Where, in 1925, both the respondent and the subsidiary gained, the total taxable income was the same on the consolidated return as upon separate ones. Where, however, the subsidiary sustained losses and the respondent gained, the losses of the former went in reduction of the taxable income of the latter. The effect of this is that the respondent's tax burden remained the same in 1925, the year when the subsidiary gained, but was lessened in 1926, 1927, and 1928, the years when the subsidiary lost. In the instant case, the respondent took credit in 1926, 1927, and 1928 for the gross operating losses sustained by the subsidiary and thereby reduced the income tax which it would have been obliged to pay on its own gross profits for the three years in question. The fact that an income tax was paid on the profit earned by the subsidiary in 1925 did not increase the income tax the respondent was obliged to pay on its own profit for that year. In our opinion, credit for the investment loss should be allowed only to the extent to which the investment loss exceeds the credit already taken by the respondent for the operating losses sustained by the subsidiary during the three years in question. In effect, what the Board did when it reduced the operating losses by the 1925 profit, was to allow the respondent to take credit for a profit.

We conclude that the Board of Tax Appeals erred in so far as it allowed the operating losses of the subsidiary to be reduced by the profits of the subsidiary. The decision of the Board of Tax Appeals in that respect is reversed.

SUPPLEMENT E.—ESTATES AND TRUSTS.

## SECTION 162.—NET INCOME.

### Article 861: Estates and trusts.

XV–5–7929
Ct. D. 1071

INCOME TAX—REVENUE ACTS OF 1924, 1926, AND 1928—DECISION OF SUPREME COURT.

1. Income—Trust—Whether Separate Trusts were Created by Amendment.

Where, by amendment under a reserved power, a deed creating a single trust was altered so that a separate account was opened for each beneficiary, to which account an undivided one-third interest in the trust property was assigned although there was no physical division of the trust assets, the amendment accomplished the purpose of creating three separate and distinct trusts, the income from which was separately taxable.

2. Decision Affirmed.

Decision of the Circuit Court of Appeals, Seventh Circuit (78 Fed. (2d), 787), affirming decision of the Board of Tax Appeals (29 B. T. A., 304), affirmed.

Supreme Court of the United States.

*Guy T. Helvering, Commissioner of Internal Revenue, petitioner*, v. *William B. McIlvaine and John P. Wilson, Jr., Trustees under Deed of Trust of John P. Wilson.*

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

[January 6, 1936.]

OPINION.

Mr. Chief Justice Hughes delivered the opinion of the Court.

The question presented in this case is similar to that involved in *United States Trust Co.* v. *Commissioner*, decided this day [Ct. D. 1072, below]. By amendments under a reserved power, the terms of an original trust created by John P. Wilson, in 1913, were altered with the intention of creating three separate trusts. The Board of Tax Appeals, upon findings supported by evidence, concluded that this purpose was accomplished and hence that there was no deficiency. (28 B. T. A., 304.) The circuit court of appeals affirmed the order of the Board. (78 F. (2d), 787.) We granted certiorari because of the conflict with the decision of the Circuit Court of Appeals for the Second Circuit, in the case of the *United States Trust Co.*, supra (75 F. (2d), 973), and, for the reasons stated in our opinion in that case, the decree of the circuit court of appeals is affirmed.

Affirmed.

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### Article 861: Estates and trusts.

XV–5–7930
Ct. D. 1072

INCOME TAX—REVENUE ACTS OF 1924, 1926, AND 1928—DECISION OF SUPREME COURT.

1. Income—Trust—Whether Separate Trusts Were Created by Amendment.

Where, by amendment under a reserved power, a deed creating a single trust was altered so that a separate account was opened for each beneficiary, to which account an undivided one-third interest in the trust property was assigned although there was no physical division of the trust assets, the amendment accomplished the purpose to create three separate and distinct trusts, the income from which was separately taxable.

2. Decision Reversed.

Decision of the Circuit Court of Appeals, Second Circuit (75 Fed. (2d), 973), reversed.

Supreme Court of the United States.

*United States Trust Co. of New York, Trustee under Deed of Trust of John P. Wilson, petitioner,* v. *Commissioner of Internal Revenue.*

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

[January 6, 1936.]

OPINION.

Mr. Chief Justice Hughes delivered the opinion of the Court.

Petitioner is trustee under a trust created by John P. Wilson, in 1913, for the benefit of his three children. Under a reserved power, the trust was four times amended. The sole question is whether the amendments created three separate trusts. The question arises in relation to the taxation of income. If there is but a single trust, as the Commissioner of Internal Revenue ruled, an additional tax would be payable. If there are three trusts, as the Board of Tax Appeals determined, there would be no additional tax. The circuit court of appeals held that there was only one trust. (75 F. (2d), 973.) Certiorari was granted because of the conflicting decision of the Circuit Court of Appeals for the Seventh Circuit in *Helvering* v. *McIlvaine* (78 F. (2d), 787 [Ct. D. 1071, page 245, this Bulletin].)

By the original deed, one-third of the net income of the securities held in trust was to be paid to each of the three children while living, and upon the death of any one, to those who were to succeed to his or her interest in accordance with the provisions of the deed. During the first 15 years of the trust the income could be accumulated by the trustee, with the written consent of the primary beneficiaries, and added to the principal. The trust was terminable at any time in whole or in part by the three children (or survivors) subject to the approval of the grantor, if living, and in any event was to terminate on the death of all the children. Upon termination, one-third of the principal was to be distributed to each of the three children if living, and the share of a deceased child was to go according to the provisions of his or her will or, in the absence of such disposition, to the surviving issue of the decedent or, in default of such issue, to the surviving issue of the grantor per *stirpes*. Provision was made for the alteration of the trust "in any respect and to any extent at any time" by the three children, or survivors, subject to the approval of the grantor if living. Thereafter the "rights and powers of all parties concerned" were to be the same as though the trust deed had originally been executed in the altered form.

In 1918, the three children, with the approval of the grantor, modified the trust so as to provide:

"The trust estate now held under said trust deed shall be divided into three separate and equal parts or shares (to which may be assigned undivided interests in the whole or any part of the said trust estate), which parts or shares shall severally be designated by our respective names, and each of us and our respective legal representatives shall have the same rights, interest and power in and over one of said three equal parts or shares and the income thereof which is given to us respectively by said indenture over one-third of said trust estate and the income thereof, except as may be otherwise specifically provided herein."

It was further provided that the whole of the net income received from each share during the remainder of 1918, and one-half of the net income received thereafter and during the life of the grantor, should be accumulated and added to the principal of such share, with privilege of withdrawal by the beneficiary, with the grantor's consent, of the amount so accumulated. All the provisions of the original trust deed, except as they were "expressly or necessarily" modified by the new instrument, were to continue in force.

In 1919, the three children, with the grantor's approval, executed another modifying instrument which provided that one-half of the net income "of each of the three trust estates" should be paid over, as received, to the beneficiaries entitled thereto, and that the other one-half should be paid to them when the payment was requested by any two of the original beneficiaries; the net income not so paid over was to "be added to the principal of the trust fund from which it is derived." Provision was also made for the disposition of the net income in case of the death of any of the original beneficiaries and for the distribution of the "several trust estates" upon termination.

In 1920, the three children, with the approval of the grantor, modified the amendment of 1919 with respect to the disposition of income by providing that the trustee should pay out "as much of the net income from each of said separate trusts" to the beneficiaries as should be requested by a majority in interest of the beneficiaries, with the added requirement that "equal payments must be made out of the net income from each of said separate trusts, to the end that said several separate trusts may be maintained on a basis of equality in amount so far as practicable." There was a further provision that so much of the net income, "received in any year from each separate trust estate," which was not paid out should form part "of the principal of the separate trust estate" from which it was derived, and the trustee was required to devote to charitable purposes so much of the net income "of said trusts" as should be requested by the three children (or survivors), such payments to be made "in equal amounts from each of said separate trusts."

There was a further amendment in 1928 enlarging the powers conferred upon the trustee by the original deed with respect to the borrowing of money, the borrowed sums to be dealt with "as part of the principal of the three trusts hereunder, in equal shares."

The purpose of the first amendment and the subsequent course of dealings are thus described in the findings of the Board of Tax Appeals, which are adequately supported by the evidence:

"The purpose of the amendment of September 21, 1918, was to create three separate and distinct trusts, one for each of the beneficiaries of the single trust then in existence, in order to reduce liability for income taxes on the income of the trust.

"Prior to the first amendment the trustee kept one cash account for the trust under the heading 'Trust under deed of John P. Wilson, for John P. Wilson, Jr., and others' to which was credited all income of the trust. On September 27, 1918, three accounts were opened up by the trustee, one in the name of 'Trust under Deed of John P. Wilson for John P. Wilson, Jr.'; one under the name of 'Trust under Deed of John P. Wilson, for Anna W. Dickinson'; and the other under the name of 'Trust under Deed of John P. Wilson, for Martha Wilson.' The single account was then closed by transferring equal amounts of its balance to each of the new accounts. Thereafter cash received and disbursed on account of the trust property was entered in these accounts, one-third in each.

"At the same time the property account kept by the trustee for the stock of the single trust was closed out by transferring the items thereof equally to accounts opened up under the names of the three beneficiaries. There was no actual division of the property held under the trust indenture. The new accounts as set up showed that one-third of each asset of the old trust represented the corpus of three new trusts, one for each of the three children of the grantor. Acquisitions of additional principal by purchase were divided equally among the three trusts.

"The stock certificates acquired by the trustee before and after September 21, 1918, were carried in the name of the petitioner as trustee under the deed of trust of John P. Wilson or in the name of a nominee of the trustee. The cash belonging to the trusts in question here and all other trusts being administered by the trustee was kept in one general account with another bank.

"During the taxable years the trustee rendered separate reports each month to the beneficiaries on the basis of a separate trust for each. For each of the years 1924 to 1929, inclusive, it filed fiduciary and income tax returns on the basis of a separate and distinct trust for each child. In his audit of the returns the respondent determined that the income held in trust under the indenture of

March 12, 1913, as amended, was taxable on the basis of a single trust and a single return for each year."

The Board of Tax Appeals concluded that "three separate and distinct trusts" were created.

No question is raised as to the validity of the several amendments. The only question is as to their construction and effect. The parties, if they pleased, had power to convert the single trust into three trusts and the evidence and findings leave no doubt as to their intention to do so. The question is whether they accomplished their purpose. (*United States* v. *Phellis*, 257 U. S., 156, 172 [T. D. 3270, C. B. 5, 37].) If the various securities had been divided physically, if new certificates of stock had been obtained for the several beneficiaries, and such certificates and specific bonds and cash had been set aside for each, there would be no room for argument that three separate trusts were not created. But it was not necessary to have such a physical division in order to carry out the clear intention of the parties. An undivided interest in property may constitute the corpus of a trust. The original trust deed provided that its provisions and limitations should be construed according to the laws of Illinois. But the elementary principle is applied in Illinois, as elsewhere, that "every kind of vested right which the law recognizes as valuable may be transferred in trust." (*Burke* v. *Burke*, 259 Ill., 262, 268.) "It (a trust) may be created in any property, real or personal, legal or equitable, which is in existence, and which in the eye of a court of equity, is of value." (*Gurnett* v. *Mutual Life Insurance Co.*, 356 Ill., 612, 617. Perry on Trusts, seventh edition, sections 67, 68.) Nor are the amending instruments open to the objection that the subject of the trusts was not adequately defined. (Compare *Snyder* v. *Snyder*, 280 Ill., 467, 469, 470; *Marble* v. *Marble's Estate*, 304 Ill., 229, 236.) Where there is an intention to create separate trusts, the fact that "the trusts" are "kept in one fund" does not necessarily defeat the intention and require the conclusion that there is but a single trust. (*Matter of Colegrove*, 221 N. Y., 455, 459.) "In many cases," said the Court of Appeals of New York in *Vanderpoel* v. *Lowe* (112 N. Y., 167, 180), where "income and principal were given in equal shares, although out of one fund kept *in solido* for convenience of investment, a severance of the trust into its component parts has been adjudged. * * * The shares and interests are several, although the fund remains undivided." (See, also, *Rollestone* v. *National Bank of Commerce*, 299 Mo., 57, 71.)

In the instant case, immediately following the first amendment, the trustee opened separate accounts for the three trusts and the single account previously kept was closed. Income received and amounts disbursed were divided and entered in the separate accounts. The property account of the single trust was closed and the items were transferred equally to separate accounts in the names of the beneficiaries, showing one-third of the assets of the old trust as representing the corpus of each of the three trusts. New principal was divided equally in the same way. If, at the outset, there had been three trust deeds, each creating a trust for the benefit of a distinct beneficiary in an undivided one-third of the property involved, no question would have arisen. We think the same result was achieved by the use of the power of amendment. We find no ground for concluding that the purpose of the parties to create the three trusts was not carried out.

The decision of the circuit court of appeals is reversed and the order of the Board of Tax Appeals is affirmed.

It is so ordered.

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## SECTION 166.—REVOCABLE TRUSTS.

Article 881: Income of trusts taxable to grantor. XV–20–8089
Ct. D. 1117

INCOME TAX—REVENUE ACTS OF 1926 AND 1928—DECISION OF COURT.

1. Income—Revocable Trust—Taxable to Settlor.

Where four trusts were created in 1925, each for the benefit of a single beneficiary and each designating two trustees, of whom in three instances one was the beneficiary, and to each being attached a condition that any two of a committee of three named persons, who were neither trustees nor beneficiaries and of whom the settlor was not one, might alter or terminate the trusts provided the settlor stated in writing that he had no objection thereto, the income from the trusts was taxable to the settlor under the provisions of section 219(g) of the Revenue Act of 1926 and section 166 of the Revenue Act of 1928. *Reinecke* v. *Smith* (289 U. S., 172 [Ct. D. 664, C. B. XII-1, 256]) followed.

2. Decision Affirmed.

Decision of the Board of Tax Appeals (31 B. T. A., 594) affirmed.

United States Circuit Court of Appeals for the Second Circuit.

*Robert B. Bowler, appellant,* v. *Guy T. Helvering, Commissioner of Internal Revenue, appellee.*

Appeal (petition to review) by a taxpayer from an order of the Board of Tax Appeals fixing deficiencies in his income taxes for the years 1926, 1927, 1928, and 1929.

Before L. Hand, Swan, and Chase, Circuit Judges.

[December 9, 1935.]

OPINION.

*Per curiam:* This case involves income taxes for the years 1926, 1927, 1928, and 1929; the only question is whether the income of four trusts created by the taxpayer on December 25, 1925, is taxable to him as settlor under section 219(g) of the Revenue Act of 1926, and section 166 of the Act of 1928. Each trust was for a single beneficiary; in each there were two trustees, of whom in three instances one was the beneficiary; to each was attached a condition that any two members of a committee of three named persons who were neither trustees nor beneficiaries of the trust for which they were appointed and of whom the settlor was not one, might "change and alter any of or all the trusts herein set forth and declare new trusts of the property in any way or manner whatsoever; also to terminate or modify the beneficial interest of any person or class of persons or to name or appoint any other persons or classes of persons beneficiaries." The settlement also provided: "No exercise of said power shall be valid while I am alive and competent to act until and unless I shall have in writing signified that I have no objection thereto." The "power" so mentioned was that of the committee. The Board held that the last clause just quoted brought the case within the statutes (*Reinecke* v. *Smith*, 289 U. S., 172), and fixed deficiencies accordingly.

The taxpayer argues that *Reinecke* v. *Smith* does not rule because in that case one of the cotrustees with the settlor was his son, over whose will he must be supposed to have had an influence and whom he could therefore bend to his purposes. Each case must therefore depend upon the actual relation between the settlor and the other trustees and the income will be taxable to the settlor only in case it appears that his is the dominant will. This quite misunderstands the decision. The son was a direct beneficiary in one trust and a contingent beneficiary in the others; the court assumed sub silentio that he could not count, as indeed he could not, being flatly within the terms of section 219(g), Act of 1924, which is the same as the sections here involved. It was only because the settlor might revoke the trust with the concurrence of the third trustee, a trust company, that the statute applied, and thus the case is on all fours with that at bar, except for the fact that here the settlor has only a veto upon the action of the committee. We can not see that this makes any difference save in form. All donees of a joint power must concur in its exercise; the refusal of any one is an effective veto. It is true that in form any change in the limitations of the trusts at bar had to originate with the committee; at least we may assume that they are first to decide and then submit their decision to the settlor for his approval, while in the case of a joint power any of the donees may suggest an exercise of the power to the others. But such a difference is of no practical moment whatever; if the settlor wishes to modify any of these trusts he need only persuade two of the committee to his mind, exactly as he would have had to do if he had been a member. Nothing prevents his taking the affirmative; his power is as much and as little as it was in *Reinecke* v. *Smith*, supra, except that here he has two persons to convince while there he had only one. The constitutional apology for the doctrine is that unless the income is regarded as the settlor's, it will always be easy for him to induce complaisant trustees to qualify and practically to control the income, resuming it when he chooses. That reasoning applies equally well to these trusts.

Order affirmed.

SUPPLEMENT H.—NONRESIDENT ALIEN INDIVIDUALS.

## SECTION 212.—GROSS INCOME.

ARTICLE 1042: Exclusion of earnings of foreign ships from gross income.

REVENUE ACT OF 1928.

Belgium, equivalent exemption. (See I. T. 2969, page 144.)

SUPPLEMENT I.—FOREIGN CORPORATIONS.

## SECTION 238.—AFFILIATION.

SECTION 238.

XV–10–7984
Ct. D. 1088

INCOME TAX—REVENUE ACT OF 1928—DECISION OF COURT.

1. CONSOLIDATED RETURNS—AFFILIATES—FOREIGN CORPORATION.

Two domestic corporations were not entitled to file a consolidated return as affiliates for the year 1929, when their affiliation depended entirely upon the fact that a foreign corporation held more than 95 per cent of the shares of each. Such corporations were not "an affiliated group," in view of section 238 of the Revenue Act of 1928, which expressly states that a foreign corporation shall not be deemed to be affiliated with any other corporation within the meaning of section 141 or 142.

2. DECISION REVERSED.

Decision of the Board of Tax Appeals (30 B. T. A., 1015) reversed.

3. CERTIORARI DENIED.

Petition for certiorari denied January 6, 1936.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

*Commissioner of Internal Revenue, petitioner,* v. *Manus Muller & Co., Inc., respondent.*

On petition to review an order of the Board of Tax Appeals expunging a deficiency in the respondent's income tax for the year 1929.

Before MANTON, L. HAND, and AUGUSTUS N. HAND, Circuit Judges.

[July 1, 1935.]

OPINION.

L. HAND, Circuit Judge: This appeal presents the single question of law whether under section 141 and section 238 of the Revenue Act of 1928, two domestic corporations may file a consolidated return as affiliates, when their affiliation depends entirely upon the fact that a foreign corporation holds more than 95 per cent of the shares of each. Article 2(b) of Regulations 75 forbids this, but the taxpayer maintains, and the Board has found, that it is invalid. The House wished to end with the year 1928 any privilege whatever of filing a consolidated return; section 141 of its bill was then in the same form as section 142 of the Act as it became law. Section 238 was also in the bill, and read as it does now, except that it ended with the words, "within the meaning of section 141," instead of "within the meaning of section 141 or 142"; its meaning was what it would have been, had it become law reading, "within the meaning of section 142." The Senate had other views and interjected a new section, now section 141, which granted a more limited privilege of affiliation after the year 1928. Subdivision (e) of that section read as it does now; "A consolidated return shall be made only for the domestic corporations within the affiliated group"; an intimation that there might be "an affiliated group" of which a foreign corporation was one member. However section 238 was extended to both sections; it expressly contradicted the implication; it declared that "a foreign corporation shall not be deemed to be affiliated with any other corporation within the meaning of section 141 or 142." In the face of such a conflict the express provision must prevail, unless there be some reason to suppose that it did not really mean what it said.

It is the view of the taxpayer, which the Board has adopted, that it did not. The argument rests upon the formal pattern of the Act of 1928, which contained general provisions in the first four "Supplements," and particular provisions in others that were compendia of all that was peculiarly applicable to classified subjects. Section 141 is among the general provisions (Supplement D); section 238 is in Supplement I which touches foreign corporations only. We do not see the force of this fact; it is as reasonable to suppose that the paramount intent is in one place as in the other. Although section 238 is redundant as to section 142, and although that is also the case with other sections in Supplement I and perhaps elsewhere in the Act, it is surely inadmissible to say that so far as not redundant, that is, qua section 141, it is not to be treated as law at all. How in this view are we to reconcile its express extension to section 141? Its general purpose many have been only symmetry of arrangement, but it was cast in the imperative, and we can not play so fast and loose with the chosen words of a statute.

We have assumed that the implication of subdivision (e) must be that foreign corporations are members of an affiliated group for all purposes but the inclusion of their incomes in the consolidated return. Though that no doubt is the natural meaning, it is not the inevitable one. In the first place it contradicts the underlying notion on which affiliation rests. When a business is single, industrially and financially, it ought to be assessed as such; there is but a single income and intramural transactions cancel each other; that is the notion which supports the affiliation. But if a foreign corporation is the only nexus which unites domestic subsidiaries—if it is the "parent"—this theory can be realized only by bringing its income into hotchpot with the rest, just what section 141(e) itself forbids. To eliminate that income and still to treat as a unit those companies which are a unit only because the excluded foreign corporation holds their shares, is to deny the premise and affirm the conclusion. True, it would not compromise the result in practice when the "parent" had no income, but those would be uncommon instances. There are indeed circumstances which may justify such a course and subdivision (e) mentions one; an affiliation in which an insurance company is "parent." (*Corner Broadway-Maiden Lane, Inc.*, v. *Commissioner*, 76 Fed. (2d), 106 (C. C. A. 2).) But the income of the "parent" can there be taxed, and is excluded from the consolidated return only because a different rate and method of assessment apply to it. The income of a foreign corporation can not be taxed, except so far as it arises in this country. So much for antecedent probability. Textually the Board's interpretation is not inevitable, either. The phrase, "affiliated group" in subdivision (e) refers back to subdivision (d) for definition, and the clause may have meant that foreign corporations though within the group as so defined, were not to count as such at all. The draftsman of the phrase may have assumed that the composition of the consolidated return was the measure of all the legal consequences following upon affiliation, not foreseeing a situation like that at bar. The change in phrasing between section 141 and section 142 would indeed have been significant, had the two come from the same hand; but as the Act was composed, there is no reason to suppose that "affiliation" in one section was intended to be different from "affiliation" in the other. If we are to speculate, we should put down the discordance to mere difference in draftsmanship, even if section 238 were not present. That discordance was corrected by section 141(e) of the Act of 1932, and it would have to be much more strident to justify our setting down section 238 as brutum fulmen. Besides, affiliation is a privilege in any case, akin to an exemption, and doubts go against the taxpayer.

Order reversed; deficiency restored.

SUPPLEMENT L.—ASSESSMENT AND COLLECTION OF DEFICIENCIES.

## SECTION 275.—PERIOD OF LIMITATION UPON ASSESSMENT AND COLLECTION.

ARTICLE 1201: Period of limitation upon assessment of tax. XV-26-8144 Ct. D. 1131

INCOME TAX—REVENUE ACTS OF 1926 AND 1928—DECISION OF COURT.

1. STATUTE OF LIMITATION—VALIDITY OF WAIVER—DELIVERY AND CONSENT—DETERMINATION AND ASSESSMENT OF TAX—JURISDICTION OF BOARD OF TAX APPEALS.

A waiver of the statute of limitation upon assessment of 1924 and 1925 taxes, executed on February 1, 1929, was valid, since the execution thereof included its delivery and the Commissioner's written consent thereto was not necessary, and such waiver extended the time for both determination and assessment of the taxes so that the 60-day letter mailed within the extended period was timely, and the Board of Tax Appeals had jurisdiction of the appeal.

2. STATUTE OF LIMITATION—VALIDITY OF WAIVER—EXECUTION OF WAIVER BEFORE FINDING OF DEFICIENCY—PRESUMPTION OF REGULARITY OF COMMISSIONER'S ACTION.

A waiver of the right to file a petition with the Board of Tax Appeals and a consent to the assessment and collection of deficiencies for the years 1923 to 1926, inclusive, executed on October 23, 1929, were premature and invalid where filed before the Commissioner had found any deficiency, and did not prevent the mailing of a deficiency notice by which the running of the statute of limitation was suspended. In the absence of an affirmative showing to the contrary, it is presumed that the deficiencies were assessed, where the Commissioner admitted merely that the assessments were not made prior to the expiration of the period stated in the waiver of February 1, 1929.

3. NOTICE OF DEFICIENCY—SUFFICIENCY.

A deficiency letter addressed to "McCarthy & Co." instead of "The McCarthy Co." was a sufficient notice to the taxpayer for all purposes, where the evidence showed that the letter was sent to the correct address and was delivered to and accepted by the taxpayer as a notice in respect to its tax liability for the years in question.

4. CERTIORARI DENIED.

Petition for certiorari denied April 6, 1936.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

*The McCarthy Co., a Corporation, petitioner,* v. *Commissioner of Internal Revenue, respondent.*

Upon petition to review an order of the United States Board of Tax Appeals.

Before WILBUR, GARRECHT, and DENMAN, Circuit Judges.

[December 9, 1935.]

OPINION.

GARRECHT, Circuit Judge: According to a formal stipulation of facts filed before the Board of Tax Appeals in the instant case, the petitioner, within the time required by law, filed income tax returns for the years 1923, 1924, 1925, and 1926, and paid the income taxes shown to be due by such returns. Only the taxes for 1924, 1925, and 1926 are here in question.

On or before February 1, 1929, the petitioner executed a waiver extending the time within which any income taxes found to be due for the years 1924–1925 might be assessed, to December 31, 1929.

During the year 1929 the internal revenue agent in charge at Los Angeles, Calif., caused an audit to be made of the income tax returns filed by the petitioner for the years 1923, 1924, 1925, and 1926, and as a result of such audit determined that there were deficiencies in the taxes for those years as follows:

| | |
|---|---|
| 1923 | $5,881.91 |
| 1924 | 11,266.32 |
| 1925 | 1,247.73 |
| 1926 | 270.73 |

Subsequently to such audit, and on or about October 23, 1929, the petitioner executed a waiver of right to file a petition to the United States Board of Tax Appeals and executed a consent to the assessment and collection of the deficiencies above set forth, and delivered such waiver and consent to the internal revenue agent in charge at Los Angeles.

Under date of November 25, 1929, the Commissioner directed a letter to The McCarthy Co., 1031 South Broadway, Los Angeles, making reference to the report of the internal revenue agent in charge at San Francisco, covering the examination of the petitioner's books for the years 1922 to 1926, inclusive, indicating deficiencies in taxes of $18,666.69, pointing out that the statutory period of limitations for the years 1924 and 1925 would expire December 31, 1929, and that the Bureau would be compelled to issue a final notice of deficiency for those years unless agreements extending the statutory period for assessment were executed and filed.

On December 27, 1929, the respondent mailed a registered letter to "McCarthy & Co., 1031 South Broadway, Los Angeles, Calif.," a copy of which letter was attached to the petitioner's pleadings before the Board. The letter was delivered to the petitioner herein, and accepted by it. It was intended for the petitioner, and the directing of the letter to "McCarthy & Co." was an error of the respondent.

The petitioner's correct taxable net income for the year 1924 is $243,821.60, and the tax computed thereon is $30,477.70, of which sum the petitioner has paid $19,211.38.

The correct taxable net income for 1925 is $152,837.51, and the tax computed thereon is $19,868.87, of which the petitioner has paid $18,621.14.

The correct taxable net income for 1926 is $113,736.77, and the tax computed thereon is $15,354.46, of which the petitioner has paid $15,083.73.

Pursuant to the determination of the Board, as set forth in its memorandum opinion, there was handed down a decision declaring deficiencies as follows: 1924, $11,266.32; 1925, $1,247.73; 1926, $270.73.

From that decision by the Board, the taxpayer has filed a petition for review before this court.

In its brief, the petitioner relies upon the following specifications of error:

1. The Board erred in failing to hold that there was no valid extension of time for the assessment of deficiencies for 1924 and 1925, because the record fails to show that any such extension was delivered to the respondent or accepted by him in writing, at any rate before the limitations had expired; in failing to hold that, if the extension was valid, the time for assessment expired in any event on December 31, 1929; and in failing to hold that the statute of limitations had run as to both 1924 and 1925 deficiencies.

2. The Board erred in failing to hold that the petitioner had executed and delivered to the respondent valid consents to the assessment of the 1924 and 1925 deficiencies prior to December 31, 1929, and therefore that the right to make deficiency assessments for those years expired, in any event, December 31, 1929, so that no deficiencies could be found or assessed for those years; and the Board erred in failing to hold that since the petitioner had consented to

the 1926 deficiency on October 23, 1929, or, in any event, on November 25, 1929, the statute of limitations prevented a finding or assessment of deficiency for 1926 after March 15, 1930.

3. The Board erred in failing to hold that notice of deficiency sent to "McCarthy & Co." was not notice to the petitioner, "The McCarthy Co.," and that such notice was ineffectual for any purpose; and in failing to hold that therefore the statute of limitations had run as to all deficiencies, and that the Board was without jurisdiction to find any deficiency.

We will consider each of the petitioner's propositions *seriatim*.

The first specification of error involves only the taxes for 1924 and 1925. As the petitioner points out, the statutory limitation for the assessment of income taxes for 1924 is four years. Since the return in question was filed on March 15, 1925, the limitation, but for the waiver of February 1, 1929, would have expired on March 15, 1929. The period of limitation for 1925 is three years from the date on which the return is filed, which in this case was on March 15, 1926. Therefore, but for the waiver, the period of limitation for the tax for 1925 would likewise have expired on March 15, 1929. (Section 200(a) and section 277(a)(1)(2) of the Revenue Act of 1926.)

The question therefore turns on the validity of the waiver of February 1, 1929.

The petitioner contends that "There was no stipulation or evidence that the extension was delivered to or filed with the Commissioner or any other agency of the Government, or that the Commissioner 'consented in writing,' as required by law."

We are not impressed with the petitioner's objections to the waiver. In the first place, the stipulation sets forth that the petitioner "executed" the waiver. In California, as elsewhere, it is settled that "execution" includes "delivery." Section 1933 of the Code of Civil Procedure of California reads as follows:

"The execution of an instrument is the subscribing and delivering it, with or without affixing a seal."

(See also *Le Mesnager* v. *Hamilton*, 101 Cal., 532, 539 (mortgage); *Williams* v. *Kidd*, 170 Cal., 631, 151 P. 1, 8 (deed); *Van Valkenburgh* v. *Oldham*, 12 Cal. App., 572, 579 (note and mortgage); *White* v. *Hendley*, 35 Cal. App., 267, 275 (deed); *Washington Finance Corporation* v. *Glass*, 74 Wash., 653, 661 (note); *Aldrich* v. *Public Opinion Pub. Co.* (S. D.), 132 N. W., 278, 282 (appeal bond).)

As to the necessity for the Commissioner's consent in writing, in this circuit it is settled that such consent is not necessary in order to give validity to a taxpayer's waiver of the statute of limitations. In *Commissioner* v. *Hind* (52 F. (2d), 1075, 1078) we said:

"* * * It seems that, since the provision relative to the Commissioner's signature, as held by the Supreme Court, was for 'purely administrative purposes,' his failure to sign the waiver of February 25, 1926, did not render such waiver invalid."

It should be borne in mind that, when there is a prima facie showing that the statute of limitations has not expired, the burden is upon the taxpayer to come forward with proof to satisfy the court that the taxing arm of the Government should be stayed. As was said by Mr. Justice Sutherland in *DuPont de Nemours & Co.* v. *Davis* (264 U. S., 456, 462), "Statutes of limitation sought to be applied to bar rights of the Government, must receive a strict construction in favor of the Government." (See also *Jones* v. *Commissioner*, 18 B. T. A., 1225, 1227; *J. Friedman & Co.* v. *Commissioner*, 16 B. T. A., 1119, 1122; *Nicholson* v. *Commissioner*, 22 B. T. A., 744, 746; *Loewer Realty Co.* v. *Anderson*, 31 F. (2d), 268, 269 (C. C. A. 2) [Ct. D. 125, C. B. VIII-2, 218], certiorari denied, 280 U. S., 558; *Bowers* v. *New York & Albany Lighterage Co.*, 273 U. S., 247, 249 [T. D. 4009, C. B. VI-1, 268].)

Next, the petitioner argues that "the extension, if any, agreed only to *assessment* before December 31, 1929," and that "there is no evidence or stipulation that the taxpayer consented to a mere determination of deficiency within such time, and *assessment* afterward."

The courts, however, repeatedly have held contrary to the petitioner's contention. In *Stange* v. *United States* (282 U. S., 270, 277 [Ct. D. 274, C. B. X-1, 414]), where a similar waiver was under consideration, Mr. Justice Brandeis said:

"The parties can not have intended to have the amount of the tax ascertained and to leave the taxpayer free to pay it or not. They clearly contemplated the entire procedure necessary to determination and collection of the tax."

(See also *Aiken* v. *Burnet*, 282 U. S., 277, 282 [Ct. D. 275, C. B. X–1, 419]; *Brown & Sons Co.* v. *Burnet*, 282 U. S., 283, 287 [Ct. D. 279, C. B. X–1, 274]; *United States* v. *Southern Lumber Co.* (C. C. A. 8), 51 F. (2d), 956, 961, certiorari denied, 284 U. S., 680; *Washington Coal & Coke Co.* v. *Heiner*, 42 F. (2d), 681, 684, 685 [Ct. D. 216, C. B. IX–2, 249], affirmed, 55 F. (2d), 229 (C. C. A. 3); *Sabin* v. *United States* (Ct. Cl.), 44 F. (2d), 70, 77; *Atlas Securities Co.* v. *Commissioner* (C. C. A. 8), 58 F. (2d), 214, 215; *Crucible Steel Casting Co.* v. *Commissioner* (C. C. A. 7), 66 F. (2d), 82 [Ct. D. 807, C. B. XIII–1, 326], certiorari denied, 290 U. S., 695.)

We hold, therefore, that the waiver of February 1, 1929, was valid; that it extended the time for not only "assessment" but also "determination" of the tax, until December 31, 1929; and that, therefore, the respondent's 60-day letter of December 27, 1929, constituted a timely "determination" of the petitioner's tax liability, from which he could and did appeal to the Board, which therefore had jurisdiction.

What we have said with reference to the first specification of error relied upon, largely disposes of the second, which it will be seen covers much of the ground taken in by the first. In addition, however, the petitioner complains of the "useless act" of the Commissioner in sending to the taxpayer a notice of deficiency, on December 27, 1929, after the petitioner had, on October 23, 1929, executed a waiver of right to file a petition to the Board and a consent to the assessment and collection of the deficiencies for the years 1923, 1924, 1925, and 1926.

It has already been decided by this court that a waiver or consent of that kind, filed before the Commissioner has sent a notice of deficiency, is premature and therefore invalid. In *Mutual Lumber Co.* v. *Poe* (66 F. (2d), 904, 907, certiorari denied, 290 U. S., 706), the late Judge Sawtelle said:

"If there is *no* determination of deficiency by the Commissioner, there is no right of appeal for the taxpayer to waive; for the provisional report of an internal revenue agent can not be made the basis of an appeal. This is clear from the terms of the subsection itself, which computes the time allowed for the filing of a petition with the Board of Tax Appeals, not from the mailing of an *agent's* report but from the mailing of the *Commissioner's* notice of deficiency.

* * * * * * *

"For this reason we hold that the purported waiver was filed with the Commissioner before the latter had found any deficiency, was therefore premature, and was powerless to prevent the Commissioner's resort to a letter of deficiency, by which the running of the statute was suspended."

The petitioner also points out that he "alleged before the Board, and the Commissioner admitted in his answer, that no assessment of the 1924 and 1925 taxes has been made 'within the period prescribed by law as such period was extended by the waiver hereinbefore referred to.'" This is not tantamount, however, to an admission by the Commissioner that a valid assessment was *never* made. It is merely an assertion that an assessment was not made prior to December 31, 1929. As we have already shown, the notice of deficiency was mailed within the statutory limit, as extended by the waiver of February 1, 1929, and the petitioner seasonably appealed therefrom.

The "subsection" referred to in the excerpt from Judge Sawtelle's opinion in *Mutual Lumber Co.* v. *Poe*, supra, which we have just set out, is section 274(a) of the Revenue Act of 1926, which reads in part as follows:

"If in the case of any taxpayer, the Commissioner determines that there is a deficiency in respect of the tax imposed by this title, the Commissioner is authorized to send notice of such deficiency to the taxpayer by registered mail. Within 60 days after such notice is mailed (not counting Sunday as the sixtieth day), the taxpayer may file a petition with the Board of Tax Appeals for a redetermination of the deficiency. Except as otherwise provided in subdivision (d) or (f) of this section or in section 279, 282, or 1001, no assessment of a deficiency in respect of the tax imposed by this title, and no distraint or proceeding in court for its collection shall be made, begun, or prosecuted until such notice has been mailed to the taxpayer, nor until the expiration of such 60-day period, nor, if a petition has been filed with the Board, until the decision of the Board has become final."

As the petitioner points out, section 200 of the Revenue Act of 1926, supra, provides that "The first taxable year, to be called the taxable year 1925, shall be the calendar year 1925 or any fiscal year ending during the calendar year 1925."

Section 283(a) of the Act of 1926 provides that income taxes "computed" under the Revenue Act of 1924, shall be "assessed, collected, and paid in the same manner and subject to the same provisions and limitations * * * as in the case of a deficiency in the tax imposed by this title, except as otherwise provided in section 277 of this Act."

Since the sending out of a notice of deficiency is clearly one of the steps connected with the assessment, collection and payment of an income tax, the provisions of section 274(a) of the 1926 Act, supra, apply to the deficiency in the 1924 tax as well as to the 1925 and 1926 deficiencies.

Section 504 of the Revenue Act of 1928 is as follows:

"(a) Section 277(b) of the Revenue Act of 1926 is amended to read as follows:

"'(b) The running of the statute of limitations provided in this section or in section 278 on the making of assessments and the beginning of distraint or a proceeding in court for collection, in respect of any deficiency, shall (after the mailing of a notice under subdivision (a) of section 274) be suspended for the period during which the Commissioner is prohibited from making the assessment or beginning distraint or a proceeding in court (and in any event, if a proceeding in respect of the deficiency is placed on the docket of the Board, until the decision of the Board becomes final), and for 60 days thereafter.'

"(b) Subsection (a) of this section shall apply in all cases where the period of limitation has not expired prior to the enactment of this Act."

Accordingly, the Commissioner had ample time within which to make assessments of deficiencies for all the taxes herein involved, after December 31, 1929. Under the presumption of regularity, we can not assume, at the taxpayer's behest, that the Commissioner failed to perform his duty. It is the duty of an appellant to bring up a record that affirmatively shows error. This the petitioner has failed to do; for the stipulation is silent as to the making of assessments after December 31, 1929. The Commissioner's admission covers the absence of assessments only "within the period prescribed by law as such period was extended by the waiver hereinbefore referred to"; *i. e.*, a period ending on December 31, 1929.

The third specification of error attacks the respondent's notice of deficiency on the ground that it was addressed to "McCarthy & Co." instead of "The McCarthy Co." The stipulations, however, show that the letter of the Commissioner was sent to the correct address, that it was delivered to the petitioner, and that it was accepted by the petitioner. The copy of the deficiency notice attached to the petition in this case stated that a copy of the notice had been furnished to the attorney whose name is signed to the brief filed before us, and the Board so found. The Board further found that it was "quite evident that the taxpayer was in no way misled by the notice and clearly understood it to be one in respect to its tax liability for the years in question." The first sentence of the petition filed before the Board prays for a redetermination of the deficiency set forth in the very notice that the petitioner claims was misdirected.

In view of such record, and of such uncontradicted findings by the Board, we regard the petitioner's criticism of the address as too microscopic to merit extended discussion.

Relying upon a number of recent decisions by circuit courts of appeals, in the case of *Haag* v. *Commissioner* ((C. C. A. 7), 59 F. (2d), 516, 518), the court said:

"These cases hold that although the notice was not directed to the proper party, nevertheless if it appeared that the proper party had received the notice or that the party who succeeded to the title of the party filing the return had received the notice, it was sufficient."

(See also *Burnet* v. *San Joaquin Fruit & Investment Co.* (C. C. A. 9), 52 F. (2d), 123, 128 [Ct. D. 406, C. B. X–2, 260]; *Commissioner* v. *New York Trust Co.* (C. C. A. 2), 54 F. (2d), 463, 465 [Ct. D. 540, C. B. XI–2, 320], certiorari denied, 285 U. S., 556; *Commissioner* v. *Oswego Falls Corporation* (C. C. A. 2), 71 F. (2d), 673, 677.)

The decision of the Board is affirmed.

# SECTION 294.—ADDITIONS TO THE TAX IN CASE OF NONPAYMENT.

SECTION 294. XV-6-7941
Ct. D. 1076

INCOME TAX—REVENUE ACT OF 1928—DECISION OF COURT.

INTEREST—PENALTY.

Where interest was charged upon an unpaid income tax deficiency assessed against an individual who was later adjudicated a bankrupt, at the rate of 12 per cent per annum from the date of notice and demand to the date of appointment of a receiver of the bankrupt's property, and thereafter at the rate of 6 per cent per annum until payment, the higher rate was a proper interest charge, under section 294(b) of the Revenue Act of 1928, and not in part a penalty.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

*In the Matter of John Semon, Bankrupt.*

Appeals from the District Court of the United States for the District of Connecticut.

Before MANTON, L. HAND, and SWAN, Circuit Judges.

[December 16, 1936.]

OPINION.

The United States appeals from an order allowing its claim against the bankrupt in an amount less than the sum claimed to be due as interest on a delinquent deficiency income tax for 1929. Modified.

SWAN, Circuit Judge: John Semon was adjudicated bankrupt on March 9, 1933. In the bankruptcy proceedings the collector of internal revenue for the district of Connecticut filed proof of claim for a deficiency income tax for 1929 assessed against the bankrupt in November, 1931. Interest was claimed at the rate of 12 per cent per annum from November 12, 1931, to April 29, 1932 (when a receiver in equity was appointed for the bankrupt's property), and thereafter at the rate of 6 per cent per annum until payment. The district court allowed as a priority claim the principal amount of the tax, without interest until April 29, 1932, and with interest as claimed thereafter. This appeal presents only the question of the correctness of the disallowance of interest prior to April 29, 1932. Although the amount in dispute is small—less than $400—the principle involved is not unimportant.

The disputed interest is claimed by the Government under section 294(b) of the Revenue Act of 1928 (45 Stat., 858), which provides that if a deficiency is not paid in full within 10 days after notice and demand, "there shall be collected as part of the tax, interest upon the unpaid amount at the rate of 1 per centum a month from the date of such notice and demand until it is paid." Because other provisions of the Revenue Act prescribe interest at the rate of 6 per cent per annum for delay in payment, the district court concluded that the above-quoted provision cloaked a penalty of one-half of 1 per cent a month, and, since penalty and interest were lumped as one sum, allowed no interest whatever, relying upon *New York* v. *Jersawit* (263 U. S., 493) and section 57(j) of the Bankruptcy Act (11 U. S. C. A., section 93(j)). Although the question is not free from doubt and the opinion of Judge Hincks contains a strong argument for the construction he has adopted, we are constrained to disagree with it.

The Revenue Act of 1928 deals with penalties and interest with particularity. Penalties proper are provided in sections 291 and 293; 25 per cent of the tax is to be added in case of failure to file a return; in the case of deficiencies, 5 per cent thereof if due to negligence, and 50 per cent thereof if due to fraud. Other sections deal with interest, eo nomine. Six per cent interest per annum is provided in certain situations: on deficiencies prior to assessment (section 292); where an estate is held by a fiduciary appointed by a court or by will (section 294(c)); during extensions granted on payment (sections 295, 296); on jeopardy assessments (section 297); and on overpayments and judgments against the United States (sections 614, 615). Interest is fixed at 1 per cent a month where the tax determined by the taxpayer is not paid when due (section 294(a)1); where such tax has not been paid within a granted period of extension (section 294(a)2); where a deficiency remains unpaid after notice and demand, or after an extension period (sections 294(b), 296). Thus Congress has declared that in certain circumstances one rate of interest shall obtain, and in others a higher rate. The question is whether this fact necessarily makes the higher rate in part a penalty though denominated interest by Congress.

An interest rate of 1 per cent a month is not per se a penalty. (*United States* v. *Childs*, 266 U. S., 304 [T. D. 3671, C. B. IV–1, 241].) That case arose under section 14(a) of the Revenue Act of 1916 (39 Stat., 772) which did not in Title I, relating to income taxes, provide different rates of interest for different delinquencies in payment, and on this ground it is said to be distinguishable from the case at bar. But in Title II, dealing with the estate tax, sections 204 and 207 provided for interest at varying rates. It would seem, therefore, that the argument now urged on behalf of the trustee in bankruptcy might have been used in the Childs case to contend that the 1 per cent a month in fact cloaked a penalty. We are not persuaded that when Congress prescribes different rates of interest for different delinquencies in payment of taxes, the higher rate must necessarily be deemed to include a penalty. Since the higher rate is one within the legislative power to prescribe as interest (*United States* v. *Childs*, supra), it may well be argued that Congress regards the higher rate as the normal compensation for delay in payment under the circumstances where it obtains, although willing to accept a lesser compensation for delay under other circumstances. Impositions which were plainly penalties were set apart and dealt with in other sections, and in the sections prescribing interest the imposition is explicitly declared to be such. This legislative declaration we do not think may be disregarded merely because different sections prescribe different rates. Although no precise authority has been found, *United States* v. *Maryland Casualty Co.* (49 F. (2d), 556, 558 (C. C. A. 7) [Ct. D. 371, C. B. X–2, 381], certiorari denied, 284 [248] U. S., 645), tends to support the view that Congress may impose different rates of interest without causing the higher rate to include a penalty; as does also *Hughson* v. *United States* (59 F. (2d), 17, 19 (C. C. A. 9) [Ct. D. 565, C. B. XI–2, 337]).

The order is modified to include interest at the rate of 1 per cent a month from the date of notice and demand by the collector, November 12, 1931, to April 29, 1932; as thus modified, it is affirmed.

# TITLE IV.—ADMINISTRATIVE PROVISIONS.

## SECTION 613.—LIEN FOR TAXES.

SECTION 613. XV–4–7921
Ct. D. 1069

FEDERAL TAXES—REVISED STATUTES—DECISION OF COURT OF APPEALS OF THE STATE OF NEW YORK.

SPENDTHRIFT TRUST—RIGHTS OF JUDGMENT CREDITORS UNDER STATE LAW—LIEN FOR FEDERAL TAXES.

Under the laws of the State of New York, the income of a spendthrift trust is not assignable by the beneficiary and is exempt from garnishee execution except as to 10 per cent thereof, and where judgment creditors have filed judgments against such a beneficiary and the United States has filed notices of lien for unpaid income taxes pursuant to section 115, Title 26, United States Code (section 3186, Revised Statutes, as amended), two of the judgments having been recorded prior to the filing of the lien notices, the United States is entitled to 90 per cent of the trust income until the prior judgments are satisfied, and thereafter, if its claim is still unpaid, it is entitled to the entire income, until paid.

COURT OF APPEALS (OF THE STATE OF NEW YORK).

(Subject to revision.)

*In the Matter of the application of Jerome Rosenberg for an order directing the Guaranty Trust Co. of New York and George J. Bauman, as Trustees under the Last Will and Testament of Henry Rosenberg, Deceased, to pay the said Jerome Rosenberg certain trust funds and adjudicate his rights in trust fund. United States of America, appellant, Jerome Rosenberg, petitioner, Leslie Lester, Receiver, Guaranty Trust Co. of New York, and George J. Bauman, Trustees, respondents.*

Appeal by the United States of America, pursuant to leave granted by order of this court, dated April 23, 1935, from an order of the Appellate Division, First Department, affirming an order of the Surrogate's Court, County of New York.

[November 29, 1935.]

OPINION.

CROUCH, J.: Jerome Rosenberg, a life beneficiary of a trust created by the will of Henry Rosenberg, instituted a proceeding in the surrogate's court to secure an adjustment of the rights of his creditors to the trust income, which was under the provisions of section 15 of the personal property law and section 103 of the real property law, not assignable by the petitioner, and exempt from garnishee execution except (C. P. A., section 684) as to 10 per cent thereof. A number of judgments against petitioner were represented in the proceeding by a receiver of the petitioner appointed by the city court in supplementary proceedings. The United States had previously informally arranged that the receivership extend to cover its claim for unpaid income taxes, for which it had filed notices of liens pursuant to United States Code, section 115, Title 26, on November 20, 1929, and May 25, 1931. Two of the judgments represented by the receiver were recorded prior to the filing of the notices of lien.

The United States intervened in the surrogate's court proceeding and asserted that inasmuch as it was not a judgment creditor, confined by United States Code, section 727, Title 28 (R. S., section 916) to the same remedies which it might have had in the State courts, nor limited by any Federal exemption to a percentage of the trust income, its right to enforce its lien under section 115 was not limited by any law of the State of New York.

The surrogate rejected that contention and directed the trustee to pay 90 per cent of the income to the beneficiary and the remaining 10 per cent to the receiver for the judgment creditor. The order was affirmed by the appellate division. The courts below seem to have found the absence of any reported holding to the contrary sufficient ground for determining that the Federal Government either has no authority to satisfy its claim from the income of a spendthrift trust or that its policy in relation to that device is in accordance with the policy of our own State.

The fundamental policy to be borne in mind is that the right of property is a right *cum onere*. A person may not ordinarily have ownership of or right to enjoy property and at the same time be able to keep it from the claims of creditors and others. (Cf. *Hallett* v. *Thompson*, 5 Paige, 586.) An individualistic crosscurrent came to permit fathers of improvident sons, by way of exception, to insure a sum necessary for education and support (Real property law, section 98) in order to protect them from their own extravagance and to prevent them from becoming public charges. Nevertheless, under the pressure of special circumstances, that apparently unreachable sum has been permitted by the courts to be reached. (*Wetmore* v. *Wetmore*, 149 N. Y., 520; and see 43 Harvard Law Rev., 63.) It is by no means certain that our State policy excludes the payment of State taxes and other possible claims by the State from the category of necessary support. A tax in some form nowadays is at least as certain as, say, medical or legal expenses.

However that may be, it is certain that no policy of this State may interfere with the power of Congress to levy and collect taxes on income. (*Burnet* v. *Harmel*, 287 U. S., 103, 110 [Ct. D. 611, C. B. XI-2, 210]; *United States* v. *Snyder*, 149 U. S., 210, 214.) Cases where State exemptions have been applied to the collection of judgments in favor of the United States have been in every instance predicated on the statutory adoption of State exemptions. (*Fink* v. *O'Neil*, 106 U. S., 272; *Custer* v. *McCutcheon*, 283 U. S., 514.)

Section 115 of Title 26 of the United States Code provides as follows:

"SEC. 115. *Lien for taxes.*—(a) If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, penalty, additional amount, or addition to such tax, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property whether real or personal, belonging to such person. Unless another date is specifically fixed by law, the lien shall arise at the time the assessment list was received by the collector and shall continue until the liability for such amount is satisfied or becomes unenforceable by reason of lapse of time."

If the right or interest which the beneficiary here has in the income of the trust may be said to fall within the sweeping limits of the phrase "all property and rights to property, whether real or personal, belonging to such person," then we see no reason to doubt the validity of the appellant's contention. It is true that the legal estate is in the trustee. Nevertheless, "the whole beneficial proprietorship, or interest, is in the *cestui que trust*, for whom he holds the estate and who has the right to enforce the performance of the trust." (*Metcalfe* v. *Union Trust Co.*, 181 N. Y., 39, 41.) To say that right is not a right to property within the meaning of the United States Code, section 115, because equity acts *in personam* and not *in rem*, would be mere legalism and would disregard the plain language and what we think is the plain intendment of the statute. Certain other arguments may be briefly noticed. It is said (granting that the beneficiary's right is a right to property), that since United States Code, section 116 of Title 26 grants to the Government the power to distrain for taxes certain specified items of personal property, among which income from a spendthrift trust is not included, the lien and right to enforce given by section 115 should be confined to the items mentioned in section 116. The two statutes are not *in pari materia*. (*Blacklock* v. *United States*, 208 U. S., 75.) As to the lack of specific statutory authority to maintain a suit or proceeding in equity to enforce a lien on trust income (which authority is specifically given with respect to interests in real property), it is enough to say that if, as we think, such a lien exists here, it must have the attributes of liens generally and is something that courts of general equitable jurisdiction may enforce. (Cf. 1 Pomeroy's Equity Jurisprudence (4th ed.), section 167; *Gilchrist* v. *Helena Hot Springs & Smelter R. Co.*, 58 Fed., 708; *Westmoreland & Trousdale* v. *Foster*, 60 Ala., 448.) The powers of a surrogate's court with respect to testamentary trusts are sufficiently broad for the purpose. Finally, since the property right here in question may not be reached at all by distraint under section 116, and may be reached under the State statute by garnishment only to the extent of 10 per cent (C. P. A., section 684; U. S. C., section 142 of chapter 3 of Title 26), it is difficult to say that there is an adequate remedy at law.

The order should be reversed and an order granted to the effect that the judgments filed prior to the filing of the notice of lien are entitled to 10 per cent of the trust income ahead of the United States and that the United States is entitled to 90 per cent of the trust income until the prior judgments are satisfied and then, if the claim of the United States is still unpaid, to the entire income until paid; all, however, without costs.

# TITLE V.—GENERAL PROVISIONS.

## SECTION 701.—DEFINITIONS.

ARTICLE 1314: Association distinguished from trust. XV-3-7910
Ct. D. 1067

INCOME TAX—REVENUE ACTS OF 1926 AND 1928—DECISION OF SUPREME COURT.

1. TRUST—TAXABLE AS ASSOCIATION.

A trust created or utilized by the beneficiary associates as a medium to carry on a joint enterprise for their joint profit is an association taxable as a corporation, as it secures for those associated the essential corporate attributes of continuity of organization, centralized management, and limited liability. The facts that only a few persons formed the association and that there was no provision for control by the beneficiaries, as such, are not determinative. Not only were they engaged in carrying on an extensive business for profit, but the terms of the trust instrument authorized a wide range of activities, and the parties are not at liberty to say that their purpose was other or narrower than that formally set forth in the instrument under which their activities were conducted. *Morrissey* v. *Commissioner*, decided by the Supreme Court December 16, 1935 [Ct. D. 1064, page 264, this Bulletin], followed.

2. DECISION REVERSED.

Decision of the Circuit Court of Appeals, First Circuit (76 Fed. (2d), 191), reversed.

SUPREME COURT OF THE UNITED STATES.

NOS. 78, 79. *Guy T. Helvering, Commissioner of Internal Revenue, petitioner,* v. *Coleman-Gilbert Associates.*

On writs of certiorari to the United States Circuit Court of Appeals for the First Circuit.

[December 16, 1935.]

OPINION.

Mr. Chief Justice HUGHES delivered the opinion of the Court.

The Commissioner of Internal Revenue determined deficiencies in income taxes for the years 1927 to 1929 upon the ground that respondent was taxable as an association. The decision of the Board of Tax Appeals, sustaining this ruling, was reversed by the circuit court of appeals. (76 F. (2d), 191.) In view of the conflict of decisions as to the test to be applied, we granted certiorari. (See *Morrissey* v. *Commissioner*, decided this day [Ct. D. 1064, page 264, this Bulletin].)

From the facts, as found by the Board of Tax Appeals, it appears that respondent was formed by an indenture of trust in November, 1926. The creators of the trust were Harry Coleman, Pauline Coleman, Bernard Gilbert, Harris Levine, and Lena Levine. They were coowners of real property consisting of about 20 apartment houses in the city of Boston and vicinity.

The property had originally been owned by Harry Coleman, Bernard Gilbert and Harris Levine in equal shares, but subsequently Coleman and Levine transferred to their wives one-half of their interests. These five persons had for some time been associated in the business of owning and operating apartment houses. By the trust instrument, which recited a contemporaneous conveyance of the property to themselves, they declared that the real estate so conveyed, and any real estate thereafter acquired under the trust, should be held by them in trust for the purposes described, with the designation "Coleman-Gilbert Associates." The trust was to continue for 15 years unless sooner terminated by sale and distribution of the trust estate. The trustees were to hold the property in order to improve and dispose of it for the benefit of the persons named as "*cestuis que trustent* and beneficiaries, and their respective representatives and assigns, devisees, or legatees" in the shares provided in the instrument. Except as stated, the beneficiaries were to have no interest in the trust property, and "especially" they were to have "no right to call for any partition thereof." The interests of the beneficiaries were to be personal property, and the death of any one or of all the beneficiaries was not to determine the trust nor entitle the legal representatives of the decedent to an accounting by the trustees.

The trustees were to have the "full power and discretion" of absolute owners, with authority to invest and reinvest the trust property, including its income, in mortgages or in obligations secured upon real estate, and "in the purchase and improvement of real estate situated in the cities or towns of the Commonwealth of Massachusetts." The trustees were authorized to sell at public or private sale any part or all of the trust property upon such terms as they might see fit, "to improve, to lease for a term beyond the possible termination" of the trust, or for any less term, "to hire for improvement or otherwise, to let, to exchange, to release, to partition," to borrow money, and to execute all necessary contracts. Funds in the possession of the trustees, being "the proceeds of sales or otherwise," or net income, which was "not required in their judgment for development or improvement of the trust property," were to be divided and paid over annually, or oftener, if convenient, equally among the said beneficiaries and their respective representatives and assigns in the proportions stated. The trustees were to have no power to bind the beneficiaries personally, and the trustees were to be responsible only for willful default and breach of trust. There was also provision for the resignation of trustees, and in case of death or resignation of a trustee, the surviving trustees were to appoint successors, and if they failed to do so, the beneficiaries were to have the right of appointment.

The Board of Tax Appeals found that the trust owned and operated some 20 apartment houses, the gross annual rents of which amounted to about $420,000. There were approximately 1,500 tenants. The gross cost of the properties was about $3,000,000. Employees' pay rolls amounted to about $25,000, and the operating expenses to about $300,000, annually. The trustees drew no salary. Two of the male trustees devoted their entire time to the management and a third trustee was also actively engaged. An office force of three persons, besides the three operating trustees, was required to keep the necessary financial records of the trust. There were no "building managers" or superintendents. The trustees supervised the maintenance of the trust properties looking after their operating condition, collecting rents, ordering repairs, purchasing supplies, arranging loans and supervising office details, securing new tenants and generally operating the trust properties. The female trustees were entirely inactive.

The Board of Tax Appeals summed up its findings by saying: "These trustees, although they did not exercise all of the powers given to them in the trust instrument, were engaged, nevertheless, in carrying on a business for profit in much the same manner as the directors of a corporation are associated together for the purpose of carrying on a business enterprise."

We think that the Board was right in its conclusion that the trust constituted an association within the meaning of the Revenue Acts. The governing principles have been discussed in *Morrissey* v. *Commissioner*, supra, and need not be restated. The small number of persons in the trust now before us does not present a difference in the legal aspect of their enterprise from the standpoint of the statutory classification. A few persons, as well as many, may form an association to conduct a business for their common profit. Nor is the absence of provision for control by the beneficiaries, as such, determinative. The fact that the enterprise was confined to dealings in real property, its management and improvement, does not prevent its being classified as an association. (See *Swanson* v. *Commissioner*, decided this day [Ct. D. 1065, page 270, this Bulletin].) The circuit court of appeals, while not questioning the sufficiency of the evidence to warrant the Board of Tax Appeals in finding that the trustees were conducting a business enterprise for the purpose of insuring an income for the beneficiaries, and that the trustees may have exercised powers in some respects as great as those of the directors of a corporation, found a distinction in the procedure that had been followed. There had been no meetings, no records, and the acts of the trustees were not determined by a majority vote. The trustees had conducted the business in the same manner as it had been conducted before the trust was formed. We think that the court unduly emphasized the mere differences of formal procedure. If such differences were to be made the test in determining whether or not an enterprise for the transaction of business constitutes an association, the subject would be enveloped in a cloud of uncertainty, and enterprises of the same essential character would be placed in different categories simply by reason of formal variations in mere procedural details. The significant resemblance to the action of directors does not lie in the formalities of meetings or records but in the fact that, by virtue of the agreement for the conduct of the business of a joint enterprise, the parties have secured the centralized management of their undertaking through designated representatives.

We agree with the circuit court of appeals that weight should be given to the purpose for which the trust was organized, but that purpose is found in the agreement of the parties. Not only were they actually engaged, as the Board of Tax Appeals determined, in carrying on an extensive business for profit, but the terms of the trust instrument authorized a wide range of activities in the purchase, improvement and sale of properties in the cities and towns of the State. The parties are not at liberty to say that their purpose was other or narrower than that which they formally set forth in the instrument under which their activities were conducted. Undoubtedly they wished to avoid partition of the property of which they had been coowners, but their purpose as declared in their agreement was much broader than that. They formed a combination to conduct the business of holding, improving and selling real estate, with provision for management through representatives, with continuity which was not to be disturbed by death or changes in ownership of beneficial interests, and with limited liability. They had been coowners but they preferred to become "associates," and also not to become partners. (*Morrissey v. Commissioner*, supra.)

The decrees of the circuit court of appeals are reversed and the orders of the Board of Tax Appeals are affirmed.

It is so ordered.

# INCOME TAX RULINGS.—PART IV.

## REVENUE ACT OF 1926 AND PRIOR ACTS.

## TITLE I.—GENERAL DEFINITIONS.

## SECTIONS 1 AND 2.—GENERAL DEFINITIONS.

ARTICLE 1504: Association distinguished from trust.

XV-3-7911
Ct. D. 1064

INCOME TAX—REVENUE ACTS OF 1924, 1926, AND 1928—DECISION OF SUPREME COURT.

1. TRUST—TAXABLE AS ASSOCIATION—RETROACTIVE STATUTE.

A trust created or utilized by the beneficiary associates as a medium to carry on a joint enterprise for their joint profit is an association taxable as a corporation, as it secures for those associated the essential corporate attributes of continuity of organization, centralized management, and limited liability. The retroactive provisions of section 704(a) of the Revenue Act of 1928 are not applicable, under the circumstances stated in the opinion, to avoid classification as an association for 1924 and subsequent years.

2. DECISION AFFIRMED.

Decision of the Circuit Court of Appeals, Ninth Circuit (74 Fed. (2d), 803), affirmed.

SUPREME COURT OF THE UNITED STATES.

*T. A. Morrissey and James M. O'Brien, Trustees of an Express Trust known as Western Avenue Golf Club, petitioners,* v. *Commissioner of Internal Revenue.*

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

[December 16, 1935.]

OPINION.

Mr. Chief Justice HUGHES delivered the opinion of the Court.

Petitioners, the trustees of an express trust, contest income taxes for the years 1924 to 1926, inclusive, upon the ground that the trust has been illegally treated as an "association." The circuit court of appeals affirmed the decision of the Board of Tax Appeals which sustained the ruling of the Commissioner of Internal Revenue. (74 F. (2d), 803.) We granted certiorari because of a conflict of decisions as to the distinction between an "association" and a "pure trust," the decisions being described in one of the cases as "seemingly in a hopeless state of confusion." (*Helvering* v. *Coleman-Gilbert Associates*, 76 F. (2d), 191, 193 [Ct. D. 1067, page 261, this Bulletin].)[1]

The facts were stipulated. In the year 1921 petitioners made a declaration of trust of real estate in Los Angeles. They were to be designated in "their collective capacity" as "Western Avenue Golf Club." The trustees were authorized to add to their number and to choose their successors; to purchase, encumber, sell, lease and operate the "described or other lands"; to construct and operate golf courses, clubhouses, etc.; to receive the rents, profits and income; to make loans and investments; to make regulations; and generally to manage the trust estate as if the trustees were its absolute owners. The

[1] *Post*, Nos. 78–79. See, also, *post*, No. 108, *Swanson* v. *Commissioner* [Ct. D. 1065, page 270, this Bulletin], and No. 238, *Helvering* v. *Combs* [Ct. D. 1066, page 272, this Bulletin].

trustees were declared to be without power to bind the beneficiaries personally by "any act, neglect or default," and the beneficiaries and all persons dealing with the trustees were required to look for payment or indemnity to the trust property. The beneficial interests were to be evidenced solely by transferable certificates for shares which were divided into 2,000 preferred shares of the par value of $100 each, and 2,000 common shares of no par value, and the rights of the respective shareholders in the surplus, profits, and capital assets were defined. "Share ledgers" showing the names and addresses of shareholders were to be kept.

The trustees might convene the shareholders in meeting for the purpose of making reports or considering recommendations, but the votes of the shareholders were to be advisory only. The death of a trustee or of a beneficiary was not to end the trust, which was to continue for 25 years unless sooner terminated by the trustees.

During the years 1921 and 1922, the trustees sold beneficial interests and paid commissions on the sales. About 42 acres (of the 155 acres described by the declaration of trust) were plotted into lots which were sold during the years 1921 to 1923, most of the sales being on the installment basis. On the remaining property a golf course and clubhouse were constructed, and in 1923 this property with the improvements was conveyed to Western Avenue Golf Club, Inc., a California corporation, in exchange for its stock. Under a lease from the corporation petitioners continued the operation of the golf course until January 12, 1924. After that date petitioners' activities were confined to collections of installments of principal and interest on contracts of purchase, the receipt of interest on bank balances and of fees on assignments by holders of purchase contracts, the execution of conveyances to purchasers, the receipt of dividends from the incorporated club, and the distribution of moneys to the holders of beneficial interests. On December 31, 1923, the total number of outstanding beneficial interests was 3,016 held by 920 persons; by December 31, 1926, the number of interests had been gradually decreased to 2,172, held by 275 persons. The holdings by the trustees ranged approximately from 16 to 29 per cent.

Petitioners contend that they are trustees "of property held in trust," within section 219 of the Revenue Acts of 1924 and 1926,[2] and are taxable accordingly and not as an "association." They urge that, to constitute an association, the applicable test requires "a quasi-corporate organization in which the beneficiaries, whether or not certificate holders, have some voice in the management and some control over the trustees and have an opportunity to exercise such control through the right to vote at meetings"; and that, in any event, the activities in which petitioners were engaged, during the tax years under consideration, did not constitute "a carrying on of business" within the rule applied by this Court.

The Government insists that the distinction between associations and the trusts taxed under section 219 is between "business trusts on the one side" and other trusts "which are engaged merely in collecting the income and conserving the property against the day when it is to be distributed to the beneficiaries"; that Congress intended that all "business trusts" should be taxed as associations.

1. The Revenue Acts of 1924 and 1926 provided:

"The term 'corporation' includes associations, joint-stock companies, and insurance companies." (1924, section 2(a)2; 1926, section 2(a)2.[3])

A similar definition is found in the earlier Revenue Acts of 1917 (section 200), 1918 (section 1), and 1921 (section 2(2)),[4] and also in the later Acts of 1928 (section 701(a)2), 1932 (section 1111(a)2), and 1934 (section 801(a)2).[5]

The Corporation Tax Act of 1909,[6] which imposed an excise tax upon the privilege of doing business in a corporate capacity, embraced associations having a capital stock represented by shares and "organized under the laws of the United States or of any State or Territory." (*Flint* v. *Stone Tracy Co.*, 220 U. S., 108, 144; *Eliot* v. *Freeman*, 220 U. S., 178, 186.) The Income Tax Act of 1913[7] taxed the net income of "every corporation, joint-stock company or association, and every insurance company, organized in the United States, no

[2] 43 Stat., 275; 44 Stat., 32.
[3] 43 Stat., 253; 44 Stat., 9.
[4] 40 Stat., 302; 40 Stat., 1058; 42 Stat., 227.
[5] 45 Stat., 878; 47 Stat., 289; 48 Stat., 771.
[6] 36 Stat., 112.
[7] 38 Stat., 172.

matter how created or organized, not including partnerships." The case of *Crocker* v. *Malley* (249 U. S., 223) arose under the latter Act. The Court found that the declaration of trust in that case, relating to mill property, was on its face "an ordinary real estate trust of the kind familiar in Massachusetts," and that the function of the trustees was "not to manage the mills but simply to collect the rents and income of such property as may be in their hands, with a large discretion in the application of it, but with a recognition that the receipt holders are entitled to it subject to the exercise of the powers confided to the trustees." The Court thought that, if it were assumed that the words "no matter how created or organized" applied to "association," still it would be "a wide departure from normal usage" to call the beneficiaries a joint-stock association when they were not partners and had "no joint action or interest and no control over the fund." Nor could the trustees "by themselves" be treated as a joint-stock association within the meaning of the Act "unless all trustees with discretionary powers are such." (*Id.*, pages 232–234.)

The decision in *Crocker* v. *Malley* was rendered in March, 1919, and the Treasury Department thereupon assumed that the degree of control exercised by the beneficiaries over the management of the trust was determinative of the question whether the trust constituted an "association." See statement of the rulings of the Bureau by the Board of Tax Appeals in *Woodrow Lee Trust* v. *Commissioner* (17 B. T. A., 111, 112). It was in that view, that the regulations under the Revenue Acts of 1918 and 1921, in distinguishing an "association" from a "trust," provided as follows:

"If, however, the *cestuis que trust* have a voice in the conduct of the business of the trust, whether through the right periodically to elect trustees or otherwise, the trust is an association within the meaning of the statute." (Regulations Nos. 45, 62, article 1504.)

This ruling continued until our decision in May, 1924, in *Hecht* v. *Malley* (265 U. S., 144 [T. D. 3595, C. B. III–1, 489]), and furnished the test which the Board of Tax Appeals theretofore applied.[8] Accordingly, the Board in the case now before us, holding that under the trust instrument the shareholders "had no control over the trustees or the management of the business," determined that the trust was taxable as such, and not as an association, for the years 1921, 1922, and 1923.

The case of *Hecht* v. *Malley* related to the excise taxes imposed upon "associations" by the Revenue Acts of 1916 (section 407) and 1918 (section 1000(a)).[9] The provision of the Act of 1916 retained the qualifying words of the Corporation Tax Act of 1909—"organized under the laws of the United States, or any State or Territory"—and the Court followed the construction placed upon those words in *Eliot* v. *Freeman*, supra. But the Act of 1918 omitted this qualification and the excise tax as laid upon corporations applied to "associations" under the general definition. The Court thus found the terms of the Act of 1918 to be in significant contrast to the provisions of the Acts of 1909 and 1916. The omission of the qualification showed the intention of Congress "to extend the tax from one imposed solely upon organizations exercising statutory privileges, as theretofore, to include also organizations exercising the privilege of doing business as associations at the common law." (265 U. S., 155.) Shorn of the restriction, the word "association" appeared to be used in its ordinary meaning, and we referred to several definitions found in standard dictionaries, as, *e. g.*, "a body of persons united without a charter, but upon the methods and forms used by incorporated bodies for the prosecution of some common enterprise;" "a body of persons organized, for the prosecution of some purpose, without a charter, but having the general form and mode of procedure of a corporation;" "an organized but unchartered body analogous to but distinguished from a corporation." (*Id.*, 157.) We expressed the view that the word "association," as used in the excise tax provision of the Revenue Act of 1918, clearly included "Massachusetts trusts," of the sort there involved, "having quasi-corporate organizations under which they are engaged in carrying on business enterprises." We were careful to say that it was then unnecessary to determine "what other form of 'association,' if any," the Act embraced. (*Id.*)

In the Hecht case, the trustees of the Hecht and Haymarket trusts relied strongly upon the decision in *Crocker* v. *Malley* as conclusively determining that

[8] *E. A. Landreth Co.* (15 B. T. A., 655), *Van Cleave Trust* (18 B. T. A., 486), *Commercial Trust Co.* (18 B. T. A., 1248) *Rollin S. Sturgeon et al., Trustees* (25 B. T. A., 368), *Twin Bell Oil Syndicate* (26 B. T. A., 165).

[9] 39 Stat., 789; 40 Stat., 1126.

those trusts could not be held to be associations, unless the trust agreements vested "the shareholders with such control over the trustees as to constitute them more than strict trusts within the Massachusetts rule." Reviewing the reasoning of that decision, we pointed out that it was not authority for the broad proposition advanced. We concluded that, when the nature of the trusts was considered, as the petitioners were "not merely trustees for collecting funds and paying them over," but were "associated together in much the same manner as the directors in a corporation for the purpose of carrying on business enterprises," the trusts were to be deemed associations within the meaning of the Act of 1918. This was true "independently of the large measure of control exercised by the beneficiaries." And we rejected the view that Congress intended that organizations of that character "should be exempt from the excise tax on the privilege of carrying on their business merely because such a slight measure of control may be vested in the beneficiaries that they might be deemed strict trusts within the rule established by the Massachusetts courts."

Following this decision, the Treasury Department amended its regulation so as to provide that the distinction between an association and a trust should no longer depend upon beneficiary control. The new provision read:

"Operating trusts, whether or not of the Massachusetts type, in which the trustees are not restricted to the mere collection of funds and their payments to the beneficiaries, but are associated together in much the same manner as directors in a corporation for the purpose of carrying on some business enterprise, are to be deemed associations within the meaning of the Act, regardless of the control exercised by the beneficiaries." (Regulations No. 65, article 1504, issued in October, 1924, under the Revenue Act of that year.)

This provision was amended in August, 1925, so as to read as follows:

"If, however, the beneficiaries have positive control over the trust, whether through the right periodically to elect trustees or otherwise, an association exists within the meaning of section 2. Even in the absence of any control by the beneficiaries, where the trustees are not restricted to the mere collection of funds and their payment to the beneficiaries, but are associated together with similar or greater powers than the directors in a corporation for the purpose of carrying on some business enterprise, the trust is an association within the meaning of the statute." (T. D. 3748, C. B. IV-2, 7.)

The text of the regulations relating to associations, so far as pertinent here, promulgated under the Act of 1924, is set forth in the margin (Regulations No. 65, articles 1502, 1504, as amended).[10] These regulations were continued substantially unchanged under the Revenue Acts of 1926 and 1928. (No. 69, articles 1502, 1504; No. 74, articles 1312, 1314.) The corresponding regulations under the Act of 1932 were somewhat modified (No. 77, article 1314); and these were considerably expanded by the regulations issued under the Act of 1934 (No. 86, articles 801-2, 801-3).

2. As the statute merely provided that the term "corporation" should include "associations," without further definition, the Treasury Department was authorized to supply rules for the enforcement of the Act within the permissible bounds of administrative construction. Nor can this authority be deemed to be so restricted that the regulations, once issued, could not later be clarified or

[10] ART. 1502. *Association.*—Associations and joint-stock companies include associations, common law trusts, and organizations by whatever name known, which act or do business in an organized capacity, whether created under and pursuant to State laws, agreements, declarations of trust, or otherwise, the net income of which, if any, is distributed or distributable among the shareholders on the basis of the capital stock which each holds, or, where there is no capital stock, on the basis of the proportionate share or capital which each has or has invested in the business or property of the organization. * * *

ART. 1504. *Association distinguished from trust.*—Where trustees merely hold property for the collection of the income and its distribution among the beneficiaries of the trust, and are not engaged, either by themselves or in connection with the beneficiaries, in the carrying on of any business, and the beneficiaries have no control over the trust although their consent may be required for the filling of a vacancy among the trustees or for a modification of the terms of the trust, no association exists, and the trust and the beneficiaries thereof will be subject to tax as provided by section 219 and by articles 341-347. If, however, the beneficiaries have positive control over the trust, whether through the right periodically to elect trustees or otherwise, an association exists within the meaning of section 2. Even in the absence of any control by the beneficiaries, where the trustees are not restricted to the mere collection of funds and their payment to the beneficiaries, but are associated together with similar or greater powers than the directors in a corporation for the purpose of carrying on some business enterprise, the trust is an association within the meaning of the statute.

enlarged so as to meet administrative exigencies or conform to judicial decision. (Compare *Murphy Oil Co.* v. *Burnet*, 287 U. S., 299, 303–307 [Ct. D. 619, C. B. XII–1, 331].) We find no ground for the contention that by the enactment of the Revenue Act of 1924 the Department was limited to its previous regulations as to associations. And, while the case of *Hecht* v. *Malley* was concerned with the special excise tax provision of the Revenue Act of 1918, the ruling of the Court that the degree of the control by beneficiaries was not a decisive test in that relation could by similar reasoning be applied to the general income taxes laid by the Revenue Acts upon corporations and thus upon associations. These general income taxes covered both those taxes which in their nature were excise taxes on business, and as such could have been laid prior to the sixteenth amendment, and those taxes on other income which were permitted by that amendment. (*Stanton* v. *Baltic Mining Co.*, 240 U. S., 103, 107, 114.) We think that the Department did not exceed its powers in rewriting its regulation, in the light of the decision in *Hecht* v. *Malley*, so as to provide with respect to the income taxes, in general, to be paid by associations, that the extent or lack of control by the beneficiaries of a trust should not in itself determine whether there was an association within the meaning of the statute. That the revised regulation had congressional approval is persuasively evidenced by the fact that the regulation, as amended in 1925, was continued without substantial alteration until 1933, and meanwhile Congress reenacted without change the general provision as to associations in the Revenue Acts of 1926, 1928, and 1932. (See *Brewster* v. *Gage*, 280 U. S., 327, 337 [Ct. D. 148, C. B. IX–1, 274]; *McCaughn* v. *Hershey Chocolate Co.*, 283 U. S., 488, 492 [Ct. D. 345, C. B. X–1, 444]; *Murphy Oil Co.* v. *Burnet*, supra; *Helvering* v. *Bliss*, 293 U. S., 144, 151 [Ct. D. 884, C. B. XIII–2, 191].)

The question is not one of the power of Congress to impose this tax upon petitioners but is simply one of statutory construction—whether Congress has imposed it. (See *Burk-Waggoner Oil Association* v. *Hopkins*, 269 U. S., 110, 114 [T. D. 3790, C. B. V–1, 147].) The difficulty with the regulations as an exposition was that they themselves required explication; that they left many questions open with respect both to their application to particular enterprises and to their validity as applied. The so-called "control test" had led to much litigation, and the change in the regulations after the decision in *Hecht* v. *Malley* caused increased uncertainty. That situation is put in a strong light by the action of Congress, in order to afford relief to taxpayers, in enacting section 704 of the Revenue Act of 1928 as a "retroactive" provision applicable, as stated, to trust returns which had been filed for a taxable year prior to 1925 under previous regulations and rulings, and also by giving an option to a trustee, in specified circumstances, in relation to the Revenue Act of 1926 and prior Acts.[11] While it is impossible in the nature of things to translate the statutory concept of "association" into a particularity of detail that would fix the status of every sort of enterprise or organization which ingenuity may create, the recurring disputes emphasize the need of a further examination of the congressional intent.

3. "Association" implies associates. It implies the entering into a joint enterprise, and, as the applicable regulation imports, an enterprise for the transaction of business. This is not the characteristic of an ordinary trust—whether created by will, deed, or declaration—by which particular property is conveyed to a trustee or is to be held by the settlor, on specified trusts, for the benefit of named or described persons. Such beneficiaries do not ordinarily, and as mere *cestuis que trust*, plan a common effort or enter into a combination for the conduct of a business enterprise. Undoubtedly the terms of an association may make the taking or acquiring of shares or interests sufficient to constitute participation, and may leave the management, or even control of the enterprise, to designated persons. But the nature and purpose of the cooperative undertaking will differentiate it from an ordinary trust. In what are called "business trusts" the object is not to hold and conserve particular property, with incidental powers, as in the traditional type of trusts, but to provide a medium for the conduct of a business and sharing its gains. Thus a trust may be created as a convenient method by which persons become associated for dealings in real estate, the development of tracts of land, the construction of improvements, and the purchase, management and sale of properties; or for dealings in securities or other personal property; or for the production, or manufacture, and sale of commodities; or for commerce, or other sorts

[11] 45 Stat., 880.

of business; where those who become beneficially interested, either by joining in the plan at the outset, or by later participation according to the terms of the arrangement, seek to share the advantages of a union of their interests in the common enterprise.

The Government contends that such an organized community of effort for the doing of business presents the essential features of an association. Petitioners stress the significance of, and the limitations said to be implied in, the provision classifying associations with corporations.

4. The inclusion of associations with corporations implies resemblance; but it is resemblance and not identity. The resemblance points to features distinguishing associations from partnerships as well as from ordinary trusts. As we have seen, the classification can not be said to require organization under a statute, or with statutory privileges. The term embraces associations as they may exist at common law. (*Hecht* v. *Malley*, supra.) We have already referred to the definitions, quoted in that case, showing the ordinary meaning of the term as applicable to a body of persons united without a charter "but upon the methods and forms used by incorporated bodies for the prosecution of some common enterprise." These definitions, while helpful, are not to be pressed so far as to make mere formal procedure a controlling test. The provision itself negatives such a construction. Thus unincorporated joint-stock companies have generally been regarded as bearing the closest resemblance to corporations. But, in the Revenue Acts, associations are mentioned separately and are not to be treated as limited to "joint-stock companies," although belonging to the same group. While the use of corporate forms may furnish persuasive evidence of the existence of an association, the absence of particular forms, or of the usual terminology of corporations, can not be regarded as decisive. Thus an association may not have "directors" or "officers" but the "trustees" may function "in much the same manner as the directors in a corporation" for the purpose of carrying on the enterprise. The regulatory provisions of the trust instrument may take the place of "by-laws." And as there may be, under the reasoning in the Hecht case, an absence of control by beneficiaries such as is commonly exercised by stockholders in a business corporation, it can not be considered to be essential to the existence of an association that those beneficially interested should hold meetings or elect their representatives. Again, while the faculty of transferring the interests of members without affecting the continuity of the enterprise may be deemed to be characteristic, the test of an association is not to be found in the mere formal evidence of interests or in a particular method of transfer.

What, then, are the salient features of a trust—when created and maintained as a medium for the carrying on of a business enterprise and sharing its gains—which may be regarded as making it analogous to a corporate organization? A corporation, as an entity, holds the title to the property embarked in the corporate undertaking. Trustees, as a continuing body with provision for succession, may afford a corresponding advantage during the existence of the trust. Corporate organization furnishes the opportunity for a centralized management through representatives of the members of the corporation. The designation of trustees, who are charged with the conduct of an enterprise—who act "in much the same manner as directors"—may provide a similar scheme, with corresponding effectiveness. Whether the trustees are named in the trust instrument with power to select successors, so as to constitute a self-perpetuating body, or are selected by, or with the advice of, those beneficially interested in the undertaking, centralization of management analogous to that of corporate activities may be achieved. An enterprise carried on by means of a trust may be secure from termination or interruption by the death of owners of beneficial interests and in this respect their interests are distinguished from those of partners and are akin to the interests of members of a corporation. And the trust type of organization facilitates, as does corporate organization, the transfer of beneficial interests without affecting the continuity of the enterprise, and also the introduction of large numbers of participants. The trust method also permits the limitation of the personal liability of participants to the property embarked in the undertaking.

It is no answer to say that these advantages flow from the very nature of trusts. For the question has arisen because of the use and adaptation of the trust mechanism. The suggestion ignores the postulate that we are considering those trusts which have the distinctive feature of being created to enable the participants to carry on a business and divide the gains which accrue from their common undertaking—trusts that thus satisfy the primary conception of association and have the attributes to which we have referred, distinguishing them from partnerships. In such a case, we think that these attributes make the trust sufficiently analogous to corporate organization to justify the conclusion that Congress intended that the income of the enterprise should be taxed in the same manner as that of corporations.

5. Applying these principles to the instant case, we are of the opinion that the trust constituted an association. The trust was created for the development of a tract of land through the construction and operation of golf courses, clubhouses, etc., and the conduct of incidental businesses, with broad powers for the purchase, operation and sale of properties. Provision was made for the issue of shares of beneficial interests, with described rights and priorities. There were to be preferred shares of the value of $100 each and common shares of no par value. Thus those who took beneficial interests became shareholders in the common undertaking to be conducted for their profit according to the terms of the arrangement. They were not the less associated in that undertaking because the arrangement vested the management and control in the trustees. And the contemplated development of the tract of land held at the outset, even if other properties were not acquired, involved what was essentially a business enterprise. The arrangement provided for centralized control, continuity, and limited liability, and the analogy to corporate organization was carried still further by the provision for the issue of transferable certificates.

Under the trust, a considerable portion of the property was surveyed and subdivided into lots which were sold and, to facilitate the sales, the subdivided property was improved by the construction of streets, sidewalks and curbs. The fact that these sales were made before the beginning of the tax years here in question, and that the remaining property was conveyed to a corporation in exchange for its stock, did not alter the character of the organization. Its character was determined by the terms of the trust instrument. It was not a liquidating trust; it was still an organization for profit, and the profits were still coming in. The powers conferred on the trustees continued and could be exercised for such activities as the instrument authorized.

6. Petitioners contend that the trust was not taxable as an association, by reason of the retroactive provisions of section 704(a) of the Revenue Act of 1928.[12] The contention is plainly unavailing and does not require an extended discussion. Section 704(a) of the Act of 1928 provides, in substance, that where a taxpayer filed a return as a trust for a taxable year prior to 1925, the taxpayer shall be taxable as a trust, and not as a corporation, if the taxpayer was considered to be so taxable either (1) under the regulations in force at the time the return was made, or (2) under a departmental ruling then applicable and in force. Prior to the time for filing petitioners' return for the year 1924 the regulations had been amended, following the decision in *Hecht* v. *Malley*, supra, so as to provide that operating trusts in which the trustees were not restricted to the mere collection of funds and their payment to beneficiaries, but were associated together in much the same manner as directors in a corporation for the purpose of carrying on a business enterprise, should be deemed to be associations, regardless of the control exercised by the beneficiaries. (Treasury Regulations No. 65, article 1504, October, 1924.) It does not appear that there were regulations or rulings in force, at the time of the return for the taxable year 1924, under which the trust in this instance would be taxable as a trust and not as an association.

The judgment is affirmed.

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## ARTICLE 1504: Association distinguished from trust. XV-3-7912 Ct. D. 1065

INCOME TAX—REVENUE ACT OF 1926—DECISION OF SUPREME COURT.

1. TRUST—TAXABLE AS ASSOCIATION.

A trust created or utilized by the beneficiary associates as a medium to carry on a joint enterprise for their joint profit is an association taxable as a corporation, as it secures for those associated the essential corporate attributes of continuity of organization,

[12] 45 Stat., 880.

**centralized management, and limited liability.** *Morrissey* **v.** *Commissioner*, **decided by the Supreme Court December 16, 1935 [Ct. D. 1064, page 264, this Bulletin], followed.**

**2. Decision Affirmed.**

**Decision of the Circuit Court of Appeals, Seventh Circuit (76 Fed. (2d), 651), affirmed.**

Supreme Court of the United States.

No. 108. *Joseph E. Swanson et al., as Trustees of the Lake View Land Association, petitioners,* v. *Commissioner of Internal Revenue.*

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

[December 16, 1935.]

OPINION.

Mr. Chief Justice Hughes delivered the opinion of the Court.

The question presented is whether the income of the "Lake View Land Association" for the years 1925 and 1926 was subject to tax as the income of a trust under section 219 of the Revenue Act of 1926,[1] or as the income of an "association" by virtue of section 2(a)2 of that Act.[2] The circuit court of appeals held the taxpayer to be an "association" and affirmed the decision of the Board of Tax Appeals to that effect. (76 F. (2d), 651.) This Court granted a writ or certiorari. (See *Morrissey* v. *Commissioner*, decided this day [Ct. D. 1064, page 264, this Bulletin].)

The material facts as found by the Board of Tax Appeals are as follows: Joseph E. Swanson and Ralph C. Otis, in 1914, acquired a piece of vacant land in the city of Chicago with the view of improving it by the erection of an apartment house, the title being taken by Swanson. An apartment house was built. Subsequently, in 1915, at the suggestion of their attorney, they entered into a trust agreement for the purpose of carrying the title to the property. The trust was designated as the "Lake View Land Association." The first trustees were Ralph C. Otis, Joseph E. Swanson, and Allen G. Mills. Petitioners set forth the following summary of the trust agreement—taken from the opinion of the circuit court of appeals:

"Under the trust agreement, the trustees were given the complete management and control of the property, to exchange, reconstruct, remodel, sell, or improve at their discretion or to borrow money secured by the property. They were authorized to rent suitable quarters for the transaction of the business of the trust and employ such assistants as they required. The agreement provided for the issuance of 'receipts' to evidence the interests of the beneficiaries, representing 1,000 shares at the par value of $100 each. It was provided that the receipts were evidences of the ownership of personal property and not real estate. They might be transferred by assignment. Originally, one-half of the shares were issued to Otis and one-half to Swanson, who later transferred their interests to their wives, who owned the shares during 1925 and 1926. The agreement provided that the trust could sue and be sued;[3] that neither the trustees nor the beneficiaries should be personally liable, and that all persons dealing with the trustees must look only to the property of the trust; that it should be terminated at the expiration of 20 years after the death of the last survivor of certain named persons or by the trustees in their discretion at any time before the expiration of the 20 years by selling all the property held by them as such and distributing the net proceeds of such sale. The trust had succession and was not terminated by the death of a trustee or beneficiary."

The court of appeals also stated that "The trustees of the Lake View Land Association never assembled in formal meetings, never adopted resolutions or took formal action with reference to the affairs of the property, kept no minute book, had no by-laws. They elected no officers and no so-called board of directors."

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[1] 44 Stat., 32.

[2] 44 Stat., 9.

[3] Petitioners submit that this provision of the agreement should, under the law of Illinois, be taken to imply that the trustees could sue and be sued as individuals, and not "the trust as an entity."

The compensation of the trustees was to be fixed by themselves but was not to exceed 2½ per cent of the gross income of the trust. After making provision for the payment of outstanding claims, the net income was to be divided among the beneficiaries according to their interests, and on the request of any beneficiary the trustees were to render annual accounts. The trust agreement also made provision for a written registry of beneficiaries, who could transfer their interests in a described manner, after having first offered them to the other beneficiaries.

The renting of apartments, the details of management and the distribution of net income, were committed to a firm (of which Joseph E. Swanson was a member) engaged in the business of buying and selling real estate and managing properties. That firm acted under the direction of Ralph C. Otis and Joseph E. Swanson and the "entire affairs of the Lake View Land Association" were at all times in their hands.

Applying the governing principles, as set forth in our opinion in *Morrissey* v. *Commissioner*, supra, we agree with the court of appeals that the trust constituted an association and was taxable as such. The limited number of actual beneficiaries did not alter the nature and purpose of the common undertaking. Nor did the fact that the operations of the association did not extend beyond the real property first acquired change the quality of that undertaking.

The judgment is affirmed.

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## ARTICLE 1504: Association distinguished from trust. XV-3-7913 Ct. D. 1066

INCOME TAX—REVENUE ACT OF 1926—DECISION OF SUPREME COURT.

1. TRUST—TAXABLE AS ASSOCIATION.

A trust created or utilized by the beneficiary associates as a medium to carry on a joint enterprise for their joint profit is an association taxable as a corporation, as it secured for those associated the essential corporate attributes of continuity of organization, centralized management, and limited liability. The facts that the beneficiaries did not hold meetings, that the trust had no office or place of business, no seal, by-laws, or official name, and that the operations of the trustees were confined to one oil well, are not controlling. *Morrissey* v. *Commissioner*, decided by the Supreme Court December 16, 1935 [Ct. D. 1064, page 264, this Bulletin], followed.

2. DECISION REVERSED.

Decision of the Circuit Court of Appeals, Ninth Circuit (76 Fed. (2d), 682), reversed.

SUPREME COURT OF THE UNITED STATES.

No. 238. *Guy T. Helvering, Commissioner of Internal Revenue, petitioner,* v. *E. E. Combs and Edward Everett, Trustees of E. E. Combs Well No. 2, Express Trust.*

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

[December 16, 1935.]

OPINION.

Mr. Chief Justice HUGHES delivered the opinion of the Court.

The trustees of E. E. Combs Well No. 2 contested the ruling of the Commissioner of Internal Revenue that the taxpayer was taxable as an association, and not as a trust, on its income for the years 1925 and 1926. The Board of Tax Appeals sustained their contention and the circuit court of appeals affirmed the order of the Board. (76 F. (2d), 682.) A writ of certiorari was issued in view of the conflict of decisions to which we have referred in *Morrissey* v. *Commissioner*, decided this day [Ct. D. 1064, page 254, this Bulletin].

The trust was created "to finance and drill a well for production and sale of oil and other hydrocarbon substances under oil and gas lease dated July 24, 1924." By the agreement, the Hub Oil Co., a California corporation and owner of the oil and gas lease, assigned to E. E. Combs and Edward Everett as trustees all its rights under the lease, subject to a reservation of 6.5 per cent of all oil, gas, and other hydrocarbon substances which might be produced and of a royalty interest in favor of one Smithson of 2 per cent. The agreement described as beneficiaries "All persons who may own or acquire portions of the whole beneficial interest" as defined. The assignor agreed to supply to the trustees certain equipment, and one Bailes had already agreed to furnish other equipment and materials and to superintend the operation of drilling the well in consideration of 12 per cent of the production. The trust was to pay all labor claims and for materials not otherwise provided.

The "whole beneficial interest" in the trust was defined as .71333 per cent of gross production, and the beneficiaries were to be paid their pro rata shares, after deduction for the payment of lawful trust obligations, as follows: (a) 25 per cent of gross production to the beneficiaries who provided money for the trust purposes, (b) .44333 per cent to E. E. Combs, and (c) 2 per cent to Edward Everett. Certificates of beneficial interest were to be issued in approved legal form and were to be held in escrow until a producing well was brought in. Thirteen persons were named as beneficiaries, with the amounts contributed and the percentages owned by each, these amounts aggregating $25,000 and the percentage of ownership amounting to 25 per cent. The "certificate of beneficial interest" recited that the party named was the holder of a beneficial interest under the trust agreement in the amount stated and that the same was transferable only upon the books of the trustees, upon indorsement and surrender of the certificate. The trustees were authorized to hold all property and property rights, the legal title to which might vest in them under the trust, to use the moneys deposited by beneficiaries to pay for labor, casing and other materials incident to drilling and production, to manage and protect the trust property, to pay "trust debts," to sell all products of the well, to borrow money upon the credit of the trust, and to sell any "unsold beneficial interests" as they might deem best for trust purposes. The trustees were not to be individually liable except for willful misconduct. E. E. Combs was to act as production manager at a stated salary after the well was in production. All proceeds "of sale of well products" were to be paid into a designated bank to be distributed as agreed.

The provisions of the agreement were carried out. The 13 described beneficiaries contributed the amount above stated. A well was drilled in 1925 and produced oil through the remainder of that year and for a portion of the year 1926. In the latter year the trustees sold the lease. In both years they currently distributed to the beneficiaries the net proceeds from the sale of oil and from the sale of the lease and, after the latter sale and distribution of the moneys received, the trust was terminated.

The beneficiaries did not hold a meeting and the trust had no office or place of business, no seal, by-laws or official name, and the operations of the trustees were confined to the one lease they acquired.

In considering whether an association was created, the fact that the beneficiaries did not exercise control is not determinative. (*Hecht* v. *Malley*, 265 U. S., 144 [T. D. 3595, C. B. III-1, 489]; *Morrissey* v. *Commissioner*, supra.) The parties joined in a common enterprise for the transaction of business, and the beneficiaries who contributed money for that purpose became associated in the enterprise according to the terms of the arrangement. The essential features of the enterprise were not affected by the fact that the parties confined their operations to one oil well. (See *Swanson* v. *Commissioner*, decided this day [Ct. D. 1065, page 270, this Bulletin].) Parties may form an association for a small business as well as for a large one. Here, through the medium of a trust the parties secured centralized management of their enterprise, and its continuity during the trust term without termination or interruption by death or changes in the ownership of interests, and with limited liability and transferable beneficial interests evidenced by certificates. Entering into a joint undertaking they avoided the characteristic responsibilities of partners and secured advantages analogous to those which pertain to corporate organization. The fact that meetings were not held or that particular forms of corporate procedure were absent is not controlling. (*Morrissey* v. *Commissioner*, supra.)

We think that the taxpayer was taxable as an association. The judgment is reversed and the cause is remanded for further proceedings in conformity with this opinion.

It is so ordered.

ARTICLE 1504: Association distinguished from trust.

REVENUE ACT OF 1926.

Trust utilized by beneficiary associates to carry on joint enterprise. (See Ct. D. 1067, page 261.)

# TITLE II.—INCOME TAX.

## PART I.—GENERAL PROVISIONS.

## SECTION 201.—DISTRIBUTIONS BY CORPORATIONS.

ARTICLE 1545: Distributions in liquidation. XV-25-8133 I. T. 2981

REVENUE ACT OF 1918.

I. T. 1164 (C. B. I-1, 17) is revoked, in view of G. C. M. 16730. (See page 179.)

ARTICLE 1548: Stock dividends.

REVENUE ACT OF 1926.

Dividend on preferred stock paid in common stock. (See Ct. D. 1124, page 219.)

## SECTION 203.—RECOGNITION OF GAIN OR LOSS FROM SALES AND EXCHANGES.

ARTICLE 1577: Definitions. XV-2-7903 Ct. D. 1062

INCOME TAX—REVENUE ACT OF 1926—DECISION OF SUPREME COURT.

1. GAIN OR LOSS—REORGANIZATION—CONSTRUCTION OF STATUTE.

In 1926, B Corporation, under agreement with C, the petitioner, organized a new corporation with 12,500 shares nonvoting preferred stock and 30,000 shares of common, and purchased the latter for $2,000,000. The new corporation then acquired substantially all of C's property, except $100,000, in return for $2,000,000 and the entire issue of preferred stock. C used part of the cash to retire its own preferred stock and distributed the remaining cash and the preferred stock of the new corporation among its stockholders, retaining its franchise and $100,000, and continuing to be liable for certain obligations. The preferred stock, so distributed, except in case of default, had no voice in the control of the issuing corporation. Under these facts, the transaction amounted to a reorganization within the meaning of section 203(h)1(A) of the Revenue Act of 1926, in that the seller acquired a definite and substantial interest in the affairs of the purchasing corporation. The statute does not require participation in the management of the purchaser, that the conveying corporation be dissolved, or that the transferor corporation obtain a controlling interest in the transferee. Section 203(h)1(B) of the Revenue Act of 1926 was not intended to modify the provisions of clause (A) of that section, but describes a class. *Helvering* v. *Minnesota Tea Co.*, decided by the Supreme Court December 16, 1935 [Ct. D. 1060, page 189, this Bulletin], followed.

2. Decision Reversed.

Decision of the Circuit Court of Appeals, Seventh Circuit (75 Fed. (2d), 696), affirming the decision of the Board of Tax Appeals (28 B. T. A., 529), reversed.

Supreme Court of the United States.

*John A. Nelson Co., petitioner,* v. *Guy T. Helvering, Commissioner of Internal Revenue.*

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

[December 16, 1935.]

OPINION.

Mr. Justice McReynolds delivered the opinion of the Court.

The petitioner contests a deficiency income assessment made on account of alleged gains during 1926. It claims that the transaction out of which the assessment arose was reorganization within the statute. Section 203, Revenue Act, 1926 (ch. 27, 44 Stat., 9, 11), is relied upon. The pertinent parts are in the margin of the opinion in No. 174, announced this day [Ct. D. 1060, page 189, this Bulletin].

In 1926, under an agreement with petitioner, the Elliott-Fisher Corporation organized a new corporation with 12,500 shares nonvoting preferred stock and 30,000 shares of common stock. It purchased the latter for $2,000,000 cash. This new corporation then acquired substantially all of petitioner's property, except $100,000, in return for $2,000,000 cash and the entire issue of preferred stock. Part of this cash was used to retire petitioner's own preferred shares, and the remainder and the preferred stock of the new company went to its stockholders. It retained its franchise and $100,000, and continued to be liable for certain obligations. The preferred stock so distributed, except in case of default, had no voice in the control of the issuing corporation.

The Commissioner, Board of Tax Appeals and the court all concluded there was no reorganization. This, we think, was error.

The court below thought the facts showed "that the transaction essentially constituted a sale of the greater part of petitioner's assets for cash and the preferred stock in the new corporation, leaving the Elliott-Fisher Co. in entire control of the new corporation by virtue of its ownership of the common stock."

"The controlling facts leading to this conclusion are that petitioner continued its corporate existence and its franchise and retained a portion of its assets; that it acquired no controlling interest in the corporation to which it delivered the greater portion of its assets; that there was no continuity of interest from the old corporation to the new; that the control of the property conveyed passed to a stranger, in the management of which petitioner retained no voice.

"It follows that the transaction was not part of a strict merger or consolidation or part of something that partakes of the nature of a merger or consolidation and has a real semblance to a merger or consolidation involving a continuance of essentially the same interests through a new modified corporate structure. Mere acquisition by one corporation of a majority of the stock or all the assets of another corporation does not of itself constitute a reorganization, where such acquisition takes the form of a purchase and sale and does not result in or bear some material resemblance to a merger or consolidation."

True, the mere acquisition of the assets of one corporation by another does not amount to reorganization within the statutory definition. *Pinellas Ice Co.* v. *Commissioner* (287 U. S., 462 [Ct. D. 630, C. B. XII-1, 161]) so affirmed. But where, as here, the seller acquires a definite and substantial interest in the affairs of the purchasing corporation, a wholly different situation arises. The owner of preferred stock is not without substantial interest in the affairs of the issuing corporation, although denied voting rights. The statute does not require participation in the management of the purchaser; nor does it demand that the conveying corporation be dissolved. A controlling interest in the transfer corporation is not made a requisite by section 203(h)1(A). This must not be confused with paragraph (h)(2).

Finally, as has been pointed out in the Minnesota Tea case, paragraph (h)1(B) was not intended to modify the provisions of paragraph (h)1(A). It describes a class. Whether some overlapping is possible is not presently important.

The judgment below must be reversed.

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## ARTICLE 1577: Definitions. XV-2-7904 Ct. D. 1063

INCOME TAX—REVENUE ACT OF 1924—DECISION OF SUPREME COURT.

1. GAIN OR LOSS—REORGANIZATION—BONDS AS SECURITIES—CONSTRUCTION OF STATUTE.

Where the sole stockholders of B Corporation in 1924 exchanged all their stock for shares of C Corporation and mortgage bonds of B guaranteed by C, and B Corporation continued to do business until its dissolution in 1928, the transaction comes within the description of a reorganization recognized by article 1574 of Regulations 65. The bonds were securities within the meaning of the statute and can not be regarded as cash. *Helvering* v. *Minnesota Tea Co.*, decided by the Supreme Court December 16, 1935 [Ct. D. 1060, page 189, this Bulletin] followed.

2. DECISION AFFIRMED.

Decision of the Circuit Court of Appeals, Second Circuit (75 Fed. (2d), 981), reversing the decision of the Board of Tax Appeals (28 B. T. A., 1056), affirmed.

SUPREME COURT OF THE UNITED STATES.

184. *Guy T. Helvering, Commissioner of Internal Revenue, petitioner,* v. *John J. Watts.*

185. *Guy T. Helvering, Commissioner of Internal Revenue, petitioner,* v. *Hugh C. Sicard.*

186. *Guy T. Helvering, Commissioner of Internal Revenue, petitioner,* v. *Parker Sloane.*

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

[December 16, 1935.]

OPINION.

Mr. Justice MCREYNOLDS delivered the opinion of the Court.

These causes involved deficiency assessments for income tax against the three respondents for the year 1924.

They were the sole stockholders of United States Ferro Alloys Corporation—herein Ferro Alloys—and the causes, alike in all essential particulars, were dealt with below in one opinion.

The respondents maintain that they exchanged all stock of Ferro Alloys for shares of Vanadium Corporation of America and bonds of Ferro Alloys guaranteed by Vanadium; that these two corporations were parties to a reorganization, and that under section 203(b)2, Revenue Act, 1924, no taxable gain resulted. The Commissioner insists that the transaction was a sale of all the stock of the Ferro Alloys and therefore taxable gain resulted. The applicable statutory provision in section 203, Revenue Act, 1924, the pertinent parts of which are in the margin of the opinion in No. 174, ante, page 2 [Ct. D. 1060, page 189, this Bulletin].

In December, 1924, respondents owned all the stock of Ferro Alloys Corporation. They exchanged this with the Vanadium Corporation for stock of the latter valued at $30 per share and for $1,161,184.50 mortgage bonds of Ferro Alloys guaranteed by Vanadium. Ferro Alloys continued to conduct business until its dissolution in 1928. Article 1574 of Treasury Regulations 65 provided that under the Act of 1924 no gain or loss shall be recognized to the shareholders from the exchange of stock made in connection with the reorganization, if two or more corporations reorganize, for example, by either the sale of the stock of B to A, or the acquisition by A of a majority of the total number of shares of all other classes of stock of B.

The transaction here involved is within the description of reorganization recognized by the Treasury regulations above quoted. And if the regulation can be taken as properly interpreting the statute, the challenged judgment must be affirmed.

The court below recites the history of the Treasury regulation above quoted and concludes that, in view of the reenactment of the paragraph to which it refers without change, Congress intended to approve the regulation as written.

The Commissioner here maintains that the definition of reorganization found in section 203(h)1(A), Revenue Act, 1924, should be limited to transactions which partake of the nature of mergers or consolidations and that here the Vanadium merely made an investment in Ferro Alloys stock and obtained only the rights of a stockholder therein. It is also urged that an exchange of stocks for bonds results in a substantial change of position and that such bonds are "other property" within the meaning of the statute and as such subject to tax. Much of the argument presented is the same as the one considered in the Minnesota Tea Co. case, and it need not be again followed in detail. The bonds, we think, were securities within the definition and can not be regarded as cash, as were the short term notes referred to in *Pinellas Ice Co.* v. *Commissioner* (287 U. S., 462 [Ct. D. 630, C. B. XII-1, 161]).

The judgment of the court below must be affirmed.

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## SECTION 204.—BASIS FOR DETERMINING GAIN OR LOSS, DEPLETION, AND DEPRECIATION.

### Article 1591: Basis for determining gain or loss from sale.

REVENUE ACTS OF 1921, 1924, AND 1926.

Property acquired through exercise of option to buy at expiration of lease. (See Ct. D. 1098, page 196.)

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### Article 1598: Property acquired after December 31, 1920, by a corporation.

XV-8-7966
Ct. D. 1083

INCOME TAX—REVENUE ACT OF 1926—DECISION OF COURT.

GAIN OR LOSS—SALE AND EXCHANGE OF PROPERTY—BASIS—PROPERTY TRANSFERRED TO CORPORATION IN EXCHANGE FOR STOCK.

In 1921 an individual caused a corporation to be formed, to facilitate the handling of his property, and acquired practically all of its stock in exchange for shares in a British corporation. Shortly thereafter he also transferred to the corporation, without additional stock issuance or other consideration, stock of another corporation which he had acquired prior to March 1, 1913. The latter stock was sold by the transferee corporation in 1927. The transactions in 1921 must be treated in substance as the issuance of securities for property transferred, unaffected by the fact that the value of the stock sold was treated on the books of the transferee as paid-in surplus, and the basis to be used in determining gain from the sale is the same as it would be in the hands of the transferor, namely, the value of the stock at March 1, 1913, under the provisions of section 204(a)8 of the Revenue Act of 1926.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.

*Louise B. King, appellant,* v. *United States of America, appellee.*

Appeal from the District Court of the United States for the District of Maryland, at Baltimore.

[October 8, 1935.]

OPINION.

NORTHCOTT, Circuit Judge: The appellant, herein referred to as the plaintiff, brought this action against the United States, in the District Court of the United States for the District of Maryland, to recover $78,557.15, principal and interest, alleged excessive income taxes required by the Commissioner of Internal Revenue to be paid. A demurrer was filed to the plaintiff's declaration and, after argument, in a well considered opinion, the judge below sustained the demurrer and entered an order giving judgment in favor of the defendant with costs; from this order this appeal was brought.

The plaintiff was a transferee of assets from the Gramaphone & Securities Corporation, a Virginia corporation, and as such transferee paid the tax in question. The tax was originally assessed against the corporation as income tax for the year 1927. After payment, a claim for refund was filed in May, 1932. The claim was disallowed in November, 1932, whereupon the plaintiff brought this action.

The Gramaphone & Securities Corporation was organized in July, 1921, and issued Emile Berliner 1,998 shares of its capital stock in exchange for 19,998 shares of the capital stock of the Gramaphone Co., Ltd., a British corporation. The object of the formation of the Virginia corporation was to facilitate the distribution by Berliner, among his family, of a substantial part of his property, at the same time keeping it united and under his control during his lifetime. Berliner was an inventor who had close contact with the development of the business of an American corporation, the Victor Talking Machine Co. Two shares, in addition to those owned by Berliner, were issued, making the total issuance of capital stock 2,000 shares. No more stock was ever issued by the corporation. The plaintiff is one of Berliner's daughters.

Within about 30 days after the organization of the corporation and the issuance of its stock as stated, Berliner also transferred to the corporation, without additional stock issuance or other consideration, 1,200 shares of Victor Talking Machine Co. stock; this Talking Machine stock, subsequently and before its sale by the taxpayer, by virtue of stock dividends, was increased to 8,400 shares. It is admitted that the reason that the Victor Talking Machine Co.'s stock was not transferred to the taxpayer at the time of the transfer of the shares in the British company, was due to accident rather than design and because of the fact that the certificate for Victor Talking Machine stock was not immediately at hand. From this fact the judge below drew the inference that it was within the original contemplation of Berliner to transfer all this stock at the same time and that the stock given to Berliner by the Virginia corporation was really intended as compensation for the stock in the Talking Machine company as well as that in the British company. We are of the opinion that the inference was a fair one and necessarily followed from the facts admitted; but we are also of the opinion, as will be discussed later, that this inference is not material to a proper decision of the question here involved.

The Talking Machine stock, transferred by Berliner to the Virginia corporation, had been acquired by him prior to March 1, 1913, at a cost price of less than $720,000, which was its market value on March 1, 1913. When the stock was transferred to the taxpayer in 1921, its fair market value was $1,200,000. This stock was sold by the taxpayer in 1927 for $1,302,000, less expense incurred of $11,911.40. In its income tax return for 1927 the corporation treated the sale as yielding a profit represented by the difference between the value of the stock at the time of its acquisition by the taxpayer ($1,200,000) and the net sale price; but the Commissioner of Internal Revenue on review determined that the taxable profit must be computed on the basis of the net sale price less the market value as of March 1, 1913 ($720,000). He thus added to the taxable profit $480,000.

The sole question in the case is whether the value of the stock as of March 1, 1913, or its value in the year 1921, when it was transferred to the corporation, is to be deducted from its net sale price in determining what profit was taxable as income.

The revenue statutes involved are section 204(a) (2) and (8) of the Revenue Act of 1926 (26 U. S. C. A., 935) and section 203(b)4 of the Revenue Act of 1926 (U. S. C. A., Title 26, section 934), which read as follows:

"SEC. 204. (a) The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; except that—

* * * * * * *

"(2) If the property was acquired by gift after December 31, 1920, the basis shall be the same as it would be in the hands of the donor or the last preceding owner by whom it was not acquired by gift. If the facts necessary to determine such basis are unknown to the donee, the Commissioner shall, if possible, obtain such facts from such donor or last preceding owner, or any other person cognizant thereof. If the Commissioner finds it impossible to obtain such facts, the basis shall be the fair market value of such property as found by the Commissioner as of the date or approximate date at which, according to the best information that the Commissioner is able to obtain, such property was acquired by such donor or last preceding owner;

* * * * * * *

"(8) If the property (other than stock or securities in a corporation a party to a reorganization) was acquired after December 31, 1920, by a corporation by the issuance of its stock or securities in connection with a transaction described in paragraph (4) of subdivision (b) of section 203 (including, also, cases where part of the consideration for the transfer of such property to the corporation was property or money in addition to such stock or securities), then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made;

* * * * * * *

"SEC. 203. (b) (4) No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; but in the case of an exchange by two or more persons this paragraph shall apply only if the amount of the stock and securities received by each is substantially in proportion to his interest in the property prior to the exchange."

It is contended on behalf of the plaintiff that the transfer by Berliner to the Gramaphone & Securities Corporation of the Talking Machine stock was not a gift within the meaning of section 204(a)2 of the Revenue Act of 1926, and further that it was not an acquisition of property by the transferee corporation in consideration of its stock or securities within the meaning of section 204(a)8 of said Revenue Act, but that said stock when so transferred to the corporation became paid-in surplus and therefore would not come within the plain provisions of the Revenue Act. It is further contended that if the collection of the tax is sustained it would be a double tax upon essentially the same transaction.

It is contended on behalf of the Government that the transfer when made by Berliner was either a gift to the transferee corporation or was a transfer in consideration for capital stock issued to Berliner.

We are not concerned here with the question of whether or not the tax amounts to double taxation but only with whether the tax in the transaction under consideration comes clearly within the meaning of the Revenue Act. While it is not clear from the record that the tax here would in any event be a double tax, double taxation, if clearly the intention of Congress, is concededly not unconstitutional and may properly be collected. This is admitted on behalf of the plaintiff, and it has been repeatedly so held by the courts. (*Hellmich* v. *Hellman*, 276 U. S., 233 [T. D. 4217, C. B. VII-2, 238]; *Faris* v. *Helvering*, 71 F. (2d), 610 [Ct. D. 929, C. B. XIV-1, 242]; *Aluminum Co. of America* v. *United States*, 67 F. (2d), 172 [Ct. D. 799, C. B. XIII-1, 299]; *T. W. Phillips, Jr., Inc.*, v. *Commissioner*, 63 F. (2d), 101; *Perthur Holding Corporation* v. *Commissioner*, 61 F. (2d), 785 [Ct. D. 680, C. B. XII-1, 173].)

We are of the opinion that the transfer in question comes within the plain meaning and intent of section 204(a)8 of the Revenue Act of 1926. The transferee corporation was a one-man corporation, Berliner owning practically all of its stock and receiving it at the time of the transfer of the shares in the British corporation. The Talking Machine stock was not transferred at the same time because it was not convenient or because of inadvertence, but was transferred shortly after. As was well reasoned by the judge below, the issuance of additional stock in the transferee corporation to the man who already owned all of the stock would in no way have affected the value of the stock already held by him, while owned by him and the conclusion is inescapable that the transaction must be treated in substance as the issuance of securities for property transferred. The fact that the value of the Talking Machine stock was treated on the books of the transferee corporation as paid-in surplus does not in any way affect the substance of the transaction. There was a large increase in the value of the stock from March 1, 1913, to the date on which the stock was sold in 1927. This increase in value represented a profit which the Government was entitled to tax. Had the property remained in the hands of Berliner until the date of the sale, the increase in the value would have been subject to the tax. The fact that Berliner, to facilitate the handling of his estate, transferred the stock to a corporation of which he owned all the stock can not affect the right of the Government to receive the proper tax upon the increase in value. The tax basis of the transferor of stock, under the circumstances that existed here, is properly applicable to profit realized from the sale of the same stock received by a corporation from the transferor. (*T. W. Phillips, Jr., Inc.*, v. *Commissioner*, supra.)

The section in question, within the plain intent of the words used, makes the basis for determining gain or loss upon the subsequent sale of stock by a corporation the same as it would be in the hands of the transferor. This section has been held constitutional in a number of decisions. (*Faris* v. *Helvering*, supra; *Perthur Holding Corporation* v. *Commissioner*, supra.)

In his opinion the judge below reviews the legislative history of the Act as shown in the Congressional Record and, in our opinion, properly concludes that the interpretation given the Act by him was clearly the intent of Congress in its enactment.

Having reached the conclusion that the tax in question was properly collected under section 204(a)8, it is not necessary to discuss the point raised that the transfer of the Talking Machine Co. stock was a gift to the corporation. In *Commissioner* v. *Rosenbloom Finance Corporation* (66 Fed. (2d), 556 [Ct. D. 805, C. B. XIII-1, 187]), the Circuit Court of Appeals for the Third Circuit held that a transfer of stock under similar conditions was a gift. The judge below ably reasons that the transfer must either have been a gift or a transfer for stock. We think it was the latter; in any event the court below reached the proper conclusion in sustaining the demurrer to plaintiff's declaration.

The judgment of the court below is accordingly affirmed.

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## ARTICLE 1599: Stock or securities distributed in reorganization. XV-9-7975 Ct. D. 1086

INCOME TAX—REVENUE ACT OF 1926—DECISION OF COURT.

1. GAIN OR LOSS—SALE OF STOCK—BASIS—STOCK DISTRIBUTED IN REORGANIZATION—AMENDED REGULATION APPLICABLE.

M Corporation in June, 1925, purchased all the capital stock of N Corporation. In December, 1925, pursuant to a plan of reorganization, N transferred to O Corporation all of its assets, with certain exceptions, in exchange for shares of stock of O, and immediately thereafter distributed to M Corporation the stock of O and a portion of its remaining assets. In 1926, the M Corporation sold, at a loss, all the shares of N Corporation. Under these facts, the basis for measuring the loss sustained, under section 204(a)9 of the Revenue Act of 1926, is determinable by apportioning the cost of the N shares between the shares of N and the shares of O, in accordance with article 1599(2) of Regulations 69, as amended. Since the original regulation as applied to these facts would bring about an inequitable apportionment, contrary to the intent of the statute, and was unreasonable, the amended regulation in effect became the primary and controlling rule in respect of the situation presented.

2. Decision Affirmed.

Decision of the Circuit Court of Appeals, Second Circuit (76 Fed. (2d), 892), affirming decision of the Board of Tax Appeals (29 B. T. A., 395), affirmed.

Supreme Court of the United States.

*Manhattan General Equipment Co., petitioner,* v. *Commissioner of Internal Revenue.*

*Collier Service Corporation, formerly Broadway Subway Advertising Co., Inc., petitioner,* v. *Commissioner of Internal Revenue.*

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

[February 3, 1936.]

OPINION.

Mr. Justice Sutherland delivered the opinion of the Court.

These cases involve identical facts and questions of law, and were disposed of by the court below in one opinion. (76 F. (2d), 892.) The facts, so far as they concern the question here, are taken from the statement of that court.

The petitioners are affiliates of United Brokerage Co. That corporation filed income tax returns for itself and its affiliates for 1925 and 1926 and the petitioners seek to review tax deficiencies attributed to them by the Commissioner, which the Board of Tax Appeals has affirmed. * * *

On June 30, 1925, the United Brokerage Co. purchased for $3,414,345.63 in cash all the capital stock of Artemas Ward, Inc. (a New York corporation), that was issued and outstanding consisting of 4,964 shares of no par value. * * *

On December 31, 1925, pursuant to a plan of reorganization, Artemas Ward, Inc. (N. Y.), transferred to Artemas Ward, Inc. (a Delaware corporation), in exchange for 100 shares of stock of the latter company of no par value, all its assets, then of a net book value of $1,246,920.07, with the exception of cash and accounts receivable aggregating $284,967.21—that is to say, the New York corporation transferred to the Delaware corporation assets of the value of $961,952.86. Immediately after the transfer, and on December 31, 1925, Artemas Ward, Inc. (N. Y.), distributed to United Brokerage Co. the 100 shares of stock of Artemas Ward, Inc. (Del.), and accounts receivable amounting to $234,967.21. In December, 1926, United Brokerage sold the entire 4,964 shares of Artemas Ward, Inc. (N. Y.), for $49,640. That stock had cost the United Brokerage $3,414,345.63 and the total must be apportioned between the 100 shares of the Delaware corporation (which it still owns) and the 4,964 shares of Artemas Ward, Inc. (N. Y.), in order to determine the loss suffered by the United Brokerage Co. through its sale of the 4,964 shares at $49,640.

* * * * * * *

Upon the reorganization, the New York corporation had left among its assets, valued at $1,246,920.07, accounts receivable and cash aggregating $284,967.21, or approximately 22.85 per cent thereof, after $961,952.86 had been transferred to the Delaware company. Under article 1599(2) (as amended, infra) the portion of $3,414,345.63 paid by the United Brokerage Co. for the stock of Artemas Ward, Inc. (N. Y.), represented by that stock after the reorganization was $780,303.97. If from this be deducted $234,967.21 accounts receivable and the $49,640 realized from the sale in December, 1926, there would be a loss of $495,696.76. This loss the Commissioner allowed in assessing the income tax for 1925. The second point raised on this appeal is whether the loss, for the year 1926, to which the United Brokerage Co. and its affiliates were entitled was only the sum of $495,696.76 or was the sum of $2,167,785.56 which would arise through deducting from $3,414,345.63 (the cost of the stock of the New York company), the value at the time of the reorganization of the Delaware stock which was $961,952.86 and $234,967.21 realized from accounts receivable and $49,640 realized from sale of the 4,964 shares.

It thus appears, the New York company having parted with all its assets except $50,000 in cash, that the assets behind the 4,964 shares when the 100 share distribution was made consisted of only that sum, while the 100 shares of the Delaware company stock was represented by the transferred assets of the New York company of the value of $961,952.86. The sale of the 4,964 shares brought $49,640; and the simple question to be determined is what method for the purposes of taxation should be employed to determine the loss in respect of the 4,964 shares under the Revenue Act of 1926, section 204(a)9 (ch. 27, 44 Stat., 9, 14, 15). That section provides that the basis for determining the gain or loss from such sale shall be the cost of the property, except that—

"(9) If the property consists of stock or securities distributed after December 31, 1923, to a taxpayer in connection with a transaction described in subdivision (c) of section 203,[1] the basis in the case of the stock in respect of which the distribution was made shall be apportioned, under rules and regulations prescribed by the Commissioner with the approval of the Secretary, between such stock and the stock or securities distributed; * * *."

At the time of the reorganization, article 1599 of Treasury Regulations 69, which had been promulgated on August 28, 1926, was in force. Petitioners invoke subdivision 2 of that regulation which provided:

"Where the stock distributed in reorganization is in whole or in part of a character or preference materially different from the stock in respect of which the distribution is made, the cost or other basis of the old shares of stock shall be divided between such old stock and the new stock in proportion, as nearly as may be, to the respective values of each class of stock, old and new, at the time the new shares of stock are distributed, and the basis of each share of stock will be the quotient of the cost or other basis of the class with which such share belongs, divided by the number of shares in the class. *The portion of the cost or other basis of the old shares of stock to be attributed to the shares of new stock shall in no case exceed the fair market value of such shares as of the time of their distribution.*" [Italics added.]

April 3, 1928, this regulation was amended by striking from it the italicized portion. The taxpayer contended that its loss should be computed in accordance with the original regulation. This would have resulted in an allocation to the 4,964 shares of the New York corporation of $2,452,392.77; and, after making certain deductions, the allowable loss, as already appears, would have been something over $2,000,000. The Commissioner, however, proceeding in strict accordance with the amended regulation, determined the amount of loss to be $495,696.76. Without pursuing the matter in further detail, it is enough to say that the case turns entirely upon the question whether the loss was to be determined in accordance with the original or the amended regulation. If in accordance with the former, the taxpayer is right; if in accordance with the latter, the Commissioner is right. The court below held that the amended and not the original regulation furnished the applicable rule, and affirmed the determination of the Board of Tax Appeals, which in turn had sustained the Commissioner. We agree with that view.

In determining a loss, the statute requires that the basis shall be "apportioned" between the old and the new stock. To apportion is to "divide and assign in just proportion," "to distribute among two or more a just part or share to each" (*Fisher* v. *Charter Oak Life Insurance Co.*, 14 Abb. N. C., 32, 36), albeit, a division may be just without necessarily being also an exactly equal division. The result of applying the original regulation here is to bring about an inequitable apportionment, contrary to the intent of the statute, and to credit the taxpayer with a loss essentially and greatly disproportionate. On the other hand, application of the amended regulation effectuates the legislative intent that the basis of apportionment between the old and the new stock shall result in a fair and just division.

The power of an administrative officer or board to administer a Federal statute and to prescribe rules and regulations to that end is not the power to make law—for no such power can be delegated by Congress—but the power to adopt regulations to carry into effect the will of Congress as expressed by

[1] Section 203(c) provides: "If there is distributed, in pursuance of a plan of reorganization, to a shareholder in a corporation a party to the reorganization, stock or securities in such corporation or in another corporation a party to the reorganization, without the surrender by such shareholder of stock or securities in such a corporation, no gain to the distributee from the receipt of such stock or securities shall be recognized."

the statute. A regulation which does not do this, but operates to create a rule out of harmony with the statute, is a mere nullity. (*Lynch* v. *Tilden Co.*, 265 U. S., 315, 320–322 [T. D. 3605, C. B. III-1, 516]; *Miller* v. *United States*, 294 U. S., 435, 439–440, and cases cited.) And not only must a regulation, in order to be valid, be consistent with the statute, but it must be reasonable. (*International Ry. Co.* v. *Davidson*, 257 U. S., 506, 514.) The original regulation as applied to a situation like that under review is both inconsistent with the statute and unreasonable.

The contention that the new regulation is retroactive is without merit. Since the original regulation could not be applied, the amended regulation in effect became the primary and controlling rule in respect of the situation presented. It pointed the way, for the first time, for correctly applying the antecedent statute to a situation which arose under the statute. (See *Titsworth* v. *Commissioner of Internal Revenue*, 73 F. (2d), 385, 386.) The statute defines the rights of the taxpayer and fixes a standard by which such rights are to be measured. The regulation constitutes only a step in the administrative process. It does not, and could not, alter the statute. It is no more retroactive in its operation than is a judicial determination construing and applying a statute to a case in hand.

Judgment affirmed.

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## Article 1602: Basis for allowance of depletion and depreciation.

REVENUE ACT OF 1926.

Wet gas. (See Ct. D. 1084, page 209.)

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# SECTION 206.—NET LOSSES.

## Article 1621: Net losses, definition and computation. (Also Section 240, Article 632.)

XV-21-8097
Ct. D. 1120

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

1. Deduction—Net Loss—Affiliated Corporations.

A parent corporation filed consolidated returns for 1918 and 1919 on behalf of itself and its subsidiaries, the 1918 return showing a consolidated net income for the group (most of the companies having realized a profit but some having sustained a loss), and the 1919 return disclosing a consolidated net loss. No basis exists, under section 204 of the Revenue Act of 1918, for the deduction of the consolidated net loss for 1919 from the net income of the group for 1918, for the purpose of determining the tax. In an affiliated group the individual corporations are the taxpayers, and the net loss of each corporation for 1919 is to be deducted from the individual net income of the same company for 1918; if it had no income for that year there could be no deduction.

2. Affiliated Corporations—Agreement as to Payment of Tax.

A parent corporation which owned all the stock of its subsidiaries, controlled their policies and business, directly supervised the keeping of their books and the making of their tax returns, and whose officers in many instances were officers of the subsidiaries, filed consolidated returns for 1918 and 1919 on behalf of itself and the subsidiaries, the latter filing only information returns indicating that none of the taxes of the group was to be apportioned to them. Assessment of the entire tax was made against the parent without objection, and subsequent proceedings before the Commissioner and the courts were conducted by the parent. These facts are sufficient to establish an implied agreement between all parties concerned that the tax should be paid by the parent corporation, and justify the Commissioner in allocating the entire tax to the parent.

3. ESTOPPEL.

Under the facts set out above, where the parent corporation held itself out to be the proper party to pay the tax of the consolidated group until after the statute of limitations had barred assessment of the tax against the subsidiaries and it was too late to apply what it then claimed to be the correct rule of law, it is estopped to repudiate its former representations and to claim that the taxes which it paid should be refunded.

COURT OF CLAIMS OF THE UNITED STATES.

*Wilson & Co., Inc., a Corporation,* v. *The United States.*

[January 6, 1936.]

OPINION.

GREEN, Judge, delivered the opinion of the court.

The plaintiff is the successor to the corporation of the same name engaged in what is commonly called the packing-house business and seeks to recover income and profits tax which was paid by its predecessor for the year 1918. For convenience both in the findings and the opinion the name "plaintiff" is used as applying both to the old corporation, which was a New York corporation existing in 1918 and continuing in existence until 1926, and also to the plaintiff in this action, a Delaware corporation of the same name which acquired the assets of the New York corporation.

The original corporation owned all the stock of some 44 corporations, the names of which appear in the findings, and for each of these years filed on behalf of itself and these corporations a consolidated return for income and profits tax purposes. The return for 1918 showed a consolidated net income for the group upon which a tax was paid by plaintiff. The return for 1919 made in the same manner showed a loss. In 1919 the plaintiff paid part of the tax shown to be due for 1918 and filed a claim in abatement for the balance amounting to $1,016,629.82, and about June 13, 1919, each member of the affiliated corporations in the consolidated group except the plaintiff, as parent corporation, filed an information return for the year 1918 and in reply to a question propounded on the form used as follows:

"9. State the amount of income and profits taxes for the taxable year apportioned to the subsidiary or affiliated corporation making the return," made answer "None." After the filing of the returns mentioned above and before this suit was commenced, there were proceedings on behalf of the plaintiff and the Government and among others the plaintiff filed claims for refund and abatement, the revenue officers made examination of the returns, and the Commissioner determined and assessed an additional tax for 1918. This suit was begun June 7, 1927, by filing a petition in which plaintiff sought to recover the entire tax paid for 1918 on the ground that the consolidated group for which it had made a return had sustained a net loss for 1919 which should be deducted from the net income of the group for 1918, and that when such application was made as provided by section 204 of the Revenue Act of 1918 the result would show no tax liability for 1918 and accordingly the tax paid that year by plaintiff should be refunded. The Commissioner considered the claims and protests filed by plaintiff and on September 27, 1927, issued a certificate of overassessment which showed that a part of the tax paid for 1918 was refundable and refund was accordingly made to the plaintiff. The suit, however, was continued as plaintiff still contended that the whole amount which it had paid should be refunded. March 21, 1932, the amended and supplemental petition upon which the case is now submitted was filed. The amended petition alleged many errors in computing the taxes of the plaintiff and its subsidiaries for the years 1918 and 1919, which, if corrected in accordance with plaintiff's contentions, would show that no taxes whatever were due from the plaintiff for the year 1918. It is not necessary at this point to set out these claims in detail, but it should be said that the amended petition introduced an issue which defendant claims was not covered by the original petition and at least had not been mentioned in the proceedings between the parties up to the time of the filing of the amended petition. This issue relates to the manner in which the Commissioner computed the consolidated tax for the year 1918, all of which was assessed against the plaintiff. The precise nature of plaintiff's claim will appear when we consider further the facts in the case. Much of the argument made by the respective parties is devoted to questions relating to the propriety of certain allowances and deductions which plaintiff claims should have been made in computing the taxes in controversy. It will not be necessary, however, to consider these matters until other issues which may be decisive of the case have been determined.

The plaintiff contends that it was not liable for any taxes whatever for the year 1918. The defendant insists, on the contrary, that under the facts in the case the plaintiff was obligated to pay all of the taxes due for that year from the several members of the affiliated group and also that the plaintiff can not now be heard to deny its liability for these taxes. In discussing the issues so raised it will be necessary to state the facts more in detail.

The consolidated return which was filed for the year 1918 by the plaintiff on behalf of itself and the affiliated companies showed that in that year the plaintiff and most of the affiliated companies realized a profit but some of the companies sustained a loss, and similar results were shown when the Commissioner made his final determination of the tax on September 27, 1927. In making his computation the Commissioner simply deducted the aggregate net losses of the several companies which had not been profitable from the total net income of the other companies for the same year. The difference was $6,890,404.52, which he determined was the net income of all of the affiliated corporations for 1918 before applying the 1919 net loss. The Commissioner proceeded in the same manner in determining the situation in 1919. In that year the total of the losses exceeded the aggregate net income by $5,174,168.10, which the Commissioner found was the consolidated net loss for that year. The Commissioner then deducted the total consolidated net loss for 1919 from the total consolidated net income for 1918, thus showing a taxable consolidated net income for 1918 of $1,716,236.42. Upon this revised consolidated net income he computed the tax liability for the group, and, since the tax thus determined was less than the tax which had been paid by plaintiff, the difference was refunded to plaintiff. In so computing the tax, the Commissioner was in error. In the case of *Swift & Co.* v. *United States* (69 C. Cls., 171, 191), we held that in an affiliated group the individual corporations are the taxpayers, that the group is merely a tax computing unit and not a taxable unit, and that accordingly no basis exists under section 204 of the Revenue Act of 1918 for a group application of a consolidated net loss for 1919 to a consolidated net income for 1918 for the purpose of ascertaining the tax. The Commissioner of Internal Revenue has acquiesced in the rule laid down in Swift & Co., supra, and it has been approved by the courts. (Cf. *Delaware & Hudson Co.* v. *Commissioner*, 26 B. T. A., 520, affirmed, 65 Fed. (2d), 292 [Ct. D. 801, C. B. XIII-1, 197]; *Woolford Realty Co.* v. *Rose*, 286 U. S., 319 [Ct. D. 493, C. B. XI-1, 154]; and *Planters Cotton Oil Co.* v. *Hopkins*, 286 U. S., 332 [Ct. D. 492, C. B. XI-1, 153].) It follows in cases like the one before us that where an affiliated company sustained a net loss for 1919, it should be deducted from the individual net income of the same company for 1918, and if it had no income for that year there could be no deduction.

Plaintiff contends that certain adjustments other than those made by the Commissioner should have been allowed in computing its income. For the purposes of the argument it may be assumed that these adjustments should have been made, and we have set out in findings 13 and 14 an itemized statement of the determination of the Commissioner with reference to the income or loss of each company for the years 1918 and 1919 and also a computation thereof in accordance with the contentions of the taxpayer for each of these years. Finding 14(b) also includes a computation of 1918 taxable income in which allowable net losses of the various affiliated companies for 1919 are applied to the net income of the appropriate companies for 1918. From this computation it appears that a substantial part of the net loss of the group for 1919 is not allowable as a deduction for 1918 with the result that the consolidated net income for 1918, after applying the net losses of the several companies for 1919 to the extent to which they are allowable, is $2,787,156.27. The Commissioner's determination of the tax was based upon his computation of a consolidated net income of $1,716,236.42, but the recomputation of the tax liability for the group as set out in finding 14(b) shows an aggregate liability for the affiliated group for a greater amount than that previously determined by the Commissioner. In other words, so far as the total tax which should have been paid by the group as a whole is concerned, it has been underpaid instead of being overpaid.

Plaintiff does not question that even when effect is given in its favor of all of the adjustments contended for, and the principles of the Swift & Co. case are applied, the total of the tax liabilities of all of the affiliated companies would be greater than the amount which was finally collected as the tax upon the group as a whole. The argument is that so far as plaintiff individually is concerned its allowable net loss for 1919 was in excess of its net income for 1918, that under the law as it then stood it was entitled to have its loss for 1919 deducted or set off against the income for 1918[1] and therefore it had no income for 1918. Upon this basis it is insisted that plaintiff is not liable for any tax whatever for the year 1918 and that the whole amount paid by it should be refunded. Plaintiff paid all of the tax which has been paid for the group. The affiliated companies paid nothing, and it is contended that plaintiff can not be liable for the taxes of the affiliated corporations unless there was an agreement between all parties concerned that a tax should be paid by the parent company. It is insisted that there was no such agreement and consequently no liability.

Whether there was such an agreement is obviously a question of fact to be determined from all of the evidence. The conclusion of the Commissioner as to the method of computing the tax is *prima facie* correct and the burden of establishing the nonexistence of such an agreement is upon the plaintiff. On this point it may be said that it is not necessary that the agreement should be in writing. It may be implied or inferred from the established facts in the case and the conduct of the parties under all of the circumstances shown by the evidence. In this case plaintiff, as parent of the affiliated group, owned all the stock of the subsidiary corporations and controlled the policy and managed the business of each. The books of the affiliated corporations were kept and their tax returns were made under the direct supervision and control of plaintiff. In many instances the officers of the subsidiary corporations were also officers of the parent corporation. The consolidated return for 1918, which included the net income of plaintiff and the other corporations, was filed by plaintiff, and no indication was made therein other than that the tax should be assessed against and paid by plaintiff. On the contrary, it stated that plaintiff was the taxpayer, and the tax was accordingly so assessed. Plaintiff paid a part of the tax and filed a claim in abatement for the balance. No question was raised as to the propriety of the assessment against or payment by plaintiff. The subsidiary corporations whose every action was controlled by plaintiff also filed information returns in which it was stated that none of the taxes of the consolidated group was to be apportioned to them. In accordance with these proceedings no tax was assessed against or paid by the subsidiary corporations.

At all times the tax liability in the case has been considered and dealt with by the Commissioner without any objection by plaintiff on the basis that the entire tax was to be assessed against the parent company. When the Commissioner determined a deficiency an exhaustive protest was filed by plaintiff, not on the ground that it was not liable, but on the ground that the assessment was excessive. Acting on this protest an overassessment was determined in favor of plaintiff and a refund made. The facts recited above amply support the conclusion that there was an agreement that the entire tax was to be apportioned to plaintiff and paid by it. The only evidence to the contrary is the testimony of the attorney who had supervision of the preparation of the returns in question and who now appears as counsel for plaintiff in this proceeding. It may be that no written or formal agreement of any kind was ever entered into as to the apportionment, but in view of the fact that the plaintiff owned all the stock of the other affiliated corporations and controlled their actions the filing of the consolidated and information returns and the subsequent acts of the parties in conformity therewith are clearly sufficient to establish an implied agreement and justify the Commissioner in allocating the entire tax to plaintiff. The circumstantial evidence outweighs the direct testimony.

The same question of fact has often been before the courts in other cases. The evidence presented in the instant case is at least as strong in favor of the

[1] See section 204(b), Revenue Act of 1918.

action of the Commissioner as it was in any of them. In many of these cases an official of the parent corporation testified that there was no agreement, but it was held that this formal testimony was not sufficient to overcome the presumption in favor of the Commissioner's action and the circumstantial evidence. (See *Woodside Cotton Mills Co.*, 13 B. T. A., 266; *Bermont Oil Co.*, 22 B. T. A., 182; *Furniture Exhibition Building Co. et al.*, 24 B. T. A., 1279; *Washburn Wire Co.*, 26 B. T. A., 464 and 1146, affirmed on this issue, 67 Fed. (2d), 658; *Himelhoch Bros. & Co.*, 26 B. T. A., 541; *In re Temtor Corn & Fruit Products Co.*, 299 Fed., 326 [T. D. 3693, C. B. IV-1, 220]; and *Popular Price Tailoring Co.* v. *Commissioner*, 33 Fed. (2d), 464.)

It seems clear also that the plaintiff is now estopped from claiming that the taxes which it paid should be refunded. We have shown above that the plaintiff made a consolidated return referring to itself as the taxpayer in accordance with which the tax was assessed against it; that the subsidiary companies controlled by the plaintiff made only information returns stating that no part of the tax was to be paid by them; that plaintiff not disputing its liability paid part of the tax and filed a claim in abatement as to the remainder which claim was allowed and no further payment made; that its protest against the deficiency assessed by the Commissioner was not on the ground that it was not liable but under a claim that even the amount which it had paid was excessive; and that it filed a claim for refund which was allowed in part by the Commissioner and a large sum returned to plaintiff. Not until the amended and supplemental petition was filed did the defendant receive any notice that plaintiff claimed not to be liable for any tax by reason of the fact that its individual losses for 1919 exceeded its individual profits for 1918 and that the basic computation of its tax was wrong. The amended and supplemental petition was not filed until March 21, 1932. The statute of limitations had then run against the assessment of the tax against the subsidiary corporations which were liable for it individually, as plaintiff now claims.

The case of *Mahoning Investment Co.* v. *United States* (78 C. Cls., 231, certiorari denied) was in many respects like the one now before us. There were two affiliated companies. The Mahoning Investment Co. was the parent company and owned all the stock of the subsidiary company, the Rochester & Pittsburgh Coal & Iron Co. The parent company filed a return showing that the company itself had no taxable income and that the consolidated income was the income of the coal company. The Commissioner made a deficiency assessment against the parent company although no taxes were due from it and the basis of the assessment was the profits realized by the subsidiary. The parent company, however, notified the Commissioner that it would pay the tax and did so pay it. In general it accepted the situation although its officers knew that it was not liable and there was no agreement that it should pay the tax. In the case cited we held that the conduct of the parent company and its acquiescence in the proceedings taken by the defendant to collect the tax were such as would naturally mislead the defendant and cause it to continue in the course which it had begun, and that it was not necessary for the party claiming the estoppel to show that the other party intended to mislead, or that direct proof should be offered that it was in fact misled. It is sufficient if this fact is found as a natural and ordinary inference from all of the circumstances shown by the evidence and we have made such a finding in the case now before us. In the Mahoning case, supra, we said (page 248):

"The doctrine of equitable estoppel, or more properly as we think *quasi* estoppel, is gradually being extended by the modern courts to prevent a wrong being done 'wherever, in good conscience and honest dealing,' a party ought not to be permitted to repudiate his previous statements and declarations."

We are clear that the rule applies in this case. After holding itself out as the proper party to pay the tax, the plaintiff now, when the statute of limitations has run, seeks to repudiate the representations of itself and its associates when it is too late to apply what it claims to be the correct rule of law. If its position were sustained, the affiliated group would not only escape the payment of any taxes whatever for 1918 but the plaintiff would receive a refund on what had been paid although it was less than was actually due on the consolidated liability of the affiliated group which consisted of corporations all owned by the plaintiff. That equity and good conscience would not permit such a result to be brought about by the conduct of plaintiff, we think is manifest. Our conclusion is that plaintiff is estopped from maintaining its claim for a refund regardless of whether the evidence establishes that an agreement existed that it should pay the consolidated tax.

One other matter with reference to the findings should be mentioned. Finding 4 recites that "plaintiff filed a consolidated income and profits tax return for 1918 for itself and the subsidiary corporations." This does not follow the wording of the stipulation of the parties which recites that "Wilson & Co., Inc., * * * and its affiliated companies filed a consolidated income, excess-profits, and war-profits tax return for the calendar year 1918," but we have many times held that we are not bound by the stipulation when it is contrary to a fact which appears in evidence. The finding recites the fact correctly. Finding 6 makes a similar recital with reference to filing a return for the year 1919.

Plaintiff's petition must be dismissed and it is so ordered.

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## PART II.—INDIVIDUALS.

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

ARTICLE 31: What included in gross income. XV-6-7942
Ct. D. 1077

INCOME TAX—REVENUE ACTS OF 1918 AND 1926—DECISION OF COURT.

GAIN OR LOSS—SALE OF STOCK—COMPENSATION FOR SERVICES—ESTOPPEL—RETROACTIVITY OF REGULATION.

Taxpayers who used cost as the basis for reporting gain on the sale, in 1927, of stock purchased in 1920 from their employer corporation at less than its fair market value, making no disclosure in their returns that the stock had been acquired as compensation for personal services, are estopped to later claim that the basis should have been the fair market value of the stock at the date of acquisition, as allowed by article 31, Regulations 69, no income having been reported upon the transaction in 1920 and the statute of limitation having run against collection of any tax that might have been due for that year. Article 31, Regulations 69, upon which taxpayers rely, has no application, since Treasury Decision 3435 (C. B. II-1, 50), upon which it is based, was not in force until 1923, and is not retroactive in its operation.

UNITED STATES CIRCUIT COURT OF APPEALS, EIGHTH CIRCUIT.

*John J. Larkin and Herbert E. Doolittle, appellants*, v. *United States of America, appellee.*

Appeal from the District Court of the United States for the District of South Dakota.

[August 15, 1935.]

OPINION.

BOOTH, Circuit Judge, delivered the opinion of the court.

This is an appeal in a consolidated cause from judgments entered for defendant after demurrers to complaints of plaintiffs had been sustained.

The actions were brought by the appellants respectively (taxpayers) to recover refunds of income tax payments made for the tax year 1927.

The actions were consolidated pursuant to the provisions of section 734, Title 28, U. S. C. A.

The complaints alleged the following facts: The taxpayers were in 1920, and for many years prior thereto had been, employees of the Manchester Biscuit Co., a corporation in Sioux Falls, S. Dak. In that year the corporation sold to each of the taxpayers 200 shares of its common stock at $100 per share. At the time of the sale, the stock had a fair market value of $250 per share. The taxpayers were permitted to buy the stock at $100 per share by reason of their long and faithful service.

In 1927 the taxpayers sold the stock of the Manchester Biscuit Co. so acquired, 200 shares each, for $231.25 per share. In March, 1928, the taxpayers filed with the collector of internal revenue for South Dakota individual income tax returns for 1927, and in their returns reported a taxable profit from the sale of said stock in a sum equal to the difference between $100 per share and the sale price in 1927 of $231.25 per share. They paid income taxes on that basis.

The taxpayers further allege in their complaints that the amounts paid by them as their 1927 income tax on the reported profits from the sale of said stock were erroneously and illegally paid and collected; that on July 31, 1929, they filed written claims for refund of the sums so paid by each of them with the Commissioner of Internal Revenue, and alleged in said claims for refund that they in fact, each sustained a taxable loss for the year 1927 by reason of said sales.

Attached to the complaints were Exhibit "A," Income tax return of taxpayer for 1927, and Exhibit "B," Claim of taxpayer for refund. These claims for refund were rejected by the Commissioner of Internal Revenue and the present suits followed.

The demurrers interposed by the Government to the taxpayers' complaints were on the ground that the complaints did not state facts sufficient to constitute a cause of action.

The court sustained the demurrers; judgments of dismissal were entered, and this appeal was taken therefrom.

The contention of appellants is, as we gather it from their brief, that taxable income resulted in the year 1920 from the stock purchase transactions in that year between the taxpayers and the corporation; that the statute and regulations applicable are section 213(a) of the Revenue Act of 1918, and a part of article 33, Regulations 45, under the Revenue Act of 1918, which read respectively as follows:

"SEC. 213. That for the purposes of this title * * * the term 'gross income'—

"(a) Includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * * of whatever kind and in whatever form paid, * * * or gains or profits and income derived from any source whatever. The amount of all such items shall be included in the gross income for the taxable year in which received by the taxpayer * * *."

"ART. 33 (Regulations 45). * * * Compensation paid an employee of a corporation in its stock is to be treated as if the corporation sold the stock for its market value and paid the employee in cash. * * *"

The further contention of appellants is that no taxable income resulted from the sale of the stock in 1927, but in fact a loss resulted to the taxpayers, as appears by taking as the basis the market value of the stock in 1920 instead of the cost of such stock to the taxpayers, it being conceded that the sale price of the stock in 1927 was less than the market value thereof in 1920; that the error of the taxpayers in making their income tax returns in 1927 consisted in using as a basis the actual cost to them of the stock in 1920, instead of the fair market value as provided in Treasury Decision 3435, which was afterwards incorporated as part of article 31, Regulations 69, relating to the Revenue Act of 1926, and which reads as follows:

"Where property is sold by a corporation to a shareholder, or by an employer to an employee, for an amount substantially less than its fair market value, such shareholder of the corporation or such employee shall include in gross income the difference between the amount paid for the property and the amount of its fair market value. In computing the gain or loss from the subsequent sale of such property its cost shall be deemed to be its fair market value at the date of acquisition."

Appellants further contend that if any tax was due the United States by reason of the receipt of the stock by them in 1920, such tax was barred by the statute of limitations on March 15, 1926, and all liability extinguished. See section 250(d), Revenue Act of 1918; section 1106(a), Revenue Act of 1926.

The contention of appellee is that it is at least doubtful from the decisions whether any taxable income arose in 1920 at the time the stock was received, inasmuch as the transaction of 1920 was not within the strict letter of the provision contained in article 33, Regulations 45, under the Revenue Act of 1918 (above quoted); and inasmuch as the provisions contained in Treasury Decision 3435 were not in force until 1923. (See *Salvage* v. *Commissioner*, 76 F. (2d), 112; *Commissioner of Internal Revenue* v. *Van Vorst*, 59 F. (2d), 677; *Robinson* v. *Commissioner*, 59 F. (2d), 1008; *Taplin* v. *Commissioner*, 41 F. (2d), 454.)

The further contention of appellee is that appellants are precluded from claiming the benefit of the provisions of Treasury Decision 3435 (part of article 31, Regulations 69, under the Revenue Act of 1926); and, finally, that said Treasury decision has no application to the cases at bar.

We think the contentions of appellee are well founded. We pretermit discussion of the first contention.

When the appellants made out their income tax returns for the year 1927, they included the stock transactions in controversy. Larkin in his return (Exhibit "A") stated that his stock had been acquired between 1914 and 1920 at a cost of $27,075.50; that it was sold by him in 1927 for $56,716; that the expense of sale was $86.96; that the net gain was $29,552.54.

The statutes used by the taxpayers for determining the gain or loss in said stock transactions were sections 202(a) and 204(a) of the Revenue Act of 1926, which read as follows:

"SEC. 202. (a) Except as hereinafter provided in this section, the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the basis provided in subdivision (a) or (b) of section 204, and the loss shall be the excess of such basis over the amount realized." (44 Stat., 11, 26 U. S. C. A., section 933.)

"SEC. 204. (a) The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property * * *." (44 Stat., 14, 26 U. S. C. A., section 935.)

Nothing was stated to the effect that the stock had been acquired in whole or in part as compensation for services, although article 33 of Regulations 69 had been in force as part of former regulations since prior to 1920. Nor was mention made in said income tax returns of the provision (article 31, Regulations 69) upon which the taxpayers now rely, and which has been quoted above.

This paragraph was not in existence in 1920. It was first promulgated in 1923 as Treasury Decision 3435, Cumulative Bulletin II-1, 50, and was later incorporated in the regulations.

It thus seems plain that at the time of making the tax returns for 1927, the taxpayers considered the stock transaction of 1920 as a plain purchase of stock and that article 33 and article 31 of Regulations 69 had no application. Later on, however, in July, 1929, the taxpayers apparently concluded that the paragraph above quoted from article 31, Regulations 69, did have application to their income tax returns for the year 1927, and that the returns actually made by them were erroneous. Demand for refund accordingly was made on the Commissioner of Internal Revenue, and this being refused, the present suit was brought.

The income tax returns of the taxpayers for the year 1920 are not before us, so that we are not advised of their contents; but return of the taxpayer Larkin for the year 1927 is before us as Exhibit "A," made a part of the complaint. From this exhibit we learn nothing whatever about the stock transaction of 1920, but instead we are advised that the stock was acquired by the taxpayers from 1914 to 1920. We learn nothing to the effect that the stock was acquired in payment in whole or in part for services rendered. A plain purchase and sale of stock was stated and was relied upon both by the taxpayer and by the Commissioner of Internal Revenue. The tax was paid.

After the statute of limitations had run against the collection of any tax that might have been due for the year 1920, the taxpayer claimed error in his return for the year 1927. The error was not a mistake in the figures of calculation, but was an omission by the taxpayer to state the true character, as now claimed, of the stock transaction of 1920.

In *Gregory* v. *Helvering* (293 U. S., 465 [Ct. D. 911, C. B. XIV-1, 193]) the Court said (page 469):

"The legal right of a taxpayer to decrease the amount of what otherwise would be his taxes, or altogether avoid them, by means which the law permits, can not be doubted."

While this is true, yet the expression "by means which the law permits" opens up a field of inquiry.

In *Askin & Marine Co.* v. *Commissioner* (66 F. (2d), 776 [Ct. D. 806, C. B. XIII-1, 229]) the Court said (page 778):

"While the Commissioner must investigate returns to satisfy himself of their correctness in fact and law, a taxpayer may not benefit at the expense of the Government by misrepresenting facts under oath; by succeeding in having the Commissioner accept its representations as the truth; and by claiming later that what it represented to be true might have been found false had the Commissioner refused to have faith in the sworn return."

(See to the same effect *Stearns Co.* v. *United States*, 291 U. S., 54 [Ct. D. 780, C. B. XIII-1, 321]; *Commissioner* v. *Liberty Bank & Trust Co.*, 59 F. (2d), 320; *Edward G. Swartz, Inc.*, v. *Commissioner*, 69 F. (2d), 633; *Bothwell* v. *Commissioner*, 77 F. (2d), 35.)

In the Stearns case the Court said (page 61):

"The applicable principle is fundamental and unquestioned. 'He who prevents a thing from being done may not avail himself of the nonperformance which he has himself occasioned, for the law says to him in effect "this is your own act, and therefore you are not damnified."' (*Dolan* v. *Rodgers*, 149 N. Y., 489, 491; 44 N. E., 167; and *Imperator Realty Co.* v. *Tull*, 228 N. Y., 447, 457; 127 N. E., 263; quoting *West* v. *Blakeway*, 2 Man. & G., 828, 839.) Sometimes the resulting disability has been characterized as an estoppel, sometimes as a waiver. The label counts for little. Enough for present purposes that the disability has its roots in a principle more nearly ultimate than either waiver or estoppel, the principle that no one shall be permitted to found any claim upon his own inequity or take advantage of his own wrong. (*Imperator Realty Co.* v. *Tull*, supra.) A suit may not be built on an omission induced by him who sues."

We think the taxpayers are precluded by their conduct, as shown in their complaints, including exhibits, from maintaining the present suits.

Furthermore, in our opinion, the paragraph from article 31, Regulations 69 (Treasury Decision 3435), is not applicable to the case of the taxpayers here presented.

It is a rule of statutory construction that a statute should be considered as a whole, and not that its parts should be considered as separate enactments. (Lewis' Sutherland Statutory Construction (second edition), sections 344, 348; *Costanzo* v. *Tillinghast*, 287 U. S., 341, 345; *Hellmich* v. *Hellman*, 276 U. S., 233, 237 [T. D. 4217, C. B. VII-2, 238]; *Van Dyke* v. *Cordova Copper Co.*, 234 U. S., 188, 191; *Bartlett Trust Co.* v. *Elliott*, 30 F. (2d), 700; *Wainwright* v. *Pennsylvania R. Co.*, 253 F., 458, 465; *In re Crook*, 219 F., 979, 987.)

We think the same rule of construction should be applied to departmental regulations.

Treasury Decision 3435 (afterwards incorporated into the regulations) was intended to introduce and did introduce a new practice. By that ruling, an employee who was allowed by his company to purchase stock in the company at a price less than the fair market value thereof was required to include in his gross income for the year in which the stock was received the difference between the actual cost to him of the stock and its fair market value. This was not all. As owner of the stock he was obliged to state in his income tax report, if and when he sold the stock, the gain or loss, the same as any other owner. But since he had already reported as income at the time he acquired the stock the difference between the actual cost to him of the stock and its fair market value, he was allowed in reporting the sale to assume that the cost to him was the same as the fair market value, thus avoiding the possibility of a double taxation.

The last sentence in Treasury Decision 3435 must be read in connection with what precedes. The provision of the last sentence applies only to the class of persons mentioned in the first sentence. It is an adjustment provision. The taxpayers in the case at bar were not and could not be in such class of persons, and, therefore, the last sentence has no application to them.

Again, Treasury Decision 3435 was prospective and not retroactive in its operation.

Such is the rule in regard to statutes, absent language or surrounding circumstances plainly indicating the contrary. (Lewis' Sutherland Statutory Construction (second edition), section 642; *Brewster* v. *Gage*, 280 U. S., 327, 337 [Ct. D. 148, C. B. IX-1, 274]; *United States* v. *Magnolia Co.*, 276 U. S., 160, 162 [T. D. 4153, C. B. VII-1, 287]; *United States* v. *St. Louis, etc., Ry. Co.*, 270 U. S., 1, 3; *Fullerton Co.* v. *Northern Pacific*, 266 U. S., 435; *Cox* v. *Hart*, 260 U. S., 427, 434; *S. W. Coal Co.* v. *McBride*, 185 U. S., 499, 503.) And such we consider the better rule in regard to departmental decisions. (*Shearer* v. *Anderson*, 16 F. (2d), 995 [T. D. 3860, C. B. V-1, 239]. See also 26 U. S. C. A., section 1251, and as amended May 10, 1934 (48 Stat., 757).)

We are aware that the foregoing construction has not been uniformly placed upon Treasury Decision 3435, but we think it best accords with the language used, and also with the pertinent canons of construction.

It follows that Treasury Decision 3435, relied upon by the taxpayers as the basis of their complaints, has no application to the facts set up.

For the foregoing reasons, we think that the demurrers were rightly sustained.

The judgments are affirmed.

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ARTICLE 31: What included in gross income.

REVENUE ACT OF 1926 AND PRIOR REVENUE ACTS.

Taxability of income of restricted Indians of the Five Civilized Tribes. (See G. C. M. 16020, page 78.)

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ARTICLE 31: What included in gross income.

REVENUE ACT OF 1926 AND PRIOR REVENUE ACTS.

Taxability of income of restricted members of the Osage Indian Tribe. (See G. C. M. 16100, page 80.)

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ARTICLE 31: What included in gross income.

REVENUE ACT OF 1926 AND PRIOR REVENUE ACTS.

Proceeds of embezzlement. (See G. C. M. 16572, page 82.)

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ARTICLE 32: Compensation for personal services. XV-20-8090 Ct. D. 1118

INCOME TAX—REVENUE ACT OF 1924—DECISION OF COURT.

INCOME—RECEIPT OF STOCK—COMPENSATION FOR SERVICES.

Pursuant to a contract between the taxpayers and the heirs of the deceased owner of a corporation of which the taxpayers had been employees, a new corporation was organized, which the taxpayers were to manage and control and the preferred and common stock of which was to be issued to the heirs. The heirs conveyed to the new corporation the assets of the old, and, pursuant to the contract, transferred the new common stock to the taxpayers. Such transfer was not a gift, but was made in compensation for past and future services, and the value of the stock so received constituted income to the taxpayers within the meaning of section 213 of the Revenue Act of 1924.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT.

*Clemons H. Davis, petitioner,* v. *Commissioner of Internal Revenue, respondent.*

*Hugo Miller, petitioner,* v. *Commissioner of Internal Revenue, respondent.*

*Lovell R. Kraus, petitioner,* v. *Commissioner of Internal Revenue, respondent.*

Petitions to review decisions of the United States Board of Tax Appeals.

Before MOORMAN, HICKS, and ALLEN, Circuit Judges.

[January 10, 1936.]

OPINION.

MOORMAN, Circuit Judge: Hugo Scherer was the owner of the Hugo Scherer Land Co., the Detroit Forging Co. and the St. Clair-Athol Rubber Co. Petitioners were employees of the Scherer company. In November of 1923 Scherer died, leaving a will in which he devised all of his property to his wife and two daughters. About four months later his wife and daughters made a contract with petitioners by which the petitioners agreed to organize a new corporation, Davis, Kraus & Miller, Inc., with an authorized capital stock, half 6 per cent cumulative preferred and half common, equal in capital value to the value of the net assets of the Scherer company, the wife and daughters agreeing, in consideration of the issue to them of all the stock, to convey to the corporation the assets of the Scherer company, and then to transfer to the petitioners the common capital stock. The agreement was promptly carried out and the common stock of the new corporation assigned to the petitioners in equal parts. Each of the petitioners treated this stock, in his income tax return for the year 1924, as a gift. The respondent was of opinion that its value as of the date received was income and made deficiency assessments, which the Board of Tax Appeals sustained.

The question presented to us is whether there is evidence in the record to support the finding of the Board that the stock was income within the meaning of the Revenue Act of 1924 (ch. 234, 43 Stat., 253, section 213, 26 U. S. C. A., section 954(a)). It is not contended that the facts found by the Board are lacking in evidentiary support, but that they show gifts not taxable under the applicable Act. In our opinion they are sufficient to justify the Board's conclusion that the stock was transferred to the petitioners to compensate them for past and future services, and that is true, we think, though there was no legal obligation on the part of the wife and daughters to pay for past services or to make the transfers. (*Old Colony Trust Co.* v. *Commissioner*, 279 U. S., 716 [Ct. D. 80, C. B. VIII–2, 222]; *Noel* v. *Parrott*, 15 Fed. (2d), 669 (C. C. A. 2) [T. D. 3908, C. B. V–2, 149]; *Bass* v. *Hawley*, 62 Fed. (2d), 721 (C. C. A. 5) [Ct. D. 693, C. B. XII–2, 169]; *Levey* v. *Helvering*, 68 Fed. (2d), 401 (C. A. D. C.); *United States* v. *McCormick*, 67 Fed. (2d), 867 (C. C. A. 2); *Fisher* v. *Commissioner*, 59 Fed. (2d), 192 (C. C. A. 2).)

Each of the petitioners had been a valuable employee and active in the management of the Scherer company for many years. At one time or another each had contemplated severing his connection with the company and entering some other business but had been led by Scherer to believe that he would be compensated beyond his salary if he remained with the company. Each remained until after Scherer's death. The agreement with the wife and daughters stated that the common stock of the new company would be given to the petitioners "in full settlement and adjustment of any and all claims." It also provided that the petitioners should be the officers of the new company, and they agreed to devote their entire time to its business. They further agreed that the new company would act as sales agent for the Detroit Forging Co. and the St. Clair-Athol Rubber Co., which were owned by the wife and daughters. It is clear from these provisions in the contract that the wife and daughters had faith in the ability and integrity of the petitioners, and wishing to protect their own interests in the new company decided to place the control and management of it in the petitioner's hands by giving them the common stock. The profitable operation of the Detroit Forging Co. and the St. Clair-Athol Rubber Co. also depended on the efficient management of the new company. The benefits which the wife and daughters thus expected to receive, together with the past services of the petitioners, for which they were no doubt grateful, constituted ample consideration for the transfer of the stock.

The orders of the Board of Tax Appeals are affirmed.

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ARTICLE 50: When included in gross income. XV–25–8134
I. T. 2982

REVENUE ACT OF 1918.

Office Decision 825 (C. B. 4, 95) is revoked, in view of G. C. M. 16730. (See page 179.)

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

ARTICLE 88: Compensation of State officers and employees.

REVENUE ACTS OF 1924 AND 1926.

Taxability of compensation received by officers and employees of a State or political subdivision. (See Mim. 3838, revised, page 130.)

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ARTICLE 88: Compensation of State officers and employees.

REVENUE ACT OF 1926.

Attorney for irrigation district. (See Ct. D. 1114, page 226.)

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ARTICLE 90: Income accrued prior to March 1, 1913. XV-5-7931 Ct. D. 1073

INCOME TAX—REVENUE ACT OF 1926—DECISION OF SUPREME COURT.

INCOME—CAPITAL—PATENT INFRINGEMENT—PROFITS RECEIVED BY INFRINGER PRIOR AND SUBSEQUENT TO MARCH 1, 1913.

Where the taxpayer brought suit in 1912, alleging infringement of a patent, and for an accounting of profits from such infringement, which claim was contested until 1915 and the amount thereof undetermined until 1925, when the taxpayer accepted a settlement of the profits received by the infringer between January 1, 1909, and April 30, 1914, the portion of the settlement attributable to acts of infringement prior to March 1, 1913, was not capital, but the entire amount constituted income, fully accrued and taxable in 1925. The taxpayer is not entitled to a deduction on the basis of a difference between the value of the chose in action on March 1, 1913, or at any other time and the proceeds of collection, nor to a refund of the proportion of the settlement attributable to the profits of the infringer before the effective date of the sixteenth amendment.

SUPREME COURT OF THE UNITED STATES.

No. 75. *United States of America, petitioner,* v. *Safety Car Heating & Lighting Co.*

No. 76. *John R. Rogers, Collector of Internal Revenue for the Fifth District of New Jersey, petitioner,* v. *Safety Car Heating & Lighting Co.*

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

[January 6, 1936.]

OPINION.

Mr. Justice CARDOZO delivered the opinion of the Court.

The respondent claims a refund of income taxes under the Revenue Act of 1926. The petitioner in one of the cases (No. 75) is the United States, a defendant in the court below. The petitioner in the other (No. 76) is the collector of internal revenue for the fifth district of New Jersey.

Since 1907, the taxpayer, respondent, has been the owner of the Creveling patent for an improvement in the electric lighting equipment of railway passenger cars. It brought suit in 1912 against the United States Light & Heating Co. to restrain an infringement of the patent, and for an accounting of damages and profits. The suit was pending on February 25, 1913, the effective date of the sixteenth amendment, and on March 1, 1913, the effective date of the first statute enacted thereunder. (Act of October 3, 1913, ch. 16, 38 Stat., 114, 166, 168, 172, 174.[1]) The accused infringer contested its liability for infringement as well as its liability for damages and profits. Not till 1915 was the capital fact of an infringement determined. On February 15, 1915, there was entered in the district court an interlocutory decree for an injunction, which was affirmed by the circuit court of appeals in July of the same year. An accounting followed before a master and continued for eight years. On that accounting the complainant waived any recovery for damages, and confined its claim to the profits received by the infringer. On May 26, 1923, the master filed his report in which he found that there was due to the complainant for profits received by the infringer between January 1, 1909, and April 30, 1914, the sum of $501,180.32. Of this award, a large part ($436,137.41) was for profits applicable to the period before March 1, 1913. The report was confirmed by the district court on October 10, 1923, at which time the infringing defendant was in the hands of receivers. A final decree followed in October, 1924, the award being adjudged to constitute a superior lien upon the assets of the infringer then held by a successor. Cross-appeals were carried to the Court of Appeals for the Second Circuit, the complainant contending that the award was too small, the infringer and its successor contending that the award was too large and that error had been committed also in the declaration of the lien. While the appeals were undetermined, the complainant accepted a settlement in May, 1925, after 13 years of litigation, whereby it received from the infringer the sum of $200,000 in satisfaction of the judgment. After deducting the expenses incurred in connection with the suit ($23,468.05), the net amount collected was $176,531.95, of which part ($153,621.72) is attributable to acts of infringement before March 1, 1913, and part to such acts thereafter.

In May, 1926, the taxpayer filed its income tax return for 1925, showing a net income for that year of $1,473,187.13, and a tax due thereon of $172,610.19, which has been paid. It did not include in the return any part of the proceeds of the patent litigation ($176,531.95), nor did it claim any deduction for loss resulting from the settlement. Thereupon the Commissioner made a deficiency determination of $22,162.07, plus interest, the additional tax due after adding the net proceeds of the settlement to the income of the year. Two claims for refund followed. The first, filed in March, 1929, was for $69,729.18. The taxpayer took the ground that as a result of the settlement it had sustained a loss of $536,378.28, which through error it had failed to deduct in making its return and in paying the tax thereunder. Its books were kept on the accrual basis. The second of the two claims, filed in July, 1930, was for an additional refund in the amount of $19,970.82. In this the taxpayer took the ground that in determining the gross income for 1925 the Commissioner had erred by including that part of the proceeds of the settlement attributable to acts of infringement before March, 1913. Both claims were rejected by the Commissioner. The taxpayer then sued, making the United States the defendant with reference to the first claim and the collector the defendant with reference to the second.

In the suit against the United States the district court found that the taxpayer's claim for damages on account of so much of the infringement as had occurred before March 1, 1913, had a "market value" on that date of $436,137.41, the profits of the infringer up to that time as reported by the master. From this the court concluded that in the year 1925 there had been a deductible loss of the difference between $436,137.41 and the sum of $174,040.62, a like proportion of the $200,000 actually recovered. The tax upon this difference ($262,096.79) was $34,072.58. The taxpayer received an award of judgment for that amount with interest. (5 F. Supp., 276.) In the suit against the collector, the district court held that such portion of the net settlement as was allocable to acts of infringement before March 1, 1913 ($153,621.72), had accrued to the taxpayer in advance of that date, and was therefore to be treated as capital, not taxable as income for the year when the settlement was made. The taxpayer received an award of judgment for the tax on that amount (i. e., for $24,732.90) with interest.

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[1] With reference to every corporation subject thereto, that Act provides as follows: "The tax herein imposed shall be computed upon its entire net income accrued within each calendar year ending December 31: *Provided, however,* That for the year ending December 31, 1913, said tax shall be imposed upon its entire net income accrued within that portion of said year from March 1 to December 31, both dates inclusive, to be ascertained by taking five-sixths of its entire net income for said calendar year." (38 Stat., 174.)

The Circuit Court of Appeals for the Third Circuit affirmed the judgments in both suits. (76 F. (2d), 133.) To fix more precisely the taxable quality of contested and contingent choses in action belonging to a taxpayer before March 1, 1913, writs of certiorari issued from this Court.

First. Congress intended, with exceptions not now important, to lay a tax upon the proceeds of claims or choses in action for the recovery of profits, unless the right to such recovery existed unconditionally on March 1, 1913, the effective date of the first statute under the sixteenth amendment.

The tax imposed on the respondent was laid under the Revenue Act of 1926 (ch. 27, 44 Stat., 9), which includes in gross income (section 213(a)) gains on profits "from any source whatever." We have said of that Act that it reveals in its provisions an intention on the part of Congress to reach "pretty much every sort of income subject to the Federal power." (*Helvering* v. *Stockholms Enskilda Bank*, 293 U. S., 84, 89 [Ct. D. 887, C. B. XIII-2, 299].) There is no denial that profits owing to a patentee by the infringer of a patent are income within the meaning of the statute, unless withdrawn from that category by the date of the infringement. (Cf. Treasury Regulations 45, article 52; Treasury Regulations 62, article 51; Treasury Regulations 65, article 50; Treasury Regulations 69, article 50; *Commissioner* v. *S. A. Woods Machine Co.*, 57 F. (2d), 635 [Ct. D. 666, C. B. XII-1, 275].)

Until July, 1915, the existence of any liability was contested and uncertain. The amount remained contested and uncertain until May, 1925, when there was a settlement of that liability reported by the master. Then for the first time the profits flowing from the infringement became taxable as income. (*North American Oil Consolidated* v. *Burnet*, 286 U. S., 417, 423 [Ct. D. 499, C. B. XI-1, 293]; *Lucas* v. *American Code Co.*, 280 U. S., 445, 451, 452 [Ct. D. 168, C. B. IX-1, 314]; *Lucas* v. *North Texas Co.*, 281 U. S., 11 [Ct. D. 169, C. B. IX-1, 294]; *Burnet* v. *Huff*, 288 U. S., 156 [Ct. D. 640, C. B. XII-1, 220].) The respondent admits this to be true to the extent that the acts of infringement were later than February, 1913. The argument seems to be, however, that accrual has a different meaning when applied to income generated by acts committed earlier. But plainly the respondent's exemption, if it exists, will have to rest upon some other basis. A claim for profits so contingent and indefinite as to lack the quality of accrued income in March, 1913, can not have had the quality of such income before that time, its existence and extent being then equally uncertain. Only an arbitrary dichotomy could bring us to the conclusion that part of the recovery was income to the taxpayer as of the date of payment or collection and part as of the date of the underlying wrong. The respondent, to prevail, must be able to make out that though the profits were income in their entirety as of May, 1925, there was an intention of the Congress that part of this income, the part attributable to acts before March, 1913, should be excluded from the reckoning.

We find no disclosure of that intention in the provisions of the statute, and none in the history of other Acts before it. The first statute following the sixteenth amendment laid a tax, as we have seen, on the entire net income "accrued" within each calendar year, the impost being coupled with a proviso that for the year 1913 what was to be taxed should be the entire net income "accrued" within that portion of the year from March 1 to the end. Definiteness of meaning was given to that and later Acts by Treasury regulations. Article 90 of Regulations 62, adopted in 1922, provides: "Any claim existing unconditionally on March 1, 1913, whether presently payable or not, and held by a taxpayer prior to March 1, 1913, whether evidenced by writing or not" does "not constitute taxable income, although actually recovered or received subsequent to such date." This provision appears without change of form in all Treasury regulations adopted since that time. (Treasury Regulations 65, article 90; Treasury Regulations 69, article 90; Treasury Regulations 74, article 91; Treasury Regulations 77, article 90.) It appears with unimportant verbal differences in earlier regulations. (Treasury Regulations 45, article 87, as amended by T. D. 3206, C. B. 5, 116.) A claim existing "unconditionally" would include a claim for interest on a bond or for rent under a lease. A claim existing conditionally can have no better illustration than is found in a claim to recover an infringer's profits. (Cf. O. D. 917, C. B. 4, 142; O. D. 1141, C. B. 5, 134; S. M. 2285, C. B. III-2, 87, 89, 90, disapproving I. T. 1294, C. B. I-1, 111.) Nor does the case for the Government stand upon the regulations alone without confirmatory evidence. By clear implication the regulations have been ratified by Congress, which has passed Revenue Acts at frequent intervals thereafter without a sign of disapproval. "Congress must be taken to have been familiar with the existing administrative interpretation." (*McFeely* v. *Commissioner*, November 11, 1935, — U. S., — [Ct. D. 1040, C. B. XIV–2, 209]; *Zellerbach Paper Co.* v. *Helvering*, 293 U. S., 172, 179, 180 [Ct. D. 891, C. B. XIII–2, 347].) Claims existing unconditionally before March 1, 1913, being thus excluded from the tax, the plain meaning of the regulation is that conditional or contingent claims, though they may have had an inchoate existence before March 1, 1913, are to be taxed when they are shorn of their conditional or contingent quality and become unconditional or absolute. So far as the problem to be solved depends upon the intention of the Congress in the enactment of the statute, the result is hardly doubtful.

Whatever obscurity exists has its origin, one may believe, in a not uncommon confusion of the rule with the exception. There is a tendency now and again to look upon March 1, 1913, as fixing a point of time when claims of every kind, no matter how contingent, became transmuted into capital, at least for taxing purposes. This is far from the truth, as the acceptance by Congress of the foregoing regulations sufficiently attests. The intention has rather been that, with exceptions specially declared or dependent upon considerations of established methods of accounting, every form of income accruing fully or unconditionally after February, 1913, shall contribute to the Treasury, though it had a potential existence for years before its capacity to fructify. As already suggested, perception of this intention has been clouded by exceptions, actual or seeming, which have been so insulated and emphasized as to be taken for the rule itself. Thus, Congress has now provided (see, e. g., Revenue Act of 1916, ch. 463, section 2(a), 39 Stat., 756, 757; Revenue Act of 1921, ch. 135, section 201, 42 Stat., 224, 228; Revenue Act of 1926, ch. 27, section 201, 44 Stat., 9, 10) that dividends may be distributed exempt from the tax to the extent that they are made out of earnings or profits accumulated before March 1, 1913. The exemption is "a concession to the equity of stockholders" (*Lynch* v. *Hornby*, 247 U. S., 339, 346; *Helvering* v. *Canfield*, 291 U. S., 163, 167 [Ct. D. 783, C. B. XIII–1, 176]), and had no existence under the pioneer statute, the Act of 1913, a dividend, irrespective of its source, being then taxable altogether. (*Lynch* v. *Hornby*, supra.) So Congress has now provided (see, e. g., Revenue Act of 1924, ch. 232, 43 Stat., 253, 259, section 204(11)b; supra, section 204(b); Revenue Act of 1926, supra, section 204(b)) that in computing gain or loss from the sale or other disposition of property acquired before March 1, 1913, the base shall be the cost or the value on that day, whichever is the greater. (See also, Revenue Act of 1916, supra, section 2(c); Revenue Act of 1921, supra, section 202(b)1. Cf. *Merchants' L. & T. Co.* v. *Smietanka*, 255 U. S., 509 [T. D. 3173, C. B. 4, 34]; *Goodrich* v. *Edwards*, 255 U. S., 527 [T. D. 3174, C. B. 4, 40].) We are not unmindful of cases in which a like formula was applied without the aid of statute. (*Lynch* v. *Turrish*, 247 U. S., 221; *Doyle* v. *Mitchell Bros. Co.*, 247 U. S., 179; *Hays* v. *Ganley Mt. Coal Co.*, 247 U. S., 189; and cf. *MacLaughlin* v. *Alliance Insurance Co.*, 286 U. S., 244, 251 [Ct. D. 496, C. B. XI–1, 124].) They do not rule the case at hand. In those cases and others like them assets that were capital in February, 1913, had been converted into cash thereafter. Coal lands and timberlands and timber had been sold by an owner in the ordinary course of business. By the practice of merchants a stock in trade is capital according to its inventory value. (*Hays* v. *Ganley Mt. Coal Co.*, supra, at page 193.) Nothing of the kind is here. The case is not helped by speaking of the claim as "property." The question is whether it is property that has been transmitted into capital. In February, 1913, the chose in action now assessed was not a part of the respondent's capital as merchants or other business men would understand the term. (Cf. *North American Oil Consolidated* v. *Burnet*, supra.) At best it was contingent income, the income of the future. It had no inventory value, much less a value quoted in the market. Whether it would ever be worth anything was still unknown and unknowable. The answer was not given for many years thereafter.

The argument is pressed upon us that the claim collected by the respondent is to be viewed as one for damages rather than as one for profits, and that in the aspect of a claim for damages it had a "market value" ascertainable at the commencement of the suit and later. There are two reasons, if not more, why the argument must fail. In the first place, the respondent made an election to abandon any claim for damages and to confine itself to the profits received by the infringer. The amount of these profits was unknown at the commencement of the suit and must needs have remained unknown in advance of an accounting. To determine what the respondent got we are to consider what it did, and not what it could have had if it had made another choice. In the second place, a claim for damages like one for an infringer's profits is too contingent and uncertain to have a determinable market value when the validity of the patent is unsettled and contested and the factors making up the damage are arrived at by conjecture. (*Sinclair Refining Co.* v. *Jenkins Petroleum Co.*, 289 U. S., 689, 697. Cf. *Heiner* v. *Crosby*, 24 F. (2d), 191; *Walter* v. *Duffy*, 287 Fed., 41.) There is significance in the fact that the estimate of the damage in the claim filed with the Commissioner exceeded by nearly $300,000 the estimate of the damage accepted at the trial.

The case comes down to this: On February 28, 1913, the respondent had a contested claim for profits which if prosecuted effectively would ripen into income. That claim would not have been capital if it had been acquired for the first time on March 1, 1913. It was not turned into capital because it had been acquired earlier. (*Edwards* v. *Keith*, 224 Fed., 585; 231 Fed., 110; *Workman* v. *Commissioner*, 41 F. (2d), 139.) Before March 1, 1913, and afterwards, it was continuously the same thing until reduced to judgment and collected. The case is not to be confused with one where the basis of the suit is an injury to capital, with the result that the recovery is never income, no matter when collected. Examples of such a claim are *Saunders* v. *Commissioner* (29 F. (2d), 834) and *Heiner* v. *Hewes* (30 F. (2d), 787), cited by the taxpayer. *Buffalo Union Furnace Co.* v. *Helvering* (72 F. (2d), 399) is perhaps upon the border line, the claim being not for profits, but for recovery of out of pocket expenses. Confining it to its peculiar facts, we do not read it as inconsistent with the views herein expressed.

Second. Congress was not restrained by express or implied restrictions of the Federal Constitution from giving effect to its intention and levying a tax upon the proceeds of the settlement.

In February, 1913, if our analysis of the facts is accurate, there was a contested and contingent claim for profits, not fairly to be characterized as income for that year or earlier. In 1925, this inchoate and disputed claim became consummate and established. It was now something more than a claim. It was income fully accrued, and taxable as such. Till then the patentee had its capital, the patent, and an expectancy of income, or income, more accurately, in the process of becoming. Thereafter it had something different. No doubt the income thus accrued derived sustenance and value from the soil of past events. We do not identify the seed with the fruit that it will yield.

Income within the meaning of the sixteenth amendment is the fruit that is born of capital, not the potency of fruition. With few exceptions, if any, it is income as the word is known in the common speech of men. (*Lynch* v. *Hornby*, supra, page 344.) When it is that, it may be taxed, though it was in the making long before. (*MacLaughlin* v. *Alliance Insurance Co.*, supra, at pages 249, 250; *Taft* v. *Bowers*, 278 U. S., 470 [Ct. D. 49, C. B. VIII-1, 226]; *Helvering* v. *Canfield*, supra. Cf. *Lucas* v. *Alexander*, 279 U. S., 573, 577, 578 [Ct. D. 76, C. B. VIII-2, 273]; *Towne* v. *Eisner*, 245 U. S., 418; *Eisner* v. *Macomber*, 252 U. S., 189, 206, 207 [T. D. 3010, C. B. 3, 25].) If exceptions are to be allowed in exceptional conditions, they are inapplicable here.

Third. The taxpayer is not entitled to a deduction on the basis of a difference between the value of the chose in action on March 1, 1913, or at any other time and the proceeds of collection.

(*a*) At the time of the settlement, the amount of the infringer's liability was contested as it had been before, the outcome of the contest being uncertain as long as the appeal was pending. The respondent chose to forego a large portion of the judgment in the belief that compromise was prudent. For all that appears, if compromise had been rejected, the judgment would have been so reduced as to make the recovery even less. True the respondent insists that the fear of a reduction was not the motive for the settlement. The motive is said to have been the fear that the judgment, even if not reduced, might not be susceptible of collection. On the other hand, the infringer may have viewed the prospects differently. We have no means of ascertaining whose forecast was the better. What we know is that here was a compromise through which patentee and infringer surrendered rights and opportunities.

(*b*) The value of the chose in action, uncertain at the time of settlement, was even more uncertain in February, 1913. Unpredictable vicissitudes might reduce it to a nullity. The patent might be adjudged invalid. The infringer might become insolvent. In the earlier years as in the later ones the supposed profits of the business might have evaporated as the result of neglect or incapacity.

Not till the report by the master and its confirmation by the court could the recovery be estimated with even approximate correctness. There is no contention by the respondent that the value of the judgment was greater at that time than it was a few months later at the date of the settlement in the face of an appeal.

The conclusion is inescapable that the acceptance of the settlement did not involve a loss of income, still less a loss of capital.

Fourth. The taxpayer is not entitled to a refund of the proportion of the settlement attributable to the profits of the infringer before the effective date of the sixteenth amendment.

This conclusion follows without need for elaboration from what has been said in this opinion as to the distinction between capital and income.

The judgments are reversed.

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## SECTION 214(a)1.—DEDUCTIONS ALLOWED INDIVIDUALS: BUSINESS EXPENSES.

ARTICLE 112: When charges deductible. XV–25–8135
I. T. 2983

REVENUE ACT OF 1918.

Office Decision 1141 (C. B. 5, 134) is modified in so far as it is inconsistent with G. C. M. 16730. (See page 179.)

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## SECTION 214(a)4, 5, 6.—DEDUCTIONS ALLOWED INDIVIDUALS: LOSSES.

ARTICLE 141: Losses. XV–14–8031
I. T. 2966

REVENUE ACT OF 1926.

I. T. 2217 (C. B. IV–2, 53) and I. T. 2231 (C. B. IV–2, 115) are modified, in view of G. C. M. 16255. (See page 4.)

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ARTICLE 141: Losses. XV–15–8037
Ct. D. 1103

INCOME TAX—REVENUE ACT OF 1926—DECISION OF COURT.

1. DEDUCTION—LOSSES—PAYMENTS MADE IN COMPROMISE OF LIABILITY UNDER CONTRACTS OF INDORSEMENT AND GUARANTY.

Where the principal stockholder of a corporation made payments in 1926 and 1927, out of his personal funds, in compromise settlement of his liability under certain indorsements and guaranties of notes and obligations of the corporation, which had become insolvent in 1924, such payments being made as part of an agreement with creditors whereby the corporation was enabled to continue in business, he is not entitled to deduct the amount of the payments as losses, under the provisions of section 214(a) (4) or (5) of the Revenue Act of 1926.

2. DECISION AFFIRMED.

Decision of the Board of Tax Appeals (29 B. T. A., 169) affirmed.

3. CERTIORARI DENIED.

Petition for certiorari denied December 16, 1935.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

*Jeremiah G. Menihan, petitioner-appellant,* v. *Commissioner of Internal Revenue, respondent-appellee.*

Petition to review a decision of the Board of Tax Appeals sustaining deficiencies in income taxes for the years 1926 and 1927. Affirmed.

Before L. HAND, AUGUSTUS N. HAND, and CHASE, Circuit Judges.

[July 30, 1935.]

OPINION.

CHASE, Circuit Judge: In 1924, the petitioner, a resident of Rochester, N. Y., was president of the Menihan Co., a New York corporation, engaged in the business of manufacturing ladies' shoes. The corporation's capital stock consisted of 500 shares, of which the petitioner owned 497 and controlled the other 3, which stood in the name of his nominees for qualification purposes. During the three years immediately preceding, the corporation had expanded rapidly, and in 1924, because of a serious strike in one of its plants coupled with adverse trade conditions, it had become insolvent. The petitioner had indorsed its notes and guaranteed its accounts to the amount of $655,695.14 and had also become insolvent.

With the affairs of his corporation and himself in this situation, he applied to creditors for an adjustment in an endeavor to avoid bankruptcy proceedings and save the business if possible. A creditor's committee was formed to which he transferred all the Menihan Co. stock to enable it to assume complete control of the business. A voting trust agreement was subsequently made under which the stock was held. The creditors' committee took over the business and employed the petitioner to manage it at a salary plus a percentage of the net profits above an amount stated. A plan of reorganization was finally agreed to by all concerned which provided that the bank creditors of the corporation should receive, in full satisfaction of the liability of the corporation on their claims, bonds of the corporation of the face value of 50 per cent of their claims secured by a mortgage upon the real estate of the corporation subject to existing liens, and that all other creditors should accept the promissory notes of the corporation to the amount of 50 per cent. It was agreed that the voting trust should continue for the protection of the creditors until the bonds and notes were paid in full. The petitioner also agreed that the acceptance by creditors of the corporation's offer of compromise " shall in no wise lessen, modify, alter or release me from any liability on account of any indorsement or guaranties which I may have heretofore given on account of the Menihan Co." The petitioner reached an agreement with the creditors of the corporation holding paper he had indorsed or claims he had guaranteed to pay 15 per cent of those debts in full discharge of his personal liability upon the express condition that his payment of the 15 per cent should not be made the basis of any claim by him against the company. To secure the payment of notes he gave to pay 15 per cent of such claims, the petitioner executed and delivered to the Union Trust Co. of Rochester a deed of trust dated October 1, 1924, though not formally executed until June 30, 1925, which covered his home; 10 notes of the Menihan Co., each for $2,732.71, which had been given him on account of his payment of debts of the corporation out of his own funds; the voting trust certificate for the stock he had transferred to the creditors' committee; and a one-half interest in the bonus he might receive under his employment contract as manager of the corporation. Upon his payment of the notes the property so placed in trust was to be returned to him.

The petitioner paid $12,877.36 in 1925 on account of the agreement to pay the 15 per cent to discharge his liability as indorser or guarantor for the corporation. He claimed this amount as a deductible loss for that year and the Commissioner allowed it. In 1926 he paid $16,469.34, and in 1927 $68,-645.09, for a like purpose, and claimed a deductible loss in each year of the amount so paid. The Commissioner disallowed both of these deductions on the ground that the payments were capital contributions rather than losses. The decision of the Board of Tax Appeals sustaining the disallowance of the deductions is here for review.

In 1927 the Menihan Co. itself had outstanding notes and bonds which it had given its creditors under the 50 per cent compromise agreement which required $68,769.96 for their redemption. The petitioner in that year advanced $78,769.96 to the corporation which was used to retire the bonds and notes and to give him a credit of $10,000. He treated this advance as a capital expenditure for which he claimed no deduction. By such advance and the payment of his obligation to the extent of 15 per cent of the corporation's debts, he succeeded in having the compromise settlement with creditors fully carried out and regained his former control of the corporation. His stock was returned to him by the creditors' committee on April 28, 1927 in accordance with the terms of the voting trust agreement. Thereafter the corporation was reorganized.

The deductions are claimed under section 214 of the Revenue Act of 1926 (ch. 27, 44 Stat., 9; U. S. C. A., section 955). They are in all respects, except in amount, the same as the deduction allowed in 1925. The Commissioner declined to follow his former ruling.

Since payment by the petitioner created no debt against the corporation in view of his agreement that it should not, subdivision (a)(7) of the above section relating to debts ascertained to be worthless and charged off during the taxable period is inapplicable for that reason alone. No one owed him any debt, because of his payments, which he could ascertain to be worthless and charge off. The inquiry comes down to whether or not the payments were deductible losses sustained either in his trade or business (subdivision (a)(4) of section 214), or in a transaction entered into for profit though not connected with trade or business (subdivision (a)(5) of section 214). Although the petitioner owned or controlled all of the stock of the Menihan Co. any loss which was incurred in its trade or business was that of the corporation. It was a separate and distinct entity doing business for itself and not as the petitioner's agent. Whatever losses were incurred in that business were deductible, if at all, only from the income of the corporation itself. (See *Dalton* v. *Bowers*, 287 U. S., 404 [Ct. D. 621, C. B. XII-1, 177].) There is no basis appearing in this record for disregarding the corporate structure. The fact that petitioner owned or controlled all of the corporation's stock is alone insufficient ground for that. (*American Union Line* v. *Oriental Nav. Corporation*, 239 N. Y., 207.) Indeed, the petitioner insists that the usual distinction between corporation and stockholder should be preserved here, and with that we are in entire agreement.

The gist of the petitioner's case is that because the petitioner had previously indorsed the corporation's notes and guaranteed its obligations, he had incurred a liability which he made definitely his own individual debt to the extent of 15 per cent of such obligations of the corporation when he made the adjustment for the settlement of his liability to its creditors upon that basis; and that, as his payments gave him no right to recourse against the corporation, he lost the amounts so paid when he paid them. As the returns filed by the petitioner for the years in question were on the cash receipts and disbursements basis, he may take deductible losses in the taxable period when they are paid in cash. (*Eckert* v. *Burnet*, 283 U. S., 140 [Ct. D. 325, C. B. X-1, 241].)

The adjustment, however, which is now said to have made his own the obligations he discharged for cash in 1926 and 1927, was but a part of the entire arrangement which saved both the corporation and the petitioner from bankruptcy. Creditors of the corporation had the security of the deed of trust he gave for the performance of his promise. That deed of trust covered all his stock in the corporation. Without the adjustment, his stock was worthless. His agreement saved that stock, and, though we are not informed as to just how valuable it became, in 1926 and 1927 its value greatly exceeded what the petitioner paid the corporation's creditors to secure its return to him.

When he indorsed the corporation's paper and guaranteed its debts, he was not in the indorsement or guarantee business, but clearly did that to protect his own previous investment. (See *Burnet* v. *Clark*, 287 U. S., 410 [Ct. D. 620, C. B. XII-1, 175].) When he discharged the liability, whether it had become his alone to the extent he paid or remained secondary to that of the corporation, he was but performing his part of the compromise agreement which preserved the value of his investment. Whether he will ever sustain any loss as a result depends upon the value of that stock when events take place which close the transaction for taxation purposes. (*De Loss* v. *Commissioner*, 28 Fed. (2d), 803.) Until then the petitioner has but added to his investment in the corporate stock. Nothing took place during 1926 or 1927 to make it possible to determine that the payments he made in those years were losses. They are, on this record, in the same category with the additional capital contribution of $78,769.96 which he made to help rehabilitate the corporation and were capital investments still at risk during the taxable years in which the deductions are claimed.

Affirmed.

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## SECTION 214(a)7.—DEDUCTIONS ALLOWED INDIVIDUALS: BAD DEBTS.

ARTICLE 151: Bad debts.

XV-17-8058
Ct. D. 1108

INCOME TAX—REVENUE ACT OF 1926—DECISION OF COURT.

DEDUCTION—LOSS—DEBT ASCERTAINED TO BE WORTHLESS.

A mercantile company in 1920 asserted a claim against a concern from which it had purchased goods, alleging that the material delivered was defective, but the goods were used for another purpose than that for which purchased. The claim was never litigated, although the seller was a responsible concern, and in 1927 the account was charged off as uncollectible. Under these circumstances, the company is not entitled to a deduction in 1927, either for a loss sustained or for a debt ascertained to be worthless during the taxable year.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT.

*The H. D. Lee Mercantile Co., petitioner,* v. *Commissioner of Internal Revenue, respondent.*

On petition to review the decision of the United States Board of Tax Appeals.

Before LEWIS, PHILLIPS, and MCDERMOTT, Circuit Judges.

[August 26, 1935.]

OPINION.

MCDERMOTT, Circuit Judge, delivered the opinion of the court.

In its return of income for 1927, petitioner deducted $42,688.91 as a business loss. The Commissioner disallowed it and the Board of Tax Appeals affirmed. The circumstances are these:

In 1919 petitioner ordered 500,000 yards of cloth from Woodward, Baldwin & Co., for delivery between March and September, 1920, at 39½ cents a yard. Thirty thousand yards were delivered in April, 1920, made up into clothing and paid for. Petitioner claimed the cloth was not up to standard. Additional shipments came in until August, 1920, totaling 103,000 yards. These shipments were paid for on the invoice, taking advantage of the trade discount, before arrival of the goods covered thereby. In November, 1920, petitioner invoiced the cloth back to the seller and charged its account with the price plus interest and expenses—the amount now involved. In the spring of 1921 efforts were made to adjust the controversy, the seller offering to take back the goods and cancel out the balance of the order if petitioner would either give it a new order for 300,000 yards at 26 cents a yard or pay 5½ cents a yard for cloth undelivered under the contract. It thus appears that the market price had materially declined since the order was given, and that each asserted a claim against the other. Nothing came of these negotiations. Petitioner made the cloth up into garments, using it for linings for which cheaper cloth ordinarily was used. No credit was given the seller, nor the Government in this claim, for the value of the cloth used. Nothing more occurred except occasional statements by Mr. Lee to his employees that he believed the account collectible, until 1927 when Mr. Lee told his auditor, for the first time, that he was in doubt about collecting it. In 1927 it was charged off. Mr. Lee died in 1928 from an illness with which he was stricken in 1927.

The petition to review does not point out the section under which the deduction is claimed, merely asserting that the Board erred in holding it "is not a legal loss and an allowable deduction." The brief and oral argument are almost as vague, the position taken being that the facts give rise either to a "loss sustained during the taxable year and not compensated for by insurance or otherwise" or a "debt ascertained to be worthless and charged off within the taxable year." (Sections 234(a) 4 and 5, Revenue Act 1926, 44 Stat., 41.) Counsel indicates no preference between these sections which are mutually exclusive (*Spring City Co.* v. *Commissioner*, 292 U. S., 182, 189 [Ct. D. 829, C. B. XIII-1, 281]); we are left to understand that either section selected by the court will be satisfactory to counsel.

The record discloses neither a loss nor a worthless debt during the taxable year. Even if the cloth was not up to contract, the seller was a large and responsible concern, amply able to respond for breaches of contract. For the same reason, the debt was not worthless, even if an unadjudicated claim for breach of contract can be considered a debt, as has otherwise been held. (*Lewellyn* v. *Elec. Reduction Co.*, 275 U. S., 243, 246; *Wadsworth Mfg. Co.* v. *Commissioner* (C. C. A. 6), 44 F. (2d), 762.) It is a startling proposition that a taxpayer may, for reasons of his own, decline to enforce a valid claim against a responsible concern and then assert that he has sustained a business loss which the Government should share. "Obviously, the mere refusal to perform a contract does not justify the deduction, as a loss, of the anticipated damages. For, even an unquestionable breach does not result in a loss if the injured party forgives or refrains from prosecuting his claim." (*Lucas* v. *American Code Co.*, 280 U. S., 445, 450 [Ct. D. 168, C. B. IX-1, 314].) Petitioner suggests that it might not win the suit, intimating that the seller might have counterclaimed for breach of contract, or that a jury might find that the claim that the goods were defective was made because of the drop in the market. Perhaps so; the seller is not in court, and it may very well be a court would have found there was no loss when both sides were heard. In any event, petitioner did not choose to submit the controversy to a court.

Nor does the record disclose any identifiable event by which to associate the loss with the 1927 tax year. It is said that a lawyer once told an employee that the statute of limitations would not run before 1927, but there is no statement that it ran in 1927. No applicable Kansas statute ran in 1927; if the seller was a New York corporation, we know of no 7-year statute in that State. Even so, the statute of limitations can not be used to convert a valid claim against a responsible debtor into a deductible loss or a worthless debt. Mr. Lee was taken ill in 1927, but that untoward circumstance did not render worthless all the outstanding accounts of petitioner. In 1927 Mr. Lee expressed doubt as to the collectibility of the item. The basis for that doubt is not disclosed. The facts supporting the alleged breach of contract had not changed; the courts were still open; the seller was still able to respond to a judgment.

The position of petitioner comes to this: A taxpayer has an absolute right to determine whether he shall require a defaulting contractor to make good the loss occasioned by the default. If the taxpayer decides, for business reasons or from friendly motives, not to recoup his loss from the defaulter, then he may deduct the loss from his taxable income in the year in which the decision is made; if that year happens to be one in which he has a large income, that is a matter of no concern to the Government.

We can not subscribe to such doctrine. Before a loss is deductible under either section of the statute, it must be an actual loss which occurred during the taxable year. The proof here fully sustains the action of the Commissioner and the decision of the Board of Tax Appeals. In reaching this conclusion, we have examined the following authorities, among others, which have some bearing on the propositions decided: *Spring City Co.* v. *Commissioner* (292 U. S., 182); *United States Cartridge Co.* v. *United States* (281 U. S., 511 [Ct. D. 460, C. B. XI-1, 282]); *Burnet* v. *Sanford & Brooks Co.* (282 U. S., 359 [Ct. D. 277, C. B. X-1, 363]); *Lewellyn* v. *Elec. Reduction Co.* (275 U. S., 243); *United States* v. *White Dental Co.* (274 U. S., 398); *Darling* v. *Commissioner* (C. C. A. 4) (49 F. (2d), 111, certiorari denied, 283 U. S., 866); *Avery* v. *Commissioner* (C. C. A. 5) (22 F. (2d), 6 [T. D. 4116, C. B. VII-1, 155]); *Commissioner* v. *Thatcher* (C. C. A. 2) (— F. (2d), — (decided April 8, 1935)); *Olympia Harbor Lumber Co.* v. *Commissioner* (C. C. A. 9) (— F. (2d), — (decided August 12, 1935)).

If there was a loss, the record is silent as to the amount of it, for these goods were used in making garments, and except for the sketchy statement that trimmings "relatively cost us 14 cents a yard for 52.85 weight," we have no idea how much of the loss has been thus recouped.

Affirmed.

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## SECTION 214(a)8.—DEDUCTIONS ALLOWED INDIVIDUALS: DEPRECIATION.

ARTICLE 161: Depreciation.

XV-12-8010
Ct. D. 1095

INCOME TAX—REVENUE ACTS OF 1917, 1918, 1921, 1924, AND 1926—DECISION OF COURT.

1. DEDUCTION—DEPRECIATION—OBSOLESCENCE—999-YEAR LEASE.

Where the lessee under a 999-year lease, entered into in 1912, agreed to renew, repair, and replace the leased premises so as to maintain them in their then state of efficiency, and to furnish at its own cost all new equipment, and, so far as appeared from the evidence, the terms of the lease were strictly carried out, the lessor was not entitled, upon the termination of the lease by cancellation, in 1927, to any deduction for depreciation on account of exhaustion, wear and tear. In the absence of proof of the cost or fair market value, as of March 1, 1913, of property abandoned or sold, or of any amount which might be allocable to obsolescence, the lessor was not entitled to deduction on account of obsolescence or loss sustained as to such property.

2. CERTIORARI DENIED.

Petition for certiorari denied October 14, 1935.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT.

*Georgia Railway & Electric Co. et al., petitioners,* v. *Commissioner of Internal Revenue, respondent.*

Petition for review of decision of United States Board of Tax Appeals (district of Georgia).

Before BRYAN, FOSTER, and HUTCHESON, Circuit Judges.

[June 1, 1935.]

OPINION.

BRYAN, Circuit Judge: On January 1, 1912, the Georgia Railway & Electric Co. leased all its property of every description, including its street railway, electric light and heating plants, to the Georgia Railway & Power Co. for a term of 999 years. In 1927 the lessor and the lessee were merged in the Georgia Power Co., and the lease was canceled. The Commissioner of Internal Revenue in determining deficiencies in the lessor's income taxes for the years 1917 to 1926, inclusive, refused to allow to it any deduction on account of depreciation of the leased property, and the deficiencies assessed by him were sustained by the Board of Tax Appeals. Petitions by the lessor and by the Georgia Power Co. as transferee bring the Board's decision here for review. The amount of depreciation sustained in operating the leased property year by year was agreed upon. The only question before us stipulated by the parties to be whether the lessor is entitled to the deductions for depreciation.

By the terms of the lease the lessee bound itself to pay the lessor as rent, without any deduction even for taxes, a quarterly dividend of 1¼ per cent on preferred shares, and 2 per cent on common shares, of its capital stock; to "renew, repair and replace the same, so as to maintain and keep the demised premises in as good order, repair and condition as the same now are and in their present state of efficiency"; and to furnish at its own cost all new equipment. The lessee was given the right to sell any property which it deemed worn, damaged, or no longer suitable or necessary for its purposes, provided the proceeds of every such sale should either be applied to the substitution of property equal in value to that sold, or expended to increase the value of the remaining property; and to sell the lessor's treasury stock and bonds for the purpose of making permanent improvements and additions other than those which it was obliged to make at its own expense. At the expiration or earlier termination of the lease, the lessee was to surrender the leased property with all improvements, additions and betterments, except such as had been disposed of, and the lessor was to pay to the lessee the actual value of all extensions, improvements, renewals and betterments, except such as had been paid for out of proceeds of the sale of the lessor's property, or "in the renewal of or substitution for demised premises." The petitions before the Board alleged in general terms that the lessor was entitled to depreciation. The Board, treating those petitions to mean that the petitioners were claiming deductions only for exhaustion, wear, and tear of the physical property, held that, since the lessee was required by the lease to make good all depreciation resulting from renewals and replacements, the lessor was not entitled to any allowance on account of depreciation, citing *A. Wilhelm Co.* v. *Commissioner* (6 B. T. A., 1) and *Commissioner* v. *Terre Haute Electric Co.* (67 F. (2d), 697 [Ct. D. 838, C. B. XIII-1, 295]). On a rehearing petitioners introduced evidence for the purpose of showing that the lessor had sustained losses resulting from the abandonment and sale of some of the leased property on account of obsolescence, and that the lease, because of this practical construction thus placed upon it by the parties in the course of their dealings with each other, should be construed to mean that it was their intention that all such losses should be borne by the lessor. But as no evidence was submitted of the cost of the property which was abandoned and sold, or of its market value as of March 1, 1913, the Board, among other things, held that the loss claimed had not been proven, for the reason that the cost or the fair market value as of that date, whichever was greater, was the basis for determining gain or loss on the sale or other disposition of property acquired, as all the lessor's property had been, prior to March 1, 1913. (26 U. S. C. A., section 935(b).) Petitioners contend that they were relieved of the burden of proving the cost of the property abandoned and sold, because the total amount of the depreciation sustained was not in dispute; but even so, and assuming that obsolescence was included within the general term depreciation along with exhaustion, wear and tear, it would be necessary to know the amount allocable to obsolescence, at least in the event the lessor was not entitled to any allowance for exhaustion, wear and tear. The parties agreed only to the total amount of depreciation sustained by the property, but they did not agree that the lessor was entitled to any of it. We therefore agree with the Board in its decision that no allowance should be made on account of obsolescence, or loss sustained in the abandonment or sale of leased property.

We agree also that the lessor is not entitled to any allowance for depreciation resulting from exhaustion, wear and tear. The lease required the lessee at its own expense to make all repairs, renewals, and replacements. The lessee, in the event it exercised the right to sell any property that had become worn, or unsuitable for further use, was obliged to substitute other property, or to apply the proceeds of that sold to increase the value of the remaining property. It had the right to make permanent improvements and additions, and to receive credit therefor at the termination of the lease, except for such as had been paid for out of the proceeds of the sale of the lessor's property, and such as had been made in renewal or substitution. Clearly, under these provisions of the lease, the loss resulting from renewals and replacements, and from the exhaustion, wear, and tear of the property generally, was to be borne, not by the lessor, but by the lessee. *Commissioner* v. *Terre Haute Electric Co.*, supra, is, as we think, directly in point. In language identical with that employed in the lease before us the lessee was there required to bear the expense of renewals, repairs, and replacements, and because this was so the lessor was held not to be entitled to deduction from his income for depreciation. We also think that case was rightly decided. The ruling in *Weiss* v. *Wiener* (279 U. S., 333 [Ct. D. 60, C. B. VIII-1, 257]), that a lessee who had made no investment was not entitled to an allowance for depreciation, is equally applicable to a lessor who likewise has suffered no loss resulting from depreciation. There is no evidence whatever to sustain the contention of the petitioners that the lessor, though not required by the lease to do so, bore the losses resulting from exhaustion, wear, and tear, and required the lessee to bear only the cost of current maintenance and repairs. Nor is there any evidence that the lessor paid or bore any of such losses. It does not appear therefore that when the lease was terminated by cancellation, and the lessor and the lessee were both merged in the Georgia Power Co., the lessee owed the lessor anything on account of losses for depreciation. So far as appears the lease while it lasted underwent no change as a result of anything the parties did in carrying it out, but was enforced strictly according to its terms and provisions.

The petitions for review are denied.

## SECTION 219.—ESTATES AND TRUSTS.

### Article 341: Estates and trusts.

REVENUE ACTS OF 1924 AND 1926.

Trust deed amended so that separate account opened for each beneficiary. (See Ct. D. 1071, page 245.)

### Article 341: Estates and trusts.

REVENUE ACTS OF 1924 AND 1926.

Trust deed amended so that separate account opened for each beneficiary. (See Ct. D. 1072, page 245.)

### Article 347: Income of trusts taxable to grantor.

REVENUE ACT OF 1926.

Alteration or termination of trust by committee, provided settlor does not object. (See Ct. D. 1117, page 248.)

## PART III.—CORPORATIONS.

## SECTION 230.—TAX ON CORPORATIONS.

### Article 502: Rates of tax.

XV-24-8124
Ct. D. 1126

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

Income—Apportionment of Tax—Railroad Company Under Federal Control for Portion of Taxable Year.

In computing the tax liability of a railroad company for the year 1920, the net income for the entire year should be first computed and the tax then apportioned on the calendar year basis at the rate of 8 per cent for the 2-month period during which the company was under Federal control and at the rate of 10 per cent for the remainder of the year, under the provisions of the Revenue Act of 1918 and the Federal Railroad Control Act of March 21, 1918.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.

*Southern Railway Co., for Itself and Its Affiliated Corporations, petitioner,* v. *Commissioner of Internal Revenue, respondent.*

On petition to review the decision of the United States Board of Tax Appeals.

Before PARKER and SOPER, Circuit Judges, and CHESNUT, District Judge.

[January 6, 1936.]

OPINION.

PARKER, Circuit Judge: This is the second petition to review a decision of the Board of Tax Appeals in this case. On the first petition (74 Fed. (2d), 887), we held that, in computing income tax for the year 1920, an undermaintenance allowance of $12,805,933.68 to the taxpayer by the Director General of Railroads should not be used to diminish the taxpayer's deduction on account of expenditures for maintenance and upkeep made during the last 10 months of the year 1920, following the termination of Government control. The Board of Tax Appeals, upon remand, recomputed the tax for the year 1920, allowing the taxpayer as a deduction the full amount of the expenditures claimed, and taxing 60/366 of the annual income thus ascertained at 8 per cent, the amount of the so-called "war tax," and the remainder at 10 per cent, the amount of the "war tax" plus the "normal tax" of 2 per cent; 60/366 was the portion of the year that the railroad was under Federal control; and what the Board did was to tax a corresponding portion of the annual income at 8 per cent and the remainder at 10 per cent.

The contention of the taxpayer is that, instead of computing the net income for the tax year and apportioning it for taxation in accordance with the portion of the year that the property was under Federal control, the net income of each portion of the year should be separately computed and the expenditures for maintenance and upkeep made during the 10-month period following the termination of Federal control should be deducted from income earned during that period. In other words, the Board of Tax Appeals computed the net income for the year and divided it on the calendar basis for purpose of taxation at the different rates applicable. The taxpayer contends that the net income of the 2 months of control should be computed separately from the income of the succeeding 10 months and that the 8 per cent and 10 per cent rates should be applied to the actual income of the two separate periods as thus computed. The difference in result is some $43,000.

Some confusion in thinking with respect to the case results from considering as law what the parties have agreed is the practical effect of the law, i. e., that the income of the Federal control period is taxable at 8 per cent and that of the period following control at 10 per cent. When the law itself is considered, there is no confusion and the decision of the Board is clearly right.

There was imposed by the Revenue Act of 1916 a normal tax of 2 per cent on the income of corporations. See Act of September 8, 1916 (39 Stat., 765), and Act of March 3, 1917 (39 Stat., 1000). The War Revenue Act of October 3, 1917, imposed a special war tax of 4 per cent on the income of corporations, in addition to the normal tax of 2 per cent imposed by the Revenue Act of 1916. (See 40 Stat., 302.) The Federal Railroad Control Act of March 21, 1918 (40 Stat., 451), provided in section 12 thereof that moneys derived from the operation of the railroads under Federal control should be disbursed for expenses of operation, payment of taxes and other purposes as specified in the Act, with the exception, however, that income and excess profits taxes imposed by the War Revenue Act of October 3, 1917 (40 Stat., 302), should be paid by the carriers out of their own funds. The Revenue Act of 1918 (40 Stat., 1057, 1075, 1076) imposed an income tax of 10 per cent on corporations for years subsequent to the year 1918 and provided that, for the purposes of the Federal Railroad Control Act of March 21, 1918, four-fifths of the tax so imposed should be treated as levied by an amendment to the War Revenue Act of 1917. It resulted, therefore, that of the 10 per cent income tax imposed by the Revenue Act of 1918 on railroads, 2 per cent was normal tax and was to be borne by the Director General whereas 8 per cent was "war tax" and was to be borne by the railroads out of their own funds. (See also 40 Stat., 452; *Appeal of New York, Ontario & Western Ry. Co.*, 1 B. T. A., 1172.)

There is nothing in the Revenue Act of 1918 which provides for the assessment of income taxes otherwise than on the annual basis customarily followed.

On the contrary, that Act expressly directs what shall be included in gross income of the taxable year (sections 213 and 230) and what deductions shall be allowed in arriving at net income. Sections 214 and 234. Only in section 12 of the Federal Control Act of 1918 (40 Stat., 457) is provision made for apportionment of taxes where Federal control ends during a taxable year; and the provision there is for apportionment of taxes, not apportionment of income. The applicable provision is as follows:

"If Federal control begins or ends during the tax year for which any taxes so chargeable to railway tax accruals are assessed, the taxes for such year shall be apportioned to the date of the beginning or ending of such Federal control, and disbursements shall be made only for that portion of such taxes as is due for the part of such tax year which falls within the period of Federal control."

As the tax on the net income of the railroad for the year 1920 was not assessed or payable until the following year, it is clear that the income tax for the entire year would fall on the railroad except for the provision which we have quoted requiring apportionment; and, as the 8 per cent "war tax" is to be borne by the railroad in any event, the provision as to apportionment, in so far as it affects Federal income tax, is applicable only to the 2 per cent normal tax. In other words, the Revenue Act of 1918 imposes a tax of 10 per cent on the railroad's income, of which 2 per cent is normal tax and 8 per cent is war tax; and the Federal Railroad Control Act provides that the 2 per cent normal tax shall be apportioned between the railroad and the director in accordance with the period of the year falling under Federal control, whereas the whole of the 8 per cent tax shall be borne by the railroad. Apportioning the 2 per cent tax between the director and the railroad on this basis and imposing the 8 per cent tax on the railroad alone, is the same as imposing 8 per cent on 60/366 of the net income for the year and 10 per cent on the remainder, as 60/366 of the year was the portion of Federal control. There is, of course, no difference between relieving the road of the 2 per cent rate during 60/366 of the year, and relieving it of 60/366 of the tax computed at that rate for the entire period.

The railroad concedes that its other taxes for the year 1920 were properly apportionable on the calendar basis under the provision of the statute quoted; and we see no reason why income taxes should not be treated in the same way. Although income is earned from day to day and from month to month, it is well settled that the tax imposed by the Federal statute is on an annual income (*Burnet* v. *Sanford & Brooks Co.*, 282 U. S., 359 [Ct. D. 277, C. B. X-1, 363]); and there is no authority in the statute or elsewhere for attributing any particular portion of the tax levied on annual income to any particular portion of the income. The language of the statute is clear that it is the tax and not the income which is to be apportioned; and when this is grasped, it is readily seen that the calendar basis, admittedly applied in the case of other taxes, is the only basis of apportionment possible. This was the decision of the Board in *Union Pacific R. Co.* v. *Commissioner* (26 B. T. A., 1126, 1145); and we know of no decision anywhere to the contrary.

The decision appealed from will be affirmed.

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## SECTION 233.—GROSS INCOME OF CORPORATIONS DEFINED.

ARTICLE 545: Sale and retirement of corporate bonds. XV-16-8051 Ct. D. 1106

INCOME TAX—REVENUE ACT OF 1924—DECISION OF COURT.

DEDUCTION—UNAMORTIZED DISCOUNT, PREMIUMS, AND EXPENSES ON RETIREMENT OF BONDS.

A company which kept its books on the accrual basis issued bonds at a discount in 1921, with the right to redeem either for cash or for cash and certain other bonds of equal face value. Prior to December 31, 1923, certain of the bonds had been redeemed for cash and the then unamortized discount and expense allocable thereto had been charged off in the year of retirement. In 1924 the remaining bonds were called for redemption, some of the holders electing to receive in exchange bonds and cash, and the others electing to receive cash. Under these facts, the company was not entitled, under section 234(a) of the Revenue Act of 1924, to a deduction in 1924 of the premiums, expenses, and unamortized discount applicable to the bonds retired by exchange for other bonds. Upon the substitution of the new obligation for the old, the remaining unamortized expense of issue of the original bonds and the expense of the exchange should be amortized annually throughout the term of the bonds delivered in exchange for those retired.

SUPREME COURT OF THE UNITED STATES.

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

*Great Western Power Co. of California, petitioner,* v. *Commissioner of Internal Revenue.*

[March 16, 1936.]

OPINION.

Mr. Justice ROBERTS delivered the opinion of the Court.

The parties disagree as to petitioner's right to deduct from gross income for 1924 unamortized discount, premiums, and expenses paid and incurred in that year in connection with the retirement of certain bonds. The petitioner took the deduction in its income tax return. The respondent disallowed it and determined a deficiency. The petitioner appealed to the Board of Tax Appeals which held the deduction proper.[1] The circuit court of appeals reversed the Board's decision in part.[2] We granted the writ to resolve a conflict.[3]

March 1, 1919, the company executed a mortgage securing four series of bonds, one of which was designated "Series B 7%." February 1, 1921, the company executed another mortgage, securing bonds known as "General Lien Convertible 8% Gold Bonds," and thereby covenanted to deposit and pledge with the trustee series B 7's equal in par value to the general lien 8's at any time outstanding. The indenture provided that when this should be accomplished the debtor should have the right to redeem the general 8's at 105 and accrued interest, the holders to have the option to receive cash or series B bonds, of equal face value, plus 5 per cent in cash. The general lien 8's were issued at a discount of $150,000 and an expense of $22,283.54. Prior to December 31, 1923, certain general lien 8's had been redeemed for cash and the then unamortized discount and expense allocable to the bonds retired had been charged off in the year of retirement. May 8, 1924, the company called the remaining outstanding general lien 8's for redemption August 1, 1924. The holders of $2,354,000 face value exercised the option to exchange for series B 7's at par and a cash premium of 5 per cent. The total premium paid to them was $117,725 and the expense of the conversion was $1,461.05. The unamortized discount and expense of issuance in respect of the general lien 8's thus exchanged, at the date of exchange, was $126,176.97. For the remaining general lien 8's, which were not exchanged for series B 7's, cash was paid at the rate of 105 per cent of par and the company incurred certain expenses in the transaction. The total of the premium, the expense, and the unamortized discount applicable to all of the bonds redeemed for cash or in exchange for series B bonds was charged off in 1924 and taken as a deduction from income for that year. The company keeps its accounts on the accrual basis. The Commissioner disallowed the entire deduction, but before the Board he admitted the propriety of so much of it as applied to bonds redeemed for cash. He insisted, however, that as to those retired by exchange of the series B 7's the discount, premium, and expense should be amortized over the life of the latter. The Board overruled his contention, but the circuit court of appeals sustained it, holding that the items would not be deductible as realized losses until payment or redemption of the series B bonds, and should be amortized in annual installments during their term.

Section 234(a) of the Revenue Act of 1924[4] directs that in computing the net income of a corporation subject to the tax there shall be allowed as

[1] 30 B. T. A., 503.
[2] 79 F. (2d), 94.
[3] *San Joaquin L. & P. Corporation* v. *McLaughlin, Collector* (65 F. (2d), 677).
[4] Ch. 234, 43 Stat., 253.

deductions ordinary and necessary expenses paid or incurred during the taxable year in carrying on the business, interest paid or accrued within the year on indebtedness, and losses sustained during the year not compensated by insurance or otherwise. The Treasury promulgated a regulation under the Revenue Act of 1918 covering treatment of discounts and premiums, which, with immaterial changes, has remained in force under all the Revenue Acts and appears as article 545 of Regulations 65 applicable to the Revenue Act of 1924.[5]

Although the article does not expressly cover the items in question other than discount and premiums paid at redemption, expense in connection with the issuance of the securities is deductible on the same theory as unamortized discount.[6] It has accordingly been held that where an issue of bonds is retired for cash, whether the cash be obtained by the sale of a new issue or not, the items in question are deductible in the year of retirement.[7]

The question then is whether, upon an exchange of one obligation for another which is to be retired, the transaction is to be viewed as if the retirement were accomplished by the payment of cash. If the retired bonds had not been called, the expense items incurred in connection with their issuance would properly be amortized over the remainder of their life. Here the petitioner substituted a new obligation for the old. The remaining unamortized expenses of issue of the original bonds and the expense of the exchange are both expenses attributable to the issuance of the new bonds and should be treated as a part of the cost of obtaining the loan. They should, accordingly, be amortized annually throughout the term of the bonds delivered in exchange for those retired.

The judgment of the circuit court of appeals is affirmed.

Affirmed.

## SECTION 240.—CONSOLIDATED RETURNS OF CORPORATIONS.

ARTICLE 632: Consolidated returns.

REVENUE ACT OF 1918.

Agreement as to payment of tax, estoppel. (See Ct. D. 1120, page 283.)

## PART IV.—ADMINISTRATIVE PROVISIONS.

## SECTION 257.—RETURNS TO BE PUBLIC RECORDS.

ARTICLE 1090: Inspection of returns.

XV-17-8064
T. D. 4637

Regulations governing the inspection of income, profits, and capital stock tax returns by the Special Committee Investigating Old Age Pension Organizations, House of Representatives.

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[5] ART. 545. *Sale and retirement of corporate bonds.*— * * *

(3) (*a*) If bonds are issued by a corporation at a discount, the net amount of such discount is deductible and should be prorated or amortized over the life of the bonds. (*b*) If thereafter the corporation purchases and retires any of such bonds at a price in excess of the issuing price plus any amount of discount already deducted, the excess of the purchase price over the issuing price plus any amount of discount already deducted (or over the face value minus any amount of discount not yet deducted) is a deductible expense for the taxable year. (*c*) If, however, the corporation purchases and retires any of such bonds at a price less than the issuing price plus any amount of discount already deducted, the excess of the issuing price plus any amount of discount already deducted (or of the face value minus any amount of discount not yet deducted) over the purchase price is gain or income for the taxable year.

[6] *Helvering* v. *Union Pac. R. R. Co.* (293 U. S., 282 [Ct. D. 901, C. B. XIII-2, 305]); *Helvering* v. *Cal. Oregon Pr. Co.* (75 F. (2d), 644).

[7] *Helvering* v. *Cal. Oregon Pr. Co.*, supra; *Helvering* v. *Central States Elec. Corporation* (76 F. (2d), 1011); *Helvering* v. *Union Pub. Serv. Co.* (75 F. (2d), 723; T. D. 4603 [C. B. XIV-2, 58]).

TREASURY DEPARTMENT,
*Washington, D. C., April 20, 1936.*

*To Collectors of Internal Revenue and Others Concerned:*

Pursuant to the provisions of section 257(a) of the Revenue Act of 1926; section 55 of the Revenue Act of 1928; section 55 of the Revenue Act of 1932; section 215(e) of the National Industrial Recovery Act; and section 55(a) and section 701(e) of the Revenue Act of 1934, income and profits tax returns made under the Revenue Act of 1934 and under the prior Revenue Acts, and capital stock tax returns made under the National Industrial Recovery Act and the Revenue Act of 1934, may be inspected by the Special Committee Investigating Old Age Pension Organizations, appointed under House Resolution 443, Seventy-fourth Congress, second session, passed March 10, 1936, for the purpose of, and to the extent necessary in the investigation which the committee is authorized and directed to make by House Resolution 443. The inspection of returns herein authorized may be by the committee or by or through such examiners or agents as the committee may designate or appoint. Upon written notice by the chairman of the committee to the Secretary of the Treasury, giving the names and addresses of the taxpayers whose returns it is necessary to inspect and the taxable periods covered by the returns, the Secretary and any officer or employee of the Treasury Department shall furnish such committee with any data relating to or contained in any such return, or shall make such return available for inspection by the committee or by such examiners or agents as the committee may designate or appoint, in the office of the Commissioner of Internal Revenue. Any information thus obtained by the committee which is relevant or pertinent to the purpose of the investigation, may be submitted by the committee to the House of Representatives.

WAYNE C. TAYLOR,
*Acting Secretary of the Treasury.*

Approved.

FRANKLIN D. ROOSEVELT,
*The White House.*

**(Filed with the Division of the Federal Register April 24, 1936, 3.03 p. m.)**

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EXECUTIVE ORDER—INSPECTION OF INCOME, PROFITS, AND CAPITAL STOCK TAX RETURNS BY THE SPECIAL COMMITTEE INVESTIGATING OLD AGE PENSION ORGANIZATIONS.

By virtue of the authority vested in me by section 257(a) of the Revenue Act of 1926 (ch. 27, 44 Stat., 9, 51); section 55 of the Revenue Act of 1928 (ch. 852, 45 Stat., 791, 809); section 55 of the Revenue Act of 1932 (ch. 209, 47 Stat., 169, 189), as amended by section 218(h) of the National Industrial Recovery Act (ch. 90, 48 Stat., 195, 209); section 55(a) and section 701(e) of the Revenue Act of 1934 (ch. 277, 48 Stat., 680, 698, 770); and section 215(e) of the National Industrial Recovery Act (ch. 90, 48 Stat., 195, 208), it is hereby ordered that income, profits, and capital stock tax returns made under the Revenue Act of 1934, the National Industrial Recovery Act, the Revenue Act of 1932 as amended by the National Industrial Recovery Act, and the prior Revenue Acts shall be open to inspection by the Special Committee Investigating Old Age Pension

Organizations, appointed under House Resolution 443, Seventy-fourth Congress, second session, passed March 10, 1936, such inspection to be in accordance and upon compliance with the rules and regulations prescribed by the Secretary of the Treasury in the Treasury Decision relating to the inspection of returns by that committee approved by me this date.

FRANKLIN D. ROOSEVELT.

THE WHITE HOUSE,
*April 20, 1936.*

(7350)

(Filed with the Division of the Federal Register April 23, 1936, 10.20 a. m.)

## PART V.—PAYMENT, COLLECTION, AND REFUND OF TAX AND PENALTIES.

## SECTION 270.—DATE ON WHICH TAX SHALL BE PAID.

ARTICLE 1203: Collection of tax by suit. XV-21-8098
Ct. D. 1119

FEDERAL TAXES—JUDICIAL CODE—DECISION OF SUPREME COURT.

STATUTE OF LIMITATION—APPEAL TO CIRCUIT COURT OF APPEALS—ORIGINAL AND AMENDED DECREE.

Where the judge of a district court made an order extending the term of the court so that necessary changes might be made in a decree entered in a suit by the United States to set aside certain deeds of land, executed by the taxpayer at a time when he was indebted to the United States for taxes, appeals to the circuit court of appeals were timely where taken within the time allowed by statute from the date of the amended decree. The effect of the order was to suspend the operation of the original decree so that no appeal could be taken from it until it had been amended or confirmed.

SUPREME COURT OF THE UNITED STATES.

*Samuel Zimmern et al., petitioners, v. The United States of America.*

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

[April 27, 1936.]

OPINION.

Mr. Justice CARDOZO delivered the opinion of the Court.

The question in this case is whether the petitioners appealed to the circuit court of appeals within the time prescribed by law.

The United States brought suit to set aside a deed by Samuel Zimmern to his wife, and another deed, in which the wife joined, to his children, a separate parcel of real estate being the subject of each. At the time of the conveyance Samuel Zimmern was indebted to the complainant for a deficiency of income taxes duly assessed against him. The deeds were attacked upon the ground that they had been made without consideration and with fraudulent intent. The district court after a trial sustained the charge of fraud and gave judgment in favor of the complainant for the relief prayed for in the bill. Its decree, which was entered on March 3, 1934, directed a sale of the two parcels, and the payment of the proceeds to the United States to be applied upon the taxes after deducting what was due to the wife by reason of a homestead exemption allowed by the local law. Nothing was said in the decree as to the exception or reservation from the sale of her inchoate right of dower.

The term at which the cause was tried would have expired, unless extended, on May 28, 1934. However, before that date, the judge made an order extending the term for 90 days, the order being prefaced with the following recital: "It appearing to the court that a decree was entered in this cause on March 3, 1934, and for good reason shown it will be necessary to modify or amend said decree."[1] No petition for rehearing in behalf of the wife, Leila Zimmern, appears in the record, nor any motion for an amendment. A petition in behalf of Samuel Zimmern does appear, but it was filed on August 11, 1934, when the time to appeal had already gone by if the original decree was then presently in force. (Cf. *Conboy* v. *First National Bank of Jersey City*, 203 U. S., 141, 145.) Two days later the judge made an order amending the decree by directing that the sale be subject to any dower rights of the wife, and in all other respects denying whatever motions were before him. Appeals by all the defendants were taken and allowed. Under the applicable statute (28 U. S. C., section 230), the appeals were too late if the time is to be computed from the date of the decree as originally entered. They were regular if the time is to be computed from the date of the amendment. The court of appeals held that what had been corrected by the amendment was an accidental slip or omission, not affecting the issues in suit (Federal Equity Rule 72), and inoperative to toll the statute. Accordingly, the appeals were dismissed, two opinions being written, one upon the original hearing and the other upon rehearing. (79 F. (2d), 703; 80 F. (2d), 993.) This Court granted certiorari to review a ruling as to practice that might tend, if erroneous, to introduce confusion into the law.

We think the decision misapprehends the effect of the order of May 11, 1934, in which the judge who had tried the cause declared himself dissatisfied with the decree that he had made, and to give himself an opportunity to make the necessary changes extended the term then drawing to a close. He did not limit the amendment to matters of form only as distinguished from those of substance. He did not act, so far as the record shows, at the instance of the defendants, still less upon a showing of error in only one particular. He stated broadly and, for all that appears, of his own motion that changes must be made, and without a word to indicate whether he meant them to be great or little. We think the effect of that order was to suspend the operation of the decree so that no appeal could be taken from it until it had been amended or confirmed, and its vigor thus restored. Until such action had been taken it was no longer a decree at all. The judge had plenary power while the term was in existence to modify his judgment for error of fact or law or even revoke it altogether. (*Doss* v. *Tyack*, 14 How., 297, 313; *Basset* v. *United States*, 9 Wall., 38, 41; *Bronson* v. *Schulten*, 104 U. S., 410, 415; *Henderson* v. *Carbondale Coal & Coke Co.*, 140 U. S., 25, 40.) Finality was lacking until his choice had been announced.

The appeals being timely, the decree which dismissed them should be reversed, and the cause remanded to the Court of Appeals for the Fifth Circuit for further proceedings in harmony with this opinion.

It is so ordered.

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## ARTICLE 1204: Collection of tax by distraint. XV-19-8078 Ct. D. 1113

INCOME TAX—REVENUE ACT OF 1926—REVISED STATUTES—DECISION OF COURT.

1. DISTRAINT—ANNUITY AND LIFE INSURANCE POLICIES—INTEREST OF BENEFICIARY—LOCAL LAW.

Where the collector of internal revenue seized and advertised for sale, under warrants of distraint for collection of income taxes, an annuity contract and certain life insurance policies issued upon the life of the taxpayer, the annuity contract was subject to dis-

[1] For greater certainty the terms of the order are here stated in full:

"It appearing to the court that a decree was entered in this cause on March 3, 1934, and for good reason shown it will be necessary to modify or amend said decree,

"It is, therefore, ordered and adjudged by the court that the November term of this court which expires on the 28th day of May, 1934, be, and the same is, extended for ninety (90) days from that date, in which time all matters and orders in connection with this cause and the amendments of the decree may be entered.

"Done this 11th day of May, A. D. 1934.

"ROBERT T. ERVIN, *Judge*."

traint, but, as to the insurance policies, which designated the insured's wife as beneficiary, with right reserved to him to revoke and change such designation, the taxpayer's wife had an interest in the policies which was not subject to sale for her husband's taxes, and the effort to sell the entire policies, including the wife's interest therein as recognized by the local law, should be enjoined.

2. Decision Affirmed in Part and Reversed in Part.

Decision of the United States District Court, District of Colorado (10 Fed. Supp., 718; Ct. D. 996, C. B. XIV–2, 319), affirmed in the case of No. 1290, and reversed in the case of No. 1289.

United States Circuit Court of Appeals for the Tenth Circuit.

No. 1289. *Margaret R. Cannon, appellant,* v. *Ralph Nicholas, as Collector of Internal Revenue, appellee.*

No. 1290. *H. Brown Cannon, appellant,* v. *Ralph Nicholas, as Collector of Internal Revenue, appellee.*

Appeals from the District Court of the United States for the District of Colorado.

[December 9, 1935.]

OPINION.

McDermott, Circuit Judge, delivered the opinion of the court.

To collect income taxes for 1928 due from H. Brown Cannon, the collector seized under warrant of distraint three policies of insurance upon the life of Cannon, and one annuity contract issued to him. The collector then advertised for sale at public auction those policies and the contract, describing them only as—

"Three life insurance policies issued by the Capitol Life Insurance Co. of Denver, Colo., upon the life of H. Brown Cannon as follows: One for the sum of $10,000; one for the sum of $5,000; one for the sum of $2,000; one annuity insurance policy issued by the Travelers Insurance Co. of Hartford, Conn., upon the life of H. Brown Cannon for the sum of $25,000."

Before the sale date, these suits were brought to quash the warrant of distraint; the policies were deposited with the court to abide the litigation, and the sale called off. The essential facts were stipulated, and the bills dismissed on their merits.

No. 1290: This case involves the annuity contract, and Mr. Cannon is the plaintiff. On September 1, 1928, for a single premium of $25,000, the issuing company agreed to pay Cannon $1,000 a year during his life, and upon his death to pay his executors $25,000 plus a proportion of the current annuity. The cash and loan value of this contract when the levy was made, was $24,375, against which Cannon had borrowed $20,272.34.

There is little room for the argument that this large sum, invested in an annuity, is exempt from taxes; if taxpayers could invest their fortunes in annuities and stand aloof when the tax collector comes around, payment of taxes would be too often a voluntary matter. To collect its revenues, the power of the Government over the property of the taxpayer is plenary. State exemption laws, *ex proprio vigore,* do not apply. (*Fink* v. *O'Neil,* 106 U. S., 272.) Congress has not in the revenue laws, as it did in bankruptcy, recognized State exemption statutes; nor has it exempted either annuity contracts or life insurance policies.

The statutes governing the collection of taxes are broad and comprehensive. By 26 U. S. C. A., section 115, taxes are decreed to be a lien "upon all property and rights to property, whether real or personal" belonging to the taxpayer. By section 116 the collector is authorized to collect by distraint or sale "the goods, chattels, or effects, including stocks, securities, bank accounts, and evidences of debt" of the delinquent. By section 117 the collector is authorized to levy "upon all property and rights to property, except such as are exempt by the preceding section, belonging to such person, or on which the said lien exists." By section 118 all persons are required on demand of a collector who has or is about to distrain "on any property, or rights of property" to exhibit all books, etc. By section 129 the collector is authorized to "seize and sell any of the property, real or personal (except property exempt from distraint and sale, under section 3178 (26 U. S. C. A., 116) of the Revised Statutes), or any right or interest therein." By 26 U. S. C. A., 1268(a), any person in possession of "property, or rights to property, subject to distraint, upon which a levy has been made" is required to surrender such property to the collector.

An ingenious argument is made that because section 116 specifies "stocks, securities, bank accounts, and evidences of debt," and because "bank accounts" were brought into the statute in 1924, Congress intended to exempt all intangible property except those listed. But the doctrine of *expressio unius est exclusio alterius*, while at times an aid in construction of doubtful language, does not avail here. In the first place, reading the various sections of the statutes devoted to collection of taxes, it is clear that Congress intended to subject all of a taxpayer's property except that specifically exempted to the payment of taxes. Again, the enumeration here follows the word "including" which has various shades of meaning, sometimes of restriction and sometimes of enlargement.[1] We have no doubt that the word here was used from an excess of caution, that is, to point out certain classes of property which Congress was fearful a collector might overlook. We do not believe, in the light of the sweeping language used throughout these statutes, that Congress intended to limit distraint to tangible property and to the specified classes of intangibles. No reason is apparent why "stocks and securities" should be subject to levy and an annuity contract not. Again, in a true if not a colloquial sense, an annuity contract is an "evidence of debt."

We hold that this annuity contract is subject to taxes and to distraint. The notice of sale given has spent its force, but it is proper to say that the notice given was not specific enough as to the terms of the contract, its surrender value, loans against it, etc., fairly to apprise the public as to what they were invited to bid on. It is possible, as suggested by counsel for appellant, that the full surrender value can be realized without jeopardizing the rights of the Government or possibly sacrificing the rights of appellant at a public sale, by compelling the company to pay the balance of the surrender value to the collector under 26 U. S. C. A., 1268(a).

The order in No. 1290 is affirmed.

No. 1289: The appeal in No. 1289 presents a much more difficult question. That suit is by Mrs. Cannon, the beneficiary in two policies issued on the life of Mr. Cannon, one a 20-year endowment for $2,000, maturing in 1936. By its terms, that sum is to be paid Mrs. Cannon if her husband dies before 1936, otherwise to him. The other is a straight life policy for $10,000 with Mrs. Cannon the beneficiary. Right is reserved in Cannon to revoke and change the beneficiary in both policies.[2] The record does not disclose the loan or cash value of the $2,000 policy, but it must equal the face, for it matures in a few months. The loan or cash value of the $10,000 policy, now in its ninth year, is nearly $7,000.

Mrs. Cannon contends that, under the Colorado decisions, she is the owner of these policies, and that her property can not be subjected to the payment of her husband's taxes. The Supreme Court of the United States, in the community property and other cases, has held that State law determines the ownership of property subject to its jurisdiction, and that a wife's property can not be taken for her husband's taxes. (*Poe* v. *Seaborn*, 282 U. S., 101 [Ct. D. 259, C. B. IX-2, 202]; *Hoeper* v. *Tax Commission*, 284 U. S., 206; *Helvering* v. *City Bank Farmers Trust Co.*, arguendo, — U. S., — (decided November 11, 1935).)

The Supreme Court has also held (*Chase National Bank* v. *United States*, 278 U. S., 327 [Ct. D. 40, C. B. VIII-1, 308]), that many of the legal incidents

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[1] *Montello Salt Co.* v. *Utah* (221 U. S., 452); *Calhoun* v. *Memphis & P. R. Co.* (U. S.) (4 Fed. Cas., 1045); *Cunningham* v. *Sizer Steel Corporation* (D. C. N. Y.) (1 F. (2d), 837); *United States* v. *Pierce* (147 Fed., 199); *Sullivan Machinery Co.* v. *United States* (168 F., 501); *Decorated Metal Mfg. Co.* v. *United States* (12 Ct. Cust. App., 140); *Achelis* v. *Musgrove* (212 Ala., 47, 101 So., 670); *Fraser* v. *Bentel* (161 Cal., 390, 119 P., 509); *Kennedy* v. *Industrial Accident Commission* (50 Cal. App., 184, 195 P., 267); *Jacksonville Terminal Co.* v. *Blanshard* (77 Fla., 855, 82 So., 300); *Wyatt* v. *City of Louisville* (206 Ky., 432, 267 S. W., 146); *In re Goetz* (75 N. Y. S., 750); *In re Sheppard's Estate* (179 N. Y. S., 409); *People ex rel Woolworth's Estate* v. *State Tax Commission* (192 N. Y. S., 772); *Cooper* v. *Stinson* (5 Minn., 522); *Nehr* v. *McCook Co.* (11 S. D., 422, 78 N. W., 998); *Blank* v. *Pioneer Mining Co.* (93 Wash., 26, 159 P., 1077).

[2] The third policy covered by the notice is for $5,000 and the beneficiary is Cannon's son. That policy is not in suit, but it was deposited with the clerk, apparently to abide the result of this suit.

of ownership are vested in the insured under a policy payable to another upon his death, where the right is reserved in him to revoke the beneficiary, and among those incidents enumerates the power to pledge the policy for a loan and to dispose of the proceeds for his own benefit during his life. Mr. Cannon has the power to borrow substantial sums upon these policies and to use the proceeds for his own benefit, and that without surrendering the right to keep his insurance in force by paying premiums.[3]

Since the notice advertised for sale the entire policies, and not whatever interests therein belonged to the taxpayer, our task is to ascertain whether under Colorado law Mrs. Cannon was vested with any of the incidents of ownership.

In *Hendrie Mfg. Co.* v. *Platt* (13 Colo. App., 15, 56 P., 209), creditors undertook to reach the proceeds of several policies on the life of their debtor, after his death and after his beneficiary had received the proceeds. Two of the policies had endowment features. The opinion does not state that the insured reserved the right to change the beneficiary. There was then no Colorado statute exempting insurance money from debts. After an exhaustive review of the cases, it was held that creditors could not reach life insurance money, the court saying that the fund arose from the beneficiary's insurable interest in the life of her husband; that it did not exist until death; that public policy required that widows and children should not be left destitute; that "the moment it is issued, its ownership vests in the beneficiary," * * * "the title thereto had become vested in her," * * * that until the maturity of an endowment policy "her title was as absolute as if the insurance had been upon any other plan."

In *National Bank of Commerce* v. *Appel Clo. Co.* (35 Colo., 149, 83 P., 965), a creditor undertook to reach the surrender value of an endowment policy, with right reserved to change the beneficiary, before the maturity of the endowment or the death of the insured. There was no allegation of insolvency, or that the insured was indebted when the policy was issued. Without deciding the rule applicable in such state of the case, the court held that the beneficiary could not be divested of her interest except by the act of the insured, the opinion concluding:

"If the latter should be compelled to surrender these policies to the companies issuing them, and accept the value thereof, the rights of the beneficiaries would be destroyed. The insured may have interests in these policies which a court of equity, if their rights only were involved, might have the power to compel them to apply to the payment of their indebtedness; but, however this may be, a court of equity would not be authorized to exercise this power when thereby the vested rights of third persons would be destroyed, unless it should appear that the conditions existed under which a court of equity, at the instance of a creditor, may annul voluntary arrangements entered into between his debtors and third persons."

In *Hill* v. *Capitol Life Insurance Co.* (91 Colo., 300, 14 P. (2d), 1006), the fact situation is not pertinent, but the court held that even where the insured reserved the right to change the beneficiary, the beneficiary had an "interest in the policy" prior to the exercise of the reserved right.

In 1929 a statute was passed which is set out in the margin.[4] The Colorado courts have not yet had occasion to determine whether this statute is one of exemption or one fixing property rights. If the latter, it does not aid here because the policies in question were issued long prior to its enactment, and because it adds nothing to plaintiff's rights under the cited Colorado decisions. The second circuit, in a well-reasoned opinion, has held an identical statute to be one of exemption. (*In re Messinger* (C. C. A. 2), 29 F. (2d), 158.) As such, it is not applicable to Federal taxes.

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[3] The policies are not in the record, but it does appear that reserves have accumulated thereon, and such policies ordinarily if not uniformly grant an option to borrow the accumulated reserve without surrendering the policy. While the record is not clear, it may be that Mr. Cannon, in order to borrow on the policy, must either change the beneficiary to his estate, or procure the consent of the beneficiary. But it is conceded that, by changing the beneficiary, he may borrow the stated sum upon the sole security of the policy and without consent of the beneficiary.

[4] If a policy of insurance, whether heretofore or hereafter issued, is effected by any person on his own life or on another life, in favor of a person other than himself, or, except in cases of transfer with intent to defraud creditors, if a policy of life insurance is assigned or in any way made payable to any such person, the lawful beneficiary or assignee thereof, other than the insured or the person so effecting such insurance, or his

From these decisions it appears that in Colorado a beneficiary has a property interest in a policy of life insurance. But it does not follow that the insured has no interest therein, for two or more persons may own interests in the same property. The Bankruptcy Act provides (70–a–5) that, unless exempted by State law (*Holden* v. *Stratton*, 198 U. S., 212), the surrender value of any policy on the life of a bankrupt "payable to himself, his estate, or personal representatives" passes to the trustee in bankruptcy unless the bankrupt pays such surrender value to the trustee. In 1917 the question arose whether the surrender value of a policy not payable to the insured or his estate, but with a right to change the beneficiary to himself or his estate, passed to the trustee. Although not passing by virtue of this section, the Supreme Court held that the surrender value passed to the trustee because of his power to change the beneficiary to himself or his estate under 70–a–3. The Supreme Court held:

"It might indeed be that it would better fulfill the protection of insurance by considering the proviso alone and literally, regarding the policy at the moment of adjudication, and, if it be not payable then in words to the bankrupt—no matter what rights or powers are reserved by him, no matter what its pecuniary facility and value is to him—to consider that he has no property in it. But we think such construction is untenable. The declaration of subdivision 3 is that 'powers which he might have exercised for his own benefit' 'shall in turn be vested' in the trustee, and there is vested in him as well all property that the bankrupt could transfer or which by judicial process could be subjected to his debts, and especially as to insurance policies which have a cash surrender value payable to himself, his estate or personal representative. It is true the policies in question here are not so payable, but they can be or could have been so payable at his own will and by simple declaration. Under such conditions to hold that there was nothing of property to vest in a trustee would be to make an insurance policy a shelter for valuable assets and, it might be, a refuge for fraud. And our conclusions would be the same if we regarded the proviso alone.

"This court has been careful to define the interest of bankrupts in the insurance policies they may possess. In *Hiscock* v. *Mertens* (205 U. S., 202) we gave a bankrupt the benefit of the redemption of a policy from the claims of creditors, though a cash surrender value was not provided by it but was recognized by the insurance company. In *Burlingham* v. *Crouse* (228 U. S., 459, 472) we said that it 'was the purpose of Congress to pass to the trustee that sum which was available to the bankrupt at the time of bankruptcy as a cash asset; otherwise to leave to the insured the benefit of his life insurance.' (See also *Everett* v. *Judson*, Id., 474.)" (*Cohen* v. *Samuels*, 245 U. S., 50, 52–53.)

While constrained to hold that Mrs. Cannon has an interest in these policies not subject to sale for her husband's taxes, we do not hold that the taxpayer has no interest therein which may not be liable for his taxes. Whether the loan value can be so subjected under 26 U. S. C. A., 1268(a) or otherwise, leaving to the beneficiary the right to the proceeds upon his death if premiums are paid as provided in the policy, we are not now called upon to decide; nor need we pass upon the question of whether a sale is a proper way to realize upon values in a life insurance policy because the law limits the bidders to those having an insurable interest in the life of the insured. (*Heusner* v. *Life Insurance Co.*, 47 Mo. App., 336; *Industrial Loan & Investment Co.* v. *Missouri State Life Insurance Co.*, — Mo., —, 3 S. W. (2d), 1046.) The effort to sell the entire policy, including Mrs. Cannon's interest therein as recognized by the Colorado law, should be enjoined.

The order in No. 1289 is reversed.

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executors or administrators, shall be entitled to its proceeds and avails against the creditors and representatives of the insured and of the person effecting the same, whether or not the right to change the beneficiary is reserved or permitted, and whether or not the policy is made payable to the person whose life is insured if the beneficiary or assignee shall predecease such person; provided, that, subject to the statute of limitations, the amount of any premiums for said insurance paid with intent to defraud creditors, with interest thereon, shall inure to their benefit from the proceeds of the policy; but the company issuing the policy shall be discharged of all liability thereon by payment of its proceeds in accordance with its terms, unless before such payment the company shall have written notice, by or in behalf of a creditor, of a claim to recover for transfer made or premiums paid with intent to defraud creditors, with specifications of the amount claimed. (Ch. 113, Laws of Colo., 1929.)

# SECTIONS 277 AND 278.—PERIOD OF LIMITATION UPON ASSESSMENT AND COLLECTION OF TAX.

ARTICLE 1271: Period of limitation upon assessment of tax. XV-25-8136 G. C. M. 16724

REVENUE ACT OF 1917.

The periods of limitation upon the collection of income and profits taxes prescribed by the Revenue Acts are not applicable to the payment of such taxes made by the Alien Property Custodian under the Trading with the Enemy Act, as amended by the Settlement of War Claims Act of 1928 and the Act of June 18, 1934 (48 Stat., 978).

G. C. M. 4978 (C. B. VII-2, 163) revoked.

Advice is requested whether a refund may properly be allowed of a payment made by the Alien Property Custodian and applied by the Bureau in settlement of taxes assessed for the year 1917 against the M Company based solely upon the ground that the payment was made after the expiration of the statutory period of limitation for collection.

In the recent decision of the Court of Claims in *Marianne Krauss and Paul Hohenau, as Sole Legatees*, v. *United States*, decided April 6, 1936, the court held that the wording of subdivision (b) of section 24 of the Trading with the Enemy Act, as amended, "requires that where taxes were due from the aliens whose property had been seized they should be computed and withheld without regard to the statute of limitations."

The court's decision is in part as follows:

It is argued on behalf of the plaintiffs that the War Claims Act did not repeal the provisions of the statutes with reference to the assessment and collection of taxes and that as these statutes were not repealed, they were not only in force at the time when the Alien Property Custodian turned the money involved over to the Commissioner but applied directly to the funds in the hands of the Alien Property Custodian, and consequently the disposition of these funds was controlled by the general statutory provisions with reference to taxes. This is clearly an erroneous conclusion. We have already shown that until the War Claims Act became a law the former owners of the property seized had no enforceable rights whatever therein and when this Act was passed they acquired no rights except those granted thereby. The War Claims Act made provision for the payment of taxes and the Government having complete right to retain the property, none of the taxing statutes had any application except as specially stated in the Act itself.

At this point it should be noted that the plaintiffs did not file the only claim for refund made in this case. It was filed by the Alien Property Custodian. Why, we do not know. It would seem self-evident that the Alien Property Custodian was not the agent for the former owner of the property. He was the agent of the Government itself and did not act for the plaintiffs in filing the claim for refund. (See Opinion of Attorney General, volume 32, pages 249, 253.) The incongruous situation is presented where an agent of the Government files a claim against the Government. If anyone was authorized to file a claim for refund, it would seem to be the plaintiffs; yet the plaintiffs had not paid the tax, it was paid by the Alien Property Custodian out of money over which the Government had complete control and the right to appropriate as it saw fit. These features of the case show how difficult if not impossible it is to apply the general provisions of the taxing statutes to the case now before us. The attempt to do so leads into all sorts of inconsistencies and presents one of the many reasons why we think Congress had no intention of restricting the right of the Government to retain money or property which had been seized by the Alien Custodian by applying the general statutes with reference to the assessment and collection of taxes.

What has been said above, we think shows plainly that plaintiffs' case depends not upon whether the provisions of the revenue laws with reference to the assessment and collection of taxes were repealed by the War Claims Settlement Act but upon whether that statute made these provisions applicable in determining the amount which the claimants should receive. The taxes involved were not assessed and collected within the period prescribed by the general provisions of the revenue laws and if they are applicable in determining whether the money involved in the suit can be retained by the Government it is obvious that plaintiffs are entitled to recover. On the other hand, if the War Claims Settlement Act, as we think, provided that the taxes should be computed, as if the property had not been seized by the Alien Custodian, and then paid without any further restrictions, the plaintiffs have no foundation for their suit.

Plaintiffs rely largely on section 24 of the Trading with the Enemy Act which was amended by the War Claims Settlement Act in section 18 thereof which was headed "Taxes." Section 24 of the Trading with the Enemy Act was made subdivision (a) by the amendment and subdivisions (b) to (f) inclusive were added. Section 24 (now subdivision (a)), among other things, provided:

"The Alien Property Custodian is authorized to pay all taxes * * * heretofore or hereafter lawfully assessed * * * against any money or other property held by him * * *."

It did not direct the Alien Property Custodian to pay or turn over anything to the former owners of the property but merely authorized the payment of certain taxes. Subdivision (b) of the amendment reads as follows:

"(b) In the case of income, war-profits, excess-profits, or estate taxes imposed by any Act of Congress, the amount thereof shall, under regulations prescribed by the Commissioner of Internal Revenue with the approval of the Secretary of the Treasury, be computed in the same manner (except as hereinafter in this section provided) as though the money or other property had not been seized by or paid to the Alien Property Custodian, and shall be paid, as far as practicable, in accordance with subsection (a) of this section. Pending final determination of the tax liability the Alien Property Custodian is authorized to return, in accordance with the provisions of this Act, money or other property in any trust in such amounts as may be determined, under regulations prescribed by the Commissioner of Internal Revenue with the approval of the Secretary of the Treasury, to be consistent with the prompt payment of the full amount of the internal-revenue taxes."

* * * * * * *

We think the wording of subdivision (b) requires that where taxes were due from the aliens whose property had been seized they should be computed and withheld without regard to the statute of limitations. If it should be conceded for the sake of the argument that the statute was ambiguous, the surrounding circumstances clearly show that such must have been the intent of Congress. This money or property was turned over purely as an act of grace. In so doing, the United States was not standing upon its war-time rights but placed the matter on a moral and equitable plane highly favorable to the claimants. Having done this, it seems hardly conceivable that it was intended to turn this property back to the former owners without collecting taxes justly due from them. Our Government was intending to do exact justice to the alien claimants and it would exact no more than justice in requiring these taxes to be paid. Where the intent is manifest and the language ambiguous the intent must control.

* * * * * * *

Counsel for plaintiffs call attention to a ruling of the General Counsel of the Bureau of Internal Revenue in which it was held that the Settlement of War Claims Act did not abrogate the general statute of limitations applicable to the assessment and collection of an internal-revenue tax, but if we are correct in what has been stated above, an erroneous basis was taken for the ruling. We have already shown that the omission from the War Claims Settlement Act of any provision repealing the general provisions relating to the assessment and collection of taxes did not make them applicable to the money in the hands of the Custodian. It required a special provision in the War Claims Settlement Act to make them applicable. This ruling, however, is not very material, as the Bureau did not adhere to it, and it seems to have been withdrawn.

Under our view of the law applicable to the case the plaintiffs' petition must be dismissed and it is so ordered.

In view of the foregoing decision, it is held that the taxes in question may not be refunded on the ground that the collection thereof was barred by the statute of limitations at the time of payment by the Alien Property Custodian.

G. C. M. 4978 (C. B. VII-2, 163), which holds that the assessment and collection of income and profits taxes in respect of property held by the Alien Property Custodian under the Trading with the Enemy Act, as amended, is subject to the periods of limitation prescribed by the Revenue Acts applicable to the various taxable years, is hereby revoked.

HERMAN OLIPHANT,
*General Counsel for the Department of the Treasury.*

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ARTICLE 1271: Period of limitation upon assessment of tax.

REVENUE ACT OF 1926.

Validity of waiver with respect to assessment and determination. Execution of waiver before finding of deficiency. Sufficiency of notice. (See Ct. D. 1131, page 252.)

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## SECTION 280.—CLAIMS AGAINST TRANSFERRED ASSETS.

ARTICLE 1291: Claims in cases of transferred assets. XV-1-7891 Ct. D. 1056

INCOME AND PROFITS TAX—REVENUE ACT OF 1926—DECISION OF SUPREME COURT.

1. ASSESSMENT—LIABILITY OF TRANSFEREE—EXECUTOR AND LEGATEE UNDER WILL OF DECEASED STOCKHOLDER OF DISSOLVED CORPORATION—LOCAL LAW.

The executor of the will of a deceased stockholder of a dissolved corporation is not chargeable with liability, as legatee under the will, for a deficiency of income and profits taxes assessed against the corporation, in a proceeding against the estate as transferee of the assets of the corporation. The estate having been settled and the executors discharged before the notice of the proposed assessment was mailed, the executor was no longer subject to an assessment or suit in his representative capacity, under the law of Illinois.

2. DECISION REVERSED.

Decision of the Circuit Court of Appeals, Seventh Circuit (76 Fed. (2d), 736), which reversed the decision of the Board of Tax Appeals (27 B. T. A., 1123), reversed.

SUPREME COURT OF THE UNITED STATES.

*De Forest Hulburd, petitioner,* v. *Commissioner of Internal Revenue, respondent.*

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

[December 9, 1935.]

OPINION.

Mr. Justice CARDOZO delivered the opinion of the Court.

The controversy is one as to the liability of the executor and legatee of a shareholder in a dissolved corporation for a deficiency of income and profits taxes assessed against the company.

In September, 1919, the Van Sicklen Co., an Illinois corporation, sold all its assets to a Delaware corporation, the Van Sicklen Speedometer Co., and was thereupon dissolved. In consideration of the sale it received $250,000 in cash and 5,000 shares in the new company, which it distributed forthwith among its own shareholders. One of these shareholders was Charles H. Hulburd. His distributive portion on the dissolution of the company was $8,000 in cash and 160 shares of no par stock. He died on January 14, 1924, leaving a will by which his son, De Forest Hulburd, and Hugh McBirney Johnston were appointed executors. The son, who is the petitioner in this court, was also a legatee and devisee. The coexecutor, Johnston, is dead.

In December, 1919, the Van Sicklen Co. filed a corporation income and profits tax return for the fiscal year ending September 30, 1919. The return, however, was inadequate. Accordingly, on November 17, 1924, the Commissioner of Internal Revenue made an additional assessment in the sum of $227,872.06, with penalties in the sum of $113,936.03. Unable to collect this deficiency from the company after the distribution of its assets, he turned to the shareholders. On October 27, 1926, he mailed a letter to the "Estate of Charles H. Hulburd, c/o De Forest Hulburd, 86 East Randolph Street, Chicago, Ill." In this he gave notice of a proposed assessment "against the estate" by reason of its liability as transferee of the assets of the Illinois corporation. The amount of that liability was stated to be $24,000, but was afterwards reduced to $8,000, the cash received by the testator. In announcing this assessment, the Commissioner acted in reliance on section 280 of the Revenue Act of 1926 (26 U. S. C. App., section 1069); which permits an assessment against the transferee of a taxpayer upon the taxpayer's default. Before the passage of that Act shareholders who had received the assets of a dissolved corporation might be compelled to discharge unpaid corporate taxes, but only by bill in equity or action at law. (*Phillips* v. *Commissioner*, 283 U. S., 589, 592, 593 [Ct. D. 350, C. B. X-1, 264].) A summary procedure was added by the statute. (*Phillips* v. *Commissioner*, supra.) Upon the default of the taxpayer, the Commissioner is to apportion the deficiency among the transferees of the property and to give notice accordingly. (Revenue Act of 1926, section 274.) If the transferee is dissatisfied, he may petition the Board of Tax Appeals to redetermine the existence of liability and its proper distribution.

On October 27, 1926, when notice of the proposed assessment was sent to the petitioner, the estate of Charles H. Hulburd had been settled, the assets distributed and the executors discharged.[1] The discharged executors submitted to the Board of Tax Appeals a petition for review disclaiming liability. They stated in effect that they were the persons who had been appointed executors by the will of Charles H. Hulburd, but that their responsibilities as such were ended. Enumerating their objections to the assessment they alleged that the action of the Commissioner was erroneous for the reason that the estate had been "wholly distributed and settled and your petitioners duly discharged as executors thereof." Thus, as early as December, 1926 (when the petition for review was filed), and before the period of limitation under the statute had run against a new assessment against legatees or devisees (Revenue Act of 1926, section 280(b)2), the Commissioner was put upon notice that the deficiency had been assessed against persons no longer liable and was given the opportunity to impose it upon others. Instead of doing this he stood his ground and prayed for an order that his determination be confirmed.

The Board of Tax Appeals held that "at the time the notice was mailed there was no liability of the estate or of the petitioners as executors." It put aside

[1] The decree of the Probate Court of Cook County, Ill., the place of administration, was made on February 26, 1925, and, the text being important, is quoted in full:

"*In the Matter of the Estate of Charles H. Hulburd, Deceased.*

"This day came Hugh McBirney Johnston and De Forest Hulburd, executors of the last will and testament of Charles H. Hulburd, deceased, and presented to the court and filed herein their final account with the estate of said decedent, showing that said estate has been fully administered.

"And it now appearing to the court that more than one year has elapsed since the granting of letters testamentary herein; that due notice has been given to all of the heirs at law, legatees and beneficiaries; that all assets of said estate have been collected; that no claims have been filed against said estate; that specific legacies have been paid; that the inheritance tax, Federal estate tax, income tax, court costs and all other costs and expenses of administration herein have been paid, and that the balance of said estate has been distributed according to the last will and testament of said decedent, and guardian ad litem consenting to the approval of said final account.

"It is therefore ordered by the court that said final account be approved and recorded, that the estate be and it is declared settled and that the executors be and they are hereby discharged."

the consideration of a possible "liablity of any of the beneficiaries under the will or the distributees of the assets of the estate" on the ground that no such question was in the case. (27 B. T. A., 1123; cf. 21 B. T. A., 23.) The decision of the Board was reviewed by the Circuit Court of Appeals for the Seventh Circuit. That court decided that the executors were liable *de bonis testatoris* because they had failed to give notice to the Commissioner that their fiduciary capacity had terminated. (Revenue Act of 1926, section 281(b).) Besides this, the court held that De Forest Hulburd was liable individually to the extent of $4,000 because in the record there was evidence, not confirmed by any finding, that as legatee under the will he had received half of the $8,000 paid to his father on the dissolution of the company. The order of the Board was accordingly reversed, and the cause remanded for proceedings to conform to the opinion. (76 F. (2d), 736.) The power was thus assumed to change a deficiency assessed against the executors of an estate into a deficiency to be assessed against a legatee who had shared in the estate. To determine the validity of that assumption and to settle other questions of statutory construction, a writ of certiorari was granted by this court.

First: The petitioner is not chargeable in this proceeding with liability as legatee under the will of a deceased shareholder in the taxpayer, a corporation now dissolved.

The Act of 1926 (ch. 27, 44 Stat., 9, section 280; 26 U. S. C. App., section 1069), in supplementing by a summary procedure the cumbrous remedy of suit, laid the duty of assessment upon the Commissioner of Internal Revenue. "The liability, at law or in equity, of a transferee of property of a taxpayer" was to be "assessed, collected, and paid in the same manner and subject to the same provisions and limitations" as in the case of any other tax deficiency. (Ibid, section 280(a)1.) Pursuant to this mandate the Commissioner did assess a liability and gave notice to the transferee accordingly. He assessed it to the estate represented by executors, and not to anyone else. "As provided by section 280 of the Revenue Act of 1926, there is proposed for assessment against the estate the sum of $24,000 constituting its liability as a transferee of the assets of the Van Sicklen Co., Elgin, Ill." The Board of Tax Appeals upon petition for review had power to redetermine the deficiency thus charged to the estate (Revenue Act of 1926, section 274), but not to charge it to another. (Cf. 26 U. S. C. (1934 ed.), sections 600, 601, 619; *Williamsport Wire Rope Co.* v. *United States*, 277 U. S., 551, 562, 564 [T. D. 4172, C. B. VII–2, 323].) If some one else was to be charged, there would be need of a new assessment, which the Commissioner might make at any time within a year after the enactment of the statute. (Revenue Act of 1926, section 280(b)2.) In making it he would consider any facts material and relevant for arriving at a just apportionment of benefits and burdens. The duty to inquire and determine was imposed by the statute upon him and not upon an agency of government established for the purpose of revising his decision. These restraints upon jurisdiction were duly heeded by the Board. It disclaimed the power or the purpose to pass upon the liability of legatees or devisees or to assess a tax against them. The same restraints upon jurisdiction were binding upon the Court of Appeals in reviewing the action of the Board, and binding with greater emphasis, for the court was without power to choose between conflicting inferences unless only one was possible, or to try the case *de novo*. (*Helvering* v. *Rankin*, 295 U. S., 123 [Ct. D. 966, C. B. XIV–1, 160].) The adjudication of liability as to Hulburd individually was made in seeming forgetfulness of these jurisdictional restrictions. It was error to ignore them.

In so holding we are not unmindful of the argument for the respondent that the form of the petition to review the action of the Commissioner was effective in some way to enlarge the scope of the proceeding and to subject the legatee to a new and different assessment. The argument will not stand. There is nothing in the petition submitted to the Board whereby power was extended beyond the statutory limits, if we assume provisionally that consent might be effective, at least in certain circumstances, to bring that result about. The petitioners, having been discharged as executors, were unwilling to describe themselves as if they were still acting in that capacity. What they did was to state the facts and ask the judgment of the Board thereon. Far from conceding that the assessment ran against either of them personally, they protested that in form and in purpose it was an assessment against the estate and hence was of no validity after the estate had been settled and the executors discharged. The meaning of their protest was not subject to misconstruction, nor in fact was it misconstrued, as the opinion of the Board shows if the fact might otherwise be doubtful. When the protest had been made, the remedy available to the Commissioner was obvious and ample. He had time even then as we have already pointed out, to announce a new assessment, which would have brought up the question whether the liability once resting on the executors had devolved upon another. For reasons not disclosed he determined not to do so. In such circumstances the cases cited by the Government, where a formal defect has been ignored in circumstances tending toward an inference of waiver or estoppel,[2] have no relation to the case at hand. We are not required at this time to approve or disapprove them. In this case there was neither waiver nor estoppel, but a steady insistence that the deficiency had been assessed against the estate and no one else, and that the liability of the estate had ended. To hold that by consent, either tacit or express, the proceeding had been turned into one to review the validity of a different assessment, and one never in fact made, would be a perversion of the record.

Second: The estate having been settled and the executors discharged, the petitioner was *functus officio* under the law of Illinois, and was no longer subject to an assessment in his representative capacity.

The Court of Appeals in upholding the liability of the executors as such put its ruling upon the ground that they had failed to give notice to the Commissioner of the termination by decree or otherwise of their fiduciary capacity. The notice was thought to be requisite under section 281(b) of the Revenue Act of 1926, which is quoted in the margin.[3] But the Revenue Act of 1926 became a law in February of that year (section 286; U. S. C., section 931), and the executors were discharged in February, 1925. If their liability as executors was ended at that time, the statute will not be read as attempting to revive it. (*White* v. *United States*, 191 U. S., 545; *Winfree* v. *Northern Pacific R. Co.*, 227 U. S., 296; *Union Pacific R. Co.* v. *Laramie Stock Yards*, 231 U. S., 190, 199; *Shwab* v. *Doyle*, 258 U. S., 529 [T. D. 3339, C. B. I–2, 312]; *Liberman's Committee* v. *Commissioner*, 54 F. (2d), 527.)

Section 281(b) being found to be inapplicable, we have still to determine whether executors who have been discharged after a full settlement of the estate are subject by the law of Illinois to assessment or suit in their representative capacity.

By the common law of England an executor was deemed to carry forward the *persona* of the testator. (Holmes, The Common Law, pages 344, 345; Holdsworth's History of English Law, volume 3, pages 563, 573, 574, 583; Littleton's Tenures, section 337; Co. Litt., 209, a, b; *Mechanics' Savings Bank* v. *Waite*, 150 Mass., 234, 235; *Chipman* v. *Manufacturers' National Bank*, 156 Mass., 147, 149.) Unless the appointment was qualified in respect of time, it continued during life. (Williams, Executors, twelfth edition, volume 1, pages 131, 147, 342.) There was no such thing as a discharge upon a showing of *plene administravit*. There was no such thing as a resignation because of mere unwillingness to go on. (*Rogers* v. *Frank*, 1 Younge and Jervis, 409, 414; *In the Goods of Heslop*, 1 Robertson's Ecclesiastical Rep., 457, 458; *In the Goods of Veiga*, 3 Swabey & Tristram 13, 15.) The power to act might be suspended or revoked through the appointment of a committee or a receiver if the executor was found to be physically or mentally incapable. (*In the Goods of Binckes*, 1 Curteis, 286; *In the Goods of Newton*, 3 Curteis, 428; *In the Goods of Cooke* (1895), P. D., 68; *In the Goods of Goldschmidt*, 78 L. T. (N. S.), 763; *In the Estate of Shaw* (1905), P. D., 92.) There might be like relief if he had become insolvent after probate or had disappeared or had misappropriated the assets or otherwise abused his trust. (*In the Goods of Covell* (1889), P. D., 8; *Estate*

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[2] *Commissioner* v. *New York Trust Co.* (54 F. (2d), 463 [Ct. D. 540, C. B. XI–2, 320]); *Haag* v. *Commissioner* (59 F. (2d), 516); *Burnet* v. *San Joaquin Fruit & Investment Co.* (52 F. (2d), 123 [Ct. D. 406, C. B. X–2, 260]); *Warner Collieries Co.* v. *United States* (63 F. (2d), 34 [Ct. D. 703, C. B. XII–2, 227]); *American Equitable Assurance Co. of New York* v. *Helvering* (68 F. (2d), 46 [Ct. D. 822, C. B. XIII–1, 336]); *Continental Products Co.* v. *Commissioner* (66 F. (2d), 434); *Buzard* v. *Helvering* (77 F. (2d), 39); *Commissioner* v. *Nichols & Cox Lumber Co.* (65 F. (2d), 1009 [Ct. D. 764, C. B. XII–2, 246]); *Pittsburgh Terminal Coal Corporation* v. *Heiner* (56 F. (2d), 1072 [Ct. D. 501, C. B. XI–1, 225]).

[3] Upon notice to the Commissioner that any person is acting in a fiduciary capacity for a person subject to the liability specified in section 280, the fiduciary shall assume, on behalf of such person, the powers, rights, duties, and privileges of such person under such section (except that the liability shall be collected from the estate of such person), until notice is given that the fiduciary capacity has terminated.

*of Thomas* (1912), P. D., 177; *Utterson* v. *Mair*, 2 Ves. Jr., 95, 97, 98; *In the Goods of Loveday* (1900), P. D., 154, 156; *Oldfield* v. *Cobbett*, 4 L. J. (N. S.) (Chan.), 271, 272; *Richards* v. *Perkins*, 8 L. J. (N. S.) (Ex. Eq.), 57, 58.) Nothing short of clear necessity would cause him to be ousted. In the absence of peril to the estate, responsibility and power were not to be renounced when once they had been assumed. So the law of England continues even now.[4]

The common law rule is preserved in some of our States to-day, but in many has been abandoned, at times as the result of statute, at times through the combined force of statute and decision. The diversity of doctrine is surprising, and so often is its obscurity. The commentators tell us, however, and, as the cases show, correctly, that the growing tendency in this country is away from the English rule.[5] Some States, though they make provision for an accounting, make none for a discharge, and hold the executor suable after the estate has been distributed upon the chance that other property may be discovered later on. The judgment will be collectible out of assets *in futuro*, or *quando acciderint*, as was said in early days. (Williams, supra, volume 2, page 1253; *Mary Shipley's case*, 8 Co., 134, a, b; *Noell* v. *Nelson*, 2 Saund., 226.) This in effect is the practice in New York (*Mahoney* v. *Bernhard*, 45 App. Div., 499, 501; affirmed, 169 N. Y., 589; *Willets* v. *Haines*, 96 App. Div., 5, 7; *Rosen* v. *Ward*, 96 App. Div., 262, 266; *Pearse* v. *National Lead Co.*, 162 App. Div., 766, 769; *Paff* v. *Kinney*, 1 Bradf., 1, 9), where a judicial settlement of accounts is conclusive as to the past, but is never ultimate in the sense that it relieves the fiduciary from liability for the future. (See also *Hazlett* v. *Estate of Blakely*, 70 Neb., 613, 617; *Weyer* v. *Watt*, 48 Ohio, 545, 551.) On the other hand, there are States where by express provision of the statutes the executor is to be discharged upon a showing of full administration, and others where the requirement of a discharge has been read into the statutes by a process of construction.[6]

The courts of Illinois, as we interpret their opinions, maintain a middle ground, which is neither that of the common law on the one side nor its opposite on the other. This is not to say that there is any case in that State so like in its essential features to the one for decision here as to make the Illinois position certain. On the contrary, support will be found for the strict rule of the common law if what has been said in some of the opinions is taken from its framework and considered without reference to what was actually decided. (See, e. g., *Starr* v. *Willoughby*, 218 Ill., 485, 493.) The aspect becomes different, however, when attention is directed to the setting of the facts and to the provisions and implications of the applicable statutes. What emerges, it would seem, is this: A discharge upon an accounting will be vacated in a direct proceeding, if it appears that there were assets, not inventoried by the executor or included in his report, for which, when the decree was passed, he was properly accountable (*Fraser* v. *Fraser*, 149 Ill. App., 186, 187, 195, 196; cf. *Musick* v. *Beebe*, 17 Kan., 47, 53, 54); in the absence of such a showing, the discharge when decreed upon a finding of full administration will relieve the executor

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[4] Cf. 14 Halsbury, Laws of England, second edition, pages 171, 269, 287, 288, and cases cited.

[5] See Woerner, The American Law of Administration, third edition, volume 3, sections 571, 572, 573, where the cases are brought together.

[6] Minnesota: *Security Trust Co.* v. *Black River National Bank* (187 U. S., 211, 234), reviewing the State decisions; *State ex rel. Matteson* v. *Probate Court* (84 Minn., 289, 293) (since 1903 the right to a discharge has been reinforced by statute. Acts of 1903, ch. 195; 1 Mason's Stats., 1927, section 8886); Missouri: *Grayson* v. *Weddle* (63 Mo., 523, 539, 540); *State ex rel. Stotts* v. *Kenrick* (159 Mo., 631); *In re Estate of Rooney* (163 Mo. App., 389, 394); cf. Kentucky: *United States Fidelity & Guaranty Co.* v. *Martin* (143 Ky., 241, 242, 243); West Virginia: *Downey* v. *Kearney* (81 W. Va., 422, 426). See also, Alabama: *Modawell* v. *Holmes* (40 Ala., 391, 404); *Hicky* v. *Stallworth* (143 Ala., 535, 540); Code, 1928, section 5962; California: *Willis* v. *Farley* (24 Cal., 490, 502); *In re Clary* (112 Cal., 292, 294); Probate Code, 1933, section 1066; Georgia: *Carter* v. *Anderson* (4 Ga., 516); *Groce* v. *Field* (13 Ga., 24, 30); Code, 1933, section 113–2302; Iowa: *Diehl* v. *Miller* (56 Iowa, 313); Code, 1931, section 12052; Kansas: *Musick* v. *Beebe* (17 Kan., 47, 53, 54); *Proctor* v. *Dicklow* (57 Kan., 119, 125); Rev. Stats., 1923, section 22–931; Montana: *State ex rel. Potters & Co.* v. *District Court* (76 Mont., 143, 148); Rev. Code, 1921, sections 10311, 10331; Pennsylvania: *Vandever's Appeal* (42 Penn., 74); *Estate of John Wiseman* (12 Phila., 11); 20 Purdon's Stats., section 911; South Carolina: *Seabury* v. *Green* (294 U. S., 165, 169); *Quick* v. *Campbell* (44 S. C., 386, 392); *McNair* v. *Howle* (123 S. C., 252, 266); Code, 1932, section 9024.

for the future of responsibility and power. (Cf. *Reizer* v. *Mirtz*, 223 Ill., 555, 562, 564; *Robinson* v. *Robinson*, 214 Ill. App., 262, 268, 269.)[7]

Whatever doubt may survive a reading of the cases is dispelled or greatly attenuated when we pass to an examination of the statutes and the plan that they reveal.

First in order of importance is the statute regulating the settlement of accounts.[8] An executor is required to exhibit a report of his administration within 30 days after the expiration of one year from the date of his letters. That being done, he must exhibit a report thereafter, whenever required by the court, "until the duties of administration are fully completed." He may from time to time at his own volition file "a final report of his administration to a specified date," which, even if approved, will not terminate his office. He may also make a final report "at the conclusion of administration."[9] Such a report, if approved upon notice to all parties in interest, shall be binding upon them "in the absence of fraud, accident or mistake." A final report "at the conclusion of administration" assumes that there is a stage when administration is over. The executor is *functus officio* when discharged by the court after that stage has been attained.

Another statute of high significance is one that makes provision for an appeal of the assets.[10] If the executor discovers after the making of an inventory and appraisal that the assets of the estate do not exceed the amount of the widow's allowance, after deducting necessary expenses, he is to report the facts to the court. Thereupon the court, if it finds the report to be true, shall order the assets to be delivered to the widow, "and discharge the executor or administrator from further duty." Plainly such a discharge is equivalent to a termination of the office. There is not only exoneration for the past, but absolution for the future.[11]

The decree of the probate court discharging this executor must be read against the background of this statutory scheme. It is too precise in its terms to be dismissed as amounting to nothing more than a confirmation of the report as submitted for approval. If words can express an intention to declare administration ended, the expression is not lacking here. We may not put all this aside as surplusage. If there was no power in the Illinois court to give relief so comprehensive, the defect should be very clear before a Federal court will undertake to wrest the words of the decree from their natural and ordinary meaning or hold them to be futile. Especially is that so in view of the growing tendency of probate courts throughout the land to break the shackles of the ancient rule. Weighty considerations of expediency and justice explain this tendency and support it. In the thought of many judges, an executor discharged after a full and fair accounting is no longer to be vexed by the annoyance and expense of defending fruitless suits with assets no longer available for reimbursement or indemnity. If suitors or taxgatherers wish to go against the estate or against those who have shared in it, they must either vacate the decree upon a showing of assets unaccounted for, or procure upon a showing of neces-

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[7] Leading cases in Illinois are brought together in this note for the purpose of distinguishing dictum from decision: *Blanchard* v. *Williamson* (70 Ill., 647, 650) holds that a discharge of an administrator will be treated as a nullity if made while the estate is in course of administration; *Diversey* v. *Johnson* (93 Ill., 547, 558) holds that a discharge is of no effect if obtained by the administrator with notice of an outstanding claim and in fraud of the rights of the adverse claimant (cf. *People* v. *Rardin*, 171 Ill. App., 226, 230); *Bayless* v. *People* (56 Ill. App., 55, 58) holds that a surety is liable on an executor's bond where a balance available for creditors was wrongfully distributed; *Starr* v. *Willoughby* (218 Ill., 485, 492) holds that a power in trust, unrelated to the office of executor, will survive a decree which purports to discharge him; and *Maguire* v. *City of Macomb* (293 Ill., 441, 453) is substantially to the same effect. No case has been found where an executor whose discharge had been decreed after a full and fair accounting has been held suable thereafter in his representative capacity.

[8] Laws of 1872, page 77, at pages 105, 106, section 112; amended by Laws of 1919, page 1, at page 3; Laws of 1931, page 6; Laws of 1933, page 3, at page 6; now Revised Statutes, 1935, ch. 3, section 114.

[9] See Laws of 1931, page 6.

[10] Laws of 1872, page 77, at page 92, section 59; Laws of 1919, page 1, at page 2; now Revised Statutes, 1935, ch. 3, section 60.

[11] Still another inroad upon the common law rule is made by a statute allowing an executor to resign whenever it appears to the court that a resignation is proper. Laws of 1872, page 77, at page 88, section 40; now Revised Statutes, 1935, ch. 3, section 41.

sity the appointment of an administrator, or pass over the estate and its representatives and pursue the legatees to the extent of benefits received. There was no attempt to tread those paths, though the last at all events was open.

The controversy in this aspect is one of local law, which, once it is ascertained, must be accepted as controlling. (*Security Trust Co.* v. *Black River National Bank*, supra; *Forrest* v. *Jack*, 294 U. S., 158; *Seabury* v. *Green*, 294 U. S., 165.) The decree discharging the executors amounts to a construction of the Illinois statute by a court of the State, and a court of special competence and experience in disposing of such questions. There being no satisfactory showing that the decision overpasses the bounds of jurisdiction, we yield to its authority.

The decree of the Circuit Court of Appeals is reversed and the order of the Board of Tax Appeals affirmed.

It is so ordered.

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## ARTICLE 1291: Claims in cases of transferred assets.

XV-4-7922
Ct. D. 1068

INCOME TAX—REVENUE ACT OF 1926—DECISION OF COURT.

1. LIABILITY OF TRANSFEREES—DISSOLVED CORPORATION—JURISDICTION OF BOARD OF TAX APPEALS—STATUTE OF LIMITATION.

On February 10, 1925, notice of deficiencies for the years 1919 and 1920 was mailed to a corporation which had dissolved in 1922, and on April 11, 1925, a petition, entitled in the name of the corporation, was filed with the Board of Tax Appeals by an attorney whose action, in a corrected petition filed April 25, 1925, was ratified by the trustees appointed under authority of State law to settle the affairs of the corporation. On January 17, 1929, after promulgation of the Board's decision (February 13, 1928), notice of proposed assessments against the petitioners as transferees, under section 280 of the Revenue Act of 1926, was mailed to each of them, and an appeal for redetermination of liability as such transferees was taken, on the ground that the proposed assessments were barred by the statute of limitation at the time the notices were mailed. Under these facts, the Commissioner's deficiency notice of February 10, 1925, was in time; the petition, however styled, was in legal effect an appeal by the trustees; the Board of Tax Appeals properly took jurisdiction; the effect of the petition was to suspend the running of the statute against the corporation and its trustees until the final decision of the Board; and the deficiency notices to the petitioners as transferees, being mailed within one year after the final decision of the Board, were within the statutory period.

2. ESTOPPEL.

Where the principal stockholders and directors of a corporation applied for its dissolution and were appointed by the court as trustees to pay the debts and distribute the assets, as the real parties in interest after such dissolution, they were jointly and severally liable (to the extent of the distributive assets received by them) for taxes thereafter legally assessed against the corporation, and, having had the benefit of a hearing and reconsideration of the tax claim before the Board of Tax Appeals, thus securing the delay on which their defense is built, to permit them to continue to hold the assets of the corporation and to say that the entire proceeding before the Board was a nullity would be to allow them to repudiate their own voluntary appearance in the corporation's behalf, to deny their own pleadings, and to take inconsistent positions in the same litigation. They are therefore estopped to deny the regularity of the proceedings before the Board.

3. LIABILITY OF TRANSFEREES—INTEREST.

The transferees of a corporation dissolved in 1922 are liable for interest upon amounts of deficiencies for 1919 and 1920, stipulated before the Board of Tax Appeals, where there is nothing in the stipulation to show that interest was included in the agreed sums, such interest to be chargeable from February 26, 1926, under the provisions of sections 280(a)1 and 283(d) of the Revenue Act of 1926.

4. DECISION AFFIRMED.

Decision of the Board of Tax Appeals (29 B. T. A., 981) affirmed.

UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA.

*R. T. Buzard, petitioner,* v. *Guy T. Helvering, Commissioner of Internal Revenue, respondent.*

*E. T. Dusenbury, petitioner,* v. *Guy T. Helvering, Commissioner of Internal Revenue, respondent.*

On petitions for review of decisions of the United States Board of Tax Appeals.

Before MARTIN, C. J., and ROBB, VAN ORSDEL, HITZ, and GRONER, JJ.

[April 1, 1935.]

OPINION.

GRONER, J.: The Navarro Lumber Co. was a California corporation. It filed its income tax return for 1919 on March 15, 1920, and for 1920 on March 8, 1921. In 1922 it filed an application for voluntary dissolution in the superior court of the county of its principal place of business, and in the same year a decree was entered, dissolving the corporation and appointing its three directors (two of whom are the petitioners herein) to distribute the assets to its stockholders.

The period of limitation for assessment against the lumber company for 1919 expired March 15, 1925, and for 1920 on March 8, 1926; and on February 10, 1925 (within the limitations period), the Commissioner mailed notice of deficiencies for the years 1919 and 1920 to the lumber company at its San Francisco address; and within the allowable 60-day period thereafter a petition for redetermination was filed with the Board of Tax Appeals. The petition was signed "for Navarro Lumber Co., by John J. Heberle." Heberle, presumably, is a New York lawyer, and in signing the petition he was acting pursuant to a power of attorney to him, of date November 9, 1923, executed by the three trustees. On April 25, 1925, an additional or corrected petition, signed and verified by the three trustees personally, was filed with the Board. In this petition the trustees say:

"We desire to and do confirm all of the said acts of our said attorneys, and we verify and adopt as our own act and deed, the said petition filed with the United States Board of Tax Appeals, on April 11, 1925."

Attached to the petition was a copy of the power of attorney to Heberle, the decree of the California court dissolving the corporation and appointing trustees, a reference and quotation from section 400 of the Civil Code of California showing that the trustees had authority, under the provisions of that statute, to do the acts and things they were then doing.

On February 13, 1928, the Board promulgated its findings of fact and opinion, and entered a deficiency order against the lumber company for 1919 and 1920; and on January 17, 1929, the Commissioner mailed to each of the petitioners a notice stating:

"Under the provisions of section 280 of the Revenue Act of 1926, there is proposed for assessment against you the amount of $53,086.18 plus any accrued penalty and interest representing your liability as a transferee of the assets of the Navarro Lumber Co. for outstanding tax assessed against said company for the years 1919 and 1920."

Petitioners appealed to the Board of Tax Appeals for a redetermination of their liability as transferees under section 280 (Revenue Act of 1926). The basis of the petition was that the assessment proposed by the Commissioner against petitioners as transferees was barred when he mailed his notices (January 17, 1929). In this proceeding a stipulation was filed, as follows:

"The Board may find and determine * * * that there are deficiencies with respect to the liability of Navarro Lumber Co. * * * for the taxable years 1919 and 1920 in the respective amounts of $13,568.75 and $17,630.97, saving and reserving to the petitioners * * * such right or rights as they may have under the law and the evidence, upon their pleas that the statute of limitations has run against the assessment * * *."

The stipulation also recited it was agreed that petitioner Dusenbury received on August 7, 1922, distributions in liquidation of the lumber company in the sum of $26,947.70, and that petitioner Buzard received, at the same time, sums in excess of the total amount of the stipulated tax.

On February 1, 1934, the Board (five members dissenting) decided against petitioners, holding Buzard and Dusenbury liable, as transferees, in the amount of $31,199.72 (the stipulated amount), "plus interest thereon from February 26, 1926, to the date of assessment at the rate of 6 per cent per annum."

Petitioners have appealed to this court, and assign the following grounds of error: First, that the Navarro Lumber Co. is *the taxpayer* that incurred the tax for 1919 and 1920 on which the proposed liability of the petitioners is founded; second, that Navarro Lumber Co. was totally dissolved in 1922 and did not execute or file the appeal to the Board in 1925, on which the Commissioner relies for an extension of the periods of limitation for assessments against that company; third, that the Commissioner has not shown that the lumber company ever extended the period of limitations beyond the statutory period—March 15, 1925, and March 8, 1926, respectively; fourth, that the notices of liability mailed to these petitioners on January 17, 1929, were mailed more than one year later than either of those dates, and that the assessments proposed in them were therefore barred when the notices were mailed; and fifth, that the Board erred when it ordered for each petitioner a liability, *plus interest.*

Section 280 of the Revenue Act of 1926 authorizes the assessment of the liability of a transferee of property of a taxpayer, in respect to the latter's tax; and provides that this liability shall be assessed within one year after the expiration of the period of limitation for assessment of tax against the taxpayer; and further provides that when the taxpayer was a corporation, but has terminated its existence, the period of limitation for assessment against it shall be the period which would be in effect if it were still in existence. The provisions of the Act apply to any tax imposed by that (1926) or any prior income tax Act.

From what has been said, it will be seen that the foundation of the appeals is that the charter of the lumber company having been withdrawn in 1922, the petition filed in its behalf in 1925 by the trustee was of no effect and did not extend the period of limitation for assessments against the corporation or against petitioners as distributees of the corporation.

On the other hand, it is argued, if the appeal was properly filed and binding on the corporation, admittedly its filing would stop the running of the limitation periods until the final decision of the Board; and, in that case, notice to petitioners within "one year after the expiration of the period of limitation for assessment against the taxpayer" would bind them and carry over to them the tax liability of the corporation.

Petitioners tell us that, though an appeal was filed in behalf of the lumber company, it was not filed *by* the lumber company (the taxpayer) and therefore did not extend, as against petitioners or the company, the periods of limitation. To sustain this, they say that as the lumber company was dissolved in the year 1922 it had ceased to exist from that moment and under the law of the State of its incorporation it was legally dead and incapable of taking any action which would legally bind either itself or petitioners as transferees of its property.

Petitioners rely on *Crossman* v. *Vivienda Water Co.* (150 Cal., 575). That was an action in debt commenced against a dissolved corporation and certain persons alleged to be stockholders. Summons was served on the president of the corporation; a demurrer was filed and overruled; and an answer was then filed by the stockholder defendants in which they denied liability on the part of the alleged corporation and also denied the existence of the corporation, alleging it had been voluntarily dissolved under the California statute. No pleading or answer was filed by the corporation, and a judgment against it was taken by default. On appeal, the judgment was set aside by the Supreme Court of California on the ground that it had been entered by the clerk without an order of court. Thereupon the plaintiff dismissed the action as to the individual defendants, and an order was made by the trial court appointing a referee to take an accounting between plaintiff and the corporation. On the basis of the referee's report, judgment was entered in favor of plaintiff against the corporation. Subsequently a proceeding was begun against the stockholders individually, alleging the recovery of the judgment against the corporation and its bankruptcy. The stockholders appeared and moved to set aside the judgment upon the ground that the court had no jurisdiction to enter the same for the reason that prior to the institution of the suit the corporation had been dissolved and had ceased to exist. This motion prevailed, and on appeal the Supreme Court of California said:

"It is settled beyond question that, except as otherwise provided by statute, the effect of the dissolution of a corporation is to terminate its existence as a legal entity, and render it incapable of suing or being sued as a corporate body or in its corporate name. It is dead, and can no more be proceeded against as an existing corporation than could a natural person after his death. There is no one who can appear or act for it, and all actions pending against it are abated, and any judgment attempted to be given against it is void. As to this, all the text-writers agree, and their statement is supported by an overwhelming weight of authority. (See 5 Thompson on Corporations, sections 6721, 6722, 6723; Clark and Marshall on Private Corporations, sections 322, 329; Angell and Ames on Corporations, section 195; 2 Morawetz on Corporations, section 1031; 10 Cyc., 1316; 7 Am. and Eng. Ency. of Law, 854; *Pendleton* v. *Russell*, 144 U. S., 640 (12 Sup. Ct., 743); *First National Bank* v. *Colby*, 21 Wall., 609; *Mumma* v. *Potomac Co.*, 8 Pet., 281; *Sturges* v. *Vanderbilt*, 73 N. Y., 384; *Rodgers* v. *Adriatic, Etc., Co.*, 148 N. Y., 38 (42 N. E., 515).) There is no statute of this State that authorizes the commencement or continuance of an action against the corporation after its legal death, We have no statute similar to that of several States, providing that in the event of the dissolution of a corporation its existence shall be continued either indefinitely or for a specified time for the settlement of its affairs, Statutes similar to our section 400 of Civil Code above quoted do not have the effect of continuing the existence of the corporation as *cestui que trust*, or otherwise, so as to render it capable of defending actions in its corporate name. (Thompson on Corporations, section 6739; Clark and Marshall on Private Corporations, 333; *Sturges* v. *Vanderbilt*, 73 N. Y., 384.) If section 385 of the Code of Civil Procedure, providing that an action does not abate by the death or any disability of a party, if the cause of action survives, is applicable to the case of a corporation, it does not authorize the continuance of the action against the corporation itself, but allows the action to be continued only against the 'representative or successor in interest,' brought in on motion. (*McCulloch* v. *Norwood*, 58 N. Y., 562, 568. See, also, *Judson* v. *Love*, 35 Cal., 463.) There being no statute which can be held to modify the general rule, it would seem that the judgment in this case was as much of a nullity as if it had been given against a dead natural person, and that plaintiff's remedy, after the dissolution of this corporation, was against the directors who continued such at the time of dissolution as trustees and the stockholders. (*Sturges* v. *Vanderbilt*, 73 N. Y., 384.)"

(See also *Van Landingham* v. *U. T. Packers*, 189 Cal., 353, 208 Pac., 973; *Hogan* v. *Superior Court*, 74 Cal. App., 704, 241 Pac., 584; *Panzer-Hamilton* v. *Bray*, 274 Pac., 770; *Smith* v. *Lewis*, 287 Pac., 472, s. c., 295 Pac., 39.)

Placing themselves squarely on the California law, as interpreted and pronounced by the Supreme Court of California in the Crossman case, petitioners say that, since the Navarro Lumber Co. had been legally dissolved in 1922, it could not thereafter be served with process, could not appear, and could not itself admit anything, nor authorize anyone to do so for it. That, in these circumstances, all that was done in its behalf by its trustees in the matter of the appeal to the Board of Tax Appeals was a nullity, and therefore had no effect, and could have no effect, in extending the periods of limitations. If the premise be admitted, and if petitioners' right to challenge the binding effect of the appeal be likewise admitted, the conclusion which petitioners urge must follow because, concededly, the notices of the Commissioner to petitioners of the assessments against them, as transferees, were not mailed until January 17, 1929, and that date was considerably more than one year after the expiration of the original periods of limitation for assessment of the tax against their transferor, the lumber company. But, in our view, petitioners' premise is not sustainable on either of two grounds.

First, as we have already shown, the Commissioner's notice of deficiencies to the lumber company was dated February 10, 1925. That was within the 5-year period. Its effect, therefore, was to fix and determine the company's tax liability for the years 1919 and 1920 which, unless appealed from to the Board of Tax Appeals, would at the expiration of 60 days become final and binding. Within the 60-day period a petition for a redetermination of the deficiencies was filed with the Board. It was entitled "Appeal of Navarro Lumber Co.," but it was signed for the company by the three trustees, who, in the dissolution decree, were directed to wind up its affairs and distribute its assets.

In taking the appeal, petitioners set out the authority on which they acted. They speak of themselves as the trustees of the lumber company "now in process of liquidation" and point to the statute of California for their authority to act. By reference to that statute (Civil Code, Cal., 1921, ch. 383) we find that they have power to settle the affairs of the corporation, collect and pay outstanding debts, to sue and to be sued in relation to the debts and property of the corporation, and that they shall be jointly and severally liable to creditors to the extent of any property that shall come into their hands. It was in recognition of these duties and responsibilities that they filed the appeal. We think it can not be urged that they were without authority, or the Board without jurisdiction. Indeed, we do not understand counsel to go that far, but rather, to insist that, because the appeal was taken in the name of the lumber company, and the trustees were not themselves substituted (after the passage of the 1926 Act) formally by name in the place and stead of the corporation, the appeal was ineffective and the decision rendered thereon wholly void. Counsel say that three trustees compose "an indivisible fiduciary," a single taxpayer under present Revenue Acts, but that under the 1924 Act, in effect when the appeal was filed, the fiduciary entity which they composed could not invoke the jurisdiction of the Board of Tax Appeals by appealing from the Commissioner's notice. In the same breath they say the lumber company was dead and had no rights, so that the result of the situation when the appeal was taken was that there was nobody, natural or artificial, capable of contesting the Commissioner's determination, or availing of the provisions of law for a redetermination of the Commissioner's assessment. We have been cited no authority for this position, and we can find none; and we should be slow to follow any which might point in that direction. But however this may be, the 1926 Act (283(b)) does provide that, in any appeal then pending, the Board shall have jurisdiction; and so, on the one ground or the other, we are satisfied that when petitioners as trustees appealed to the Board, and the Board accepted jurisdiction, the powers of the Board, on the one hand, and the rights and privileges of the petitioners, on the other, were not prejudiced by the fact that the appeal was entitled in the name of the lumber company, rather than in the names of the trustees for the lumber company.

The Board of Tax Appeals is not a court and, though it may exercise judicial powers, it is essentially an administrative commission; and on appeals from its decisions, the statute admonishes us to affirm, modify, or reverse—as justice may require. The appeal from the deficiency notice, we think, was an appeal by the trustees of the lumber company, however it may have been styled in the hearings or in the pleadings. The deficiencies in tax were debts of the lumber company. If the assessment was valid, it was payable out of the assets of the lumber company. It was the duty of the trustees to preserve the assets and pay the debts, and this duty involved contesting the imposition of the additional tax. There never was the slightest doubt in the trustees' minds that this was their duty, and it is perfectly clear that in taking the appeal to the Board they considered they were performing that duty. And we think it is also clear that the decision of the Board, sustaining the deficiency notice of the Commissioner, was no more or less than an ascertainment of the validity of the debt of the lumber company for which, under the tax statutes, petitioners as trustees were liable, and bound to account under the tax laws and under the California statutes. It is an established principle that one who prosecutes a suit in the name of another to establish and protect his own rights, or who assists in the prosecution of an action in aid of some interest of his own, is bound by the judgment. (*Souffront v. Compagnie, Etc.*, 217 U. S., 475, 487.)

In this view, we hold (1) that the Commissioner's deficiency notice of February 10, 1925, was in time; (2) that the petition filed April 11, 1925, by the trustees for a redetermination of the deficiencies, however styled, was in legal effect an appeal by the trustees appointed to administer the affairs of the dissolved corporation; (3) that the Board of Tax Appeals properly took jurisdiction of the petition; (4) that the effect of the petition was to suspend the running of the statute against the lumber company and its trustees until the final decision of the Board; (5) that the deficiency notices against petitioners as transferees, mailed January 17, 1929, were mailed within one year after the final decision of the Board (February 13, 1928) and were therefore within the statutory period.

We have said there is still another ground on which the Board's conclusion should be sustained. We shall discuss it briefly. Petitioners were the principal stockholders of Navarro Lumber Co. They were also directors of that corporation. In these capacities they signed the application for dissolution of the corporation, and by an order of court they and another were appointed trustees of the creditors and stockholders of the dissolved corporation with power to settle the affairs of the corporation, pay its debts, and distribute its assets. Pursuant to this power in August, 1922, Dusenbury received $26,947.70, and Buzard received sums in excess of the total amount of the assessed tax. We think we are safe in assuming that together they received all of the distributive assets of the corporation. On this assumption, they were jointly and severally liable to the United States (to the extent of the amounts received by them) for all amounts of taxes which might be thereafter legally assessed against the corporation. This liability accrued not only under the Federal tax laws but under the California laws. They were, therefore, the parties solely in interest in resisting claims against the corporation. If, therefore, on February 10, 1925, when the Commissioner mailed the notice of deficiencies to the lumber company, they had taken no action, but allowed the 60-day period to expire, they would have been liable, at the suit of the United States, to respond to the full amount of the assessed taxes. It was, therefore, solely in their interests that the petition for redetermination should be filed with the Board. They did file such petition and prosecuted it to final decision. Thereafter, and when assessed by the Commissioner as transferees under the provisions of section 280(a) of the 1926 Act, they individually petitioned for redetermination of their individual liability, grounding their appeals on the statute of limitations, and that question we have disposed of.

But if we had concluded differently on that question, we should nevertheless be constrained to hold that it is not open to them now to raise the question of limitations. Petitioners, from the moment of the dissolution of the lumber company, were the real parties in interest in all the proceedings before the Commissioner and the Board. They sought and had the benefit of a hearing and reconsideration of the tax claim. Thus they secured the delay on which their defense is built. To permit them now to continue to hold the assets of the corporation and to say that that entire proceeding was a nullity, including the notices to petitioners as transferees, because the corporation, being dead, was without legal right to challenge the tax, would be to allow petitioners to repudiate their own voluntary appearance in the corporation's behalf, to deny their own pleadings, and to take inconsistent positions in the same litigation; and this should not be permitted either to taxpayer or Government in this case or any other. We think it clear that petitioners as transferees are now estopped to deny the regularity of the appeal which they caused to be filed with the Board.

This leaves only for consideration the question whether interest may properly be included on the amounts stipulated to be due. To decide that question, it is unfortunately necessary to repeat some of the facts. On February 10, 1925, the Commissioner mailed a notice to the lumber company, indicating a deficiency in tax for the year 1919 of $13,568.75, and for 1920, $39,517.43. The two amounts aggregate $53,086.18. Within the 60-day period thereafter petitioners, as trustees, applied to the Board for redetermination of the deficiencies. On December 10, 1925, while the appeal was pending, the Commissioner made a "jeopardy assessment" of the deficiency of $13,568.75 for 1919. On February 27, 1928, the Board entered an order of redetermination for a deficiency of $13,568.75 for 1919 and $39,517.43 for 1920, and on January 17, 1929, the Commissioner mailed to each of the petitioners a notice stating:

"Under the provisions of section 280 of the Revenue Act of 1926, there is proposed for assessment against you the amount of $53,086.18 plus any accrued penalty and interest representing your liability as a transferee of the assets of the Navarro Lumber Co. for outstanding tax assessed against said company for the years 1919 and 1920."

In the subsequent petitions to the Board (petitioners-transferees) it was stipulated that the correct deficiencies for the taxable years 1919 and 1920 were $13,568.75 and $17,630.97, respectively.

Petitioners' position here is that these conceded deficiencies represented not only the amount of the original tax but the tax plus interest, and were intended to determine finally, against both respondent and petitioners, that the total sum due from the company was $31,199.72. Petitioners, moreover, insist that there is no statutory authority for the assessment of interest on the liability of transferees. This is not our view of the law. Section 280(a)1 of the Act of 1926 imposes interest on the liability of a transferee of property of a taxpayer, and section 283(d) provides that in the case of a tax assessment imposed by Acts prior to November 23, 1921, interest shall be collected, as a part of the tax. There is certainly nothing in the stipulation itself which shows that interest was included in the agreed sum and, in this view, interest was properly chargeable from February 26, 1926, the effective date of the Revenue Act of 1926.

Inasmuch, however, as it appears that the petitioner Dusenbury received only the sum of $26,947.70 as a transferee of the corporation, the order of the Board of Tax Appeals, requiring him to pay $31,199.72, will be corrected to the sum received by him as transferee, with interest from February 26, 1926. The transferees' liability is several, and therefore each is responsible, to the extent of benefits, for the entire tax; but the payment of the entire tax by one, or both jointly, will discharge the liability.

Modified and affirmed.

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## Article 1291: Claims in cases of transferred assets. XV-16-8052 Ct. D. 1107

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

1. Joint Stock Associations—Consolidation—Jurisdiction of Board—Transferee Liability—Limitation—Estoppel.

A joint stock association in 1920 turned over all its assets to another association which had been organized, owned, and controlled by substantially the same interests, in exchange for shares of the latter's stock, and thereafter the consolidated association assumed the assets, liabilities, identity, and name of the first association. Proceedings with the Commissioner and before the Board of Tax Appeals were conducted in recognition of the fact, now sought to be denied, that the successor association was the taxpayer and was liable for the taxes asserted for 1919 and 1920. In 1931, by motion to dismiss for want of jurisdiction, the claim was first made before the Board that the two associations were not consolidated, and that the original association and not the petitioner was the taxpayer. Under the facts of the case, the Board had jurisdiction and correctly held that the petitioner was liable as transferee for the taxes accrued against its predecessor, and that the statute of limitation had not run. Moreover, having for several years dealt with the Government on the assumption that it was the taxpayer, the consolidated association was estopped, after the statute of limitation had run against its predecessor, to assume an inconsistent position.

2. Decision Affirmed.

Decision of the Board of Tax Appeals (29 B. T. A., 910) affirmed.

3. Certiorari Denied.

Petition for certiorari denied October 28, 1935.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT.

*Shamrock Oil Co., petitioner,* v. *Commissioner of Internal Revenue, respondent.*

Petition for review of decision of the United States Board of Tax Appeals (district of Texas).

Before BRYAN, FOSTER, and HUTCHESON, Circuit Judges.

[May 14, 1935.]

OPINION.

HUTCHESON, Circuit Judge: This petition to review a Board of Tax Appeals decision questions not the amount, but the existence of the tax liability found. The points made are based on the fact that while the tax accrued not against Shamrock Oil Co., petitioner, but against Shamrock Oil Co., its predecessor, waivers were obtained from, the deficiency letter was sent to, and all proceedings in connection with the determination and collection of the tax, including the proceedings before the Board, were had with petitioner. The points are the two made before the Board: (1) that the Board was without jurisdiction because the appeal had not been prosecuted by the taxpayer; (2) that the determination and collection of the deficiencies are barred by the statute of limitations, because the waivers on which the Commissioner relies were not signed by, or by the authority of, Shamrock Oil Co., the taxpayer; and (3) the additional one, that the facts do not make out a case for transferee liability. The facts and the proceedings are in all respects accurately and in most respects fully, stated in the opinion of the Board (29 B. T. A., 910). We shall abstract and supplement, but not restate, them. They show that in 1920 there were two joint stock associations,[1] Shamrock Oil Co. and Chapman-Clark-Harbin, Trustees, engaged in the oil business, which had been organized, and were owned and controlled by substantially the same interests. Shamrock Oil Co. filed timely income tax returns for the years ending December 31, 1919, and December 31, 1920, but filed none for the subsequent years. In the fall of 1920 these associations, pursuant to negotiations looking to that end,[2] were consolidated. The form chosen to effect this consolidation was a turnover of all of the Shamrock Oil Co.'s properties to Chapman-Clark-Harbin in exchange for shares of stock in Chapman-Clark-Harbin, Trustees, to be issued by that association to the stockholders of Shamrock, share for share. Thereafter, even to the extent of taking its name, the consolidation assumed to be, acted as, and was Shamrock Oil Co. So complete was this merger of the two joint stock associations, so absolute the assumption by the successor consolidation of the assets, the liabilities, the identity, even to the name, of the Shamrock company, that neither Mr. Dunaway, its president, nor the counsel employed in connection with this

[1] On June 30, 1920, the same interests owned or controlled 92.7 per cent of the outstanding capital stock of the Shamrock Oil Co., and 96.7 per cent of the outstanding capital stock of Chapman-Clark-Harbin, Trustees. On December 31, 1920, these percentages became respectively, 90.8 per cent and 95.7 per cent. Of the eight members of the board of trustees of Chapman-Clark-Harbin, Trustees, seven were on the board of trustees of the Shamrock Oil Co.

[2] On December 13, 1920, Shamrock Oil Co. proposed to purchase the Chapman-Clark-Harbin properties. On December 14, 1920, Shamrock Oil Co. addressed a communication to Chapman-Clark-Harbin, Trustees, reading in part as follows:

"I beg leave to advise that the directors of the Shamrock Oil Co. have passed a resolution favoring the consolidation of its properties with your properties. * * * Without reference to the actual values of the properties, except their relative values that the two companies be combined upon the basis of their present set-up values for the purpose of issuing certificates of fractional interest to the parties owning same. This to be accomplished in such manner as may suit your convenience, it being suggested that you take over all the properties, real and personal, cash and credits of every character whatsoever of the Shamrock Oil Co. * * *"

On the same date Chapman-Clark-Harbin, Trustees, directed this letter to the Shamrock Oil Co.:

"GENTLEMEN: Your proposition of December 14, 1920, for consolidation of your company with the Chapman-Clark-Harbin interests has this day been by resolution of the trustees, accepted and you will kindly take such steps as necessary looking to the legal consummation of the same and to that end we ask for a joint conference for the purpose of working out the details and form."

tax matter ever knew or supposed, until the 1931 change of front, anything other than that the consolidation continued to be and was, the Shamrock Oil Co.[3]

In 1925 petitioner sold its assets to the Prairie Oil Co. and quit business, but Dunaway remained in Wichita Falls to wind up the affairs of the association. Continuing for more than seven years, beginning in 1924, proceedings were conducted with the Commissioner and before the Board of Tax Appeals in complete recognition of the fact now sought to be denied, that Shamrock Oil Co., the petitioner was, and continued after the consolidation to be, Shamrock Oil Co., the taxpayer, and that the tax liability asserted for the years in question was by reason of the consolidation the tax liability of the petitioner. In its petition to the Board for the redetermination of deficiencies filed January 22, 1927, a formal and lengthy one, all of the proceedings in connection with the organization of the two associations was set out and the claim was made that the two companies were so closely affiliated as to be entitled to make a consolidated return. Indeed, it was claimed that in 1919 and 1920 when the tax liability accrued, there was such a unity of operations of the two coupled with such ownership and control by the same interests, of all of the stock of both associations as that the two were in effect one. Nothing was ever claimed to the contrary until in 1931, when this about face was made. Then it was that the claim was first tendered, that Shamrock Oil Co. was not consolidated with Chapman-Clark-Harbin, but was sold out and dissolved, and that Shamrock Oil Co., the petitioner, was not a continuation of it. In the long drawn-out proceedings and pleadings before the Board there was a claim to additional allowances for invested capital, but the main insistence was that the two concerns were affiliated, that the tax should have been figured on the basis of a consolidated return, and that since Chapman-Clark-Harbin had sustained net losses which Shamrock was entitled to take as deductions, the tax assessed was excessive. In January, 1929, there was an amendment to the petition setting up limitation, not on the ground of any want of authority on the part of Dunaway to sign waivers, but upon the ground that at the time the waivers were signed, the taxes had already become barred. In April, 1929, the petition was again amended to add certain claims for amortization, but still the main point made in this petition, as in the others, was that the two associations were affiliated most closely, in fact were identical, and should be so taxed. On February 18, 1931, by motion to dismiss for want of jurisdiction, it was for the first time claimed that petitioner Shamrock Oil Co. was not the taxpayer, and that all waivers had been signed and proceedings authorized and taken under the mistaken impression of petitioner's president, that it and the Shamrock Oil Co., which had incurred the tax, were one and the same. The Board was right in holding that the petitioner was for the purposes of the proceedings before it, the taxpayer, and that limitation had not run. We think, too, that there is no merit in the additional point the taxpayer seeks to make here, the point that petitioner is not liable as a transferee because the original Shamrock Oil Co. was a partnership,[4] and since partners may be looked to for partnership debts, a transfer of all the partnership assets does not charge them in the hands of the transferee with a lien for partnership debts.[5]

These proceedings deal with Federal taxes. As to Federal taxes, Texas stock associations are not partnerships, they are corporations. (*Burke Waggoner Association* v. *Hopkins*, 269 U. S., 110 [T. D. 3790, C. B. V-1, 147].) They are liable as corporations for the taxes they incur. Whatever may be the rule in Texas as to the liability to general creditors, of the members of such associations, as partners, and whatever may be the rule there as to the effect upon general creditors of a transfer of all the assets, we think it clear that as to tax liability, a transfer by a joint stock association which strips

[3] In his testimony given after, in 1931, the point of difference between the two associations had been raised, Dunaway, who signed the waivers, conducted the negotiations, and authorized the proceedings taken by Shamrock Oil Co. in connection with the tax, makes this clear. He testified that he did not know that "actually the Chapman-Clark-Harbin, Trustees, had purchased the Shamrock, and that the Shamrock Oil Co. then existing had been dissolved"; that he thought Shamrock had bought Chapman-Clark-Harbin. "At that time I thought that the company I was representing was still the same Shamrock Oil Co., organized in March, 1918, a continuation of the company."

[4] *Thompson* v. *Schmitt* (274 S. W., 554; 115 Tex., 53); *Victor Refining Co.* v. *City National Bank of Commerce* (274 S. W., 561; 115 Tex., 71); *Hollister* v. *McCamey* (274 S. W., 562; 115 Tex., 49); *Howe* v. *Keystone Pipe & Supply Co.* (274 S. W., 563; 115 Tex., 158).

[5] *Industrial Lumber Co.* v. *Texas Pine Land Association* (72 S. W., 875).

it bare makes the taker liable as transferee for the Federal taxes it owes. But the liability of petitioner here is not merely equitable, it is legal. It rests upon a contractual basis. We think it too clear for argument that whatever the form of the transaction by which the consolidation was effected, in fact and in law a consolidation resulted; a consolidation which, carrying forward into itself the assets and liabilities of the constituent associations, thereafter owned the assets and owed the debts of its constituents. Such a consolidation implies as one of its terms, an agreement to pay the debts of its constituents. Every action that its officers took until the change of front in 1931, testifies to the existence of this agreement, and to their intention to carry it out. After the consolidation, Shamrock Oil Co. consolidated was to all intents and purposes, as to tax liabilities its constituents had incurred, the taxpayer. Shamrock Oil Co., the petitioner here, is and has been since the consolidation Shamrock Oil Co., the taxpayer, both because of the continuation in fact, if not in form, of the identity of the original association, and because in connection with and as a part of the consolidation an implied agreement arose that it would pay and discharge all debts. The Government has and has had since the consolidation, the right to look to it for the taxes. All negotiations and agreements thereafter made with regard to the taxes were properly made with its officers. All proceedings taken with regard to the taxes were properly taken with it and with them (*Commissioner* v. *Nichols & Cox*, 65 Fed. (2d), 1009 [Ct. D. 764, C. B. XII–2, 246]; *North American Coal Corporation* v. *Commissioner*, 63 Fed. (2d), 1011; *Burnet* v. *San Joaquin*, 52 Fed. (2d), 123 [Ct. D. 406, C. B. X–2, 260]; *Pittsburgh Terminal Coal* v. *Heiner*, 56 Fed. (2d), 1072 [Ct. D. 501, C. B. XI–1, 225]; *Warner Collieries Co.* v. *United States*, 63 Fed. (2d), 34 [Ct. D. 703, C. B. XI–2, 227]; *Commissioner* v. *New York Trust Co.*, 54 Fed. (2d), 463 [Ct. D. 540, C. B. XI–2, 320]; *Traherne Pump Co.* v. *Commissioner*, 27 B. T. A., 863; affirmed 71 Fed. (2d), 584); and this wholly without reference to questions of estoppel or misleading. When it is additionally shown, as here, that through a long course of years petitioner has been assuming to be, and acting upon that assumption the Government has dealt with it as, the taxpayer, and that it commenced to claim otherwise only when, if it may now unsay what it has been saying, limitation has barred the claim, it is quite clear that it is now estopped to assume an inconsistent position. (*Philip Carey Mfg. Co.* v. *Dean*, 58 Fed. (2d), 737 [Ct. D. 557, C. B. XI–2, 325]; *Swartz* v. *Commissioner*, 69 Fed. (2d), 633; *Planters Cotton Oil Co.* v. *Hopkins*, 53 Fed. (2d), 825; *Walker* v. *Commissioner*, 63 Fed. (2d), 346; *Lucas* v. *Hunt*, 45 Fed. (2d), 781; *Hartwell Mills* v. *Rose*, 61 Fed. (2d), 441.)

The petition is denied.

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## SECTION 283.—TAXES UNDER PRIOR ACTS.

SECTION 283. XV–19–8079
Ct. D. 1115

### INCOME TAX—REVENUE ACTS OF 1918 AND 1926—DECISION OF COURT.

INTEREST—CLAIM IN ABATEMENT—NOTICE AND DEMAND—STATUTE APPLICABLE.

Deficiency assessments for 1917, 1918, and 1920 were made in 1919, 1924, and 1921, respectively, and notice and demand made and claims in abatement filed, as to the 1917 and 1918 taxes, prior to the enactment of the Revenue Act of 1926. The date of filing the claim for abatement of the 1920 taxes is not shown in the record. Upon the collection of the taxes, in 1929, interest was payable as prescribed by section 250(e) of the Revenue Act of 1918, at the rate of 6 per cent per annum from the due dates of the taxes. The interest provisions of section 283(h) of the Revenue Act of 1926 do not supersede the provisions of section 250(e) of the 1918 Act where notice and demand have been made by the collector and where a bona fide claim in abatement has been filed.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

*Crown Willamette Paper Co., a Corporation, appellant,* v. *John P. McLaughlin, as Collector of United States Internal Revenue for the First District of California, appellee.*

Upon appeal from the District Court of the United States for the Northern District of California, Southern Division.

[October 17, 1935.]

OPINION.

WILBUR, Circuit Judge: Appellant brought this action to recover certain amounts which it claims were illegally exacted from it by the collector of internal revenue of the United States, as and for interest upon taxes for the years 1917, 1918, and 1920 upon assessments made in May, 1919, March 21, 1924, and March 15, 1921, respectively, and all collected in 1929. The interest for which refund is claimed is that for the period prior to the enactment of the Revenue Act of February 26, 1926, it being conceded that the proper amount of interest for the period thereafter was collected.

The cause of action is stated in three counts, one for each of the years involved. For each year the appellant filed claims in abatement, in September, 1919, as to the 1917 tax, on March 29, 1924, as to the 1918 tax. The date of the claim in abatement for the 1920 tax is not stated in the pleadings, evidence or findings.

The deficiency tax for 1917 was assessed in May, 1919, in the amount of $177,760.21. The Commissioner reduced this amount to $146,601.46 in acting upon the claim in abatement filed in September, 1919, and on appeal to the Board of Tax Appeals this amount was further reduced to $57,872.48. This amount was collected December 18, 1929, with interest from the date of the Commissioner's assessment September 22, 1919, at one-half of 1 per cent per month (6 per cent per annum). The amount the appellant seeks to recover on this item of interest is the sum of 6 per cent per annum from September 22, 1919, to February 26, 1926, the date of the enactment of the Revenue Act of 1926.

The deficiency assessment for 1918 was made by the Commissioner March 21, 1924, in the sum of $19,786.76 and a claim in abatement was filed March 29, 1924. The appellant seeks to recover $2,324.94 being 6 per cent interest per annum on the deficiency assessment of $19,786.76 from March 21, 1924, to February 26, 1926.

The unpaid balance of the assessment for 1920 taxes amounted to $222,978.50. The tax return was filed by the taxpayer on March 15, 1921. A deficiency assessment was made by the Commissioner July 7, 1927, but was set aside by the Board of Tax Appeals on May 22, 1929, being fixed by the Board of Tax Appeals in accordance with the original assessment of the tax by the taxpayer, i. e., a tax liability of $754,276.92 with an unpaid balance of $222,978.50, and was collected November 16, 1929, with interest amounting to $111,047.97. Appellant seeks to recover $61,592.46 of this amount, being interest at 6 per cent per annum from March 15, 1921, to February 26, 1926.

The appellant relies upon the provisions of section 283 (f), (e), (h) of the Revenue Act of 1926, and particularly upon the clause providing that interest shall be collected "at the rate of 6 per cent per annum from the date of the enactment of this Act up to the date of notice and demand from the collector." (Section 283, sub. (h).) Appellant states his interpretation of this clause as follows: "On the old assessments the essential point was that interest should start on the date of the enactment of the Act." The appellee claims that the provision as to 6 per cent interest from the date of the Act above referred to is made entirely inapplicable to the assessments involved here because of concluding sentence of sub. (h) as follows: "The interest provided in this subdivision shall be included only in cases where no other interest for the same period is provided by law." Subdivision (e) of section 283 provides "interest * * * shall, except as provided in subdivision (h) of this section be computed as if this Act had not been enacted." It is clear then that the law regulating interest on income taxes in effect when the Revenue Act of 1926 was enacted is an important factor in interpreting the provisions of section 283, which twice refers to existing law, in the first instance (sub. (e)) continuing it in effect, and in the second instance limiting the new provision for interest to cases "where no other interest * * * is provided by law." The Revenue Act of 1918, section 250(e) provides for the collection of interest as follows:

"If any tax remains unpaid after the date when it is due, and for 10 days after notice and demand by the collector, then, except in the case of estates of insane, deceased, or insolvent persons, there shall be added as part of the tax the sum of 5 per centum on the amount due but unpaid, plus interest at the rate of 1 per centum per month upon such amount from the time it became due: *Provided*, That as to any such amount which is the subject of a bona fide claim for abatement such sum of 5 per centum shall not be added and the interest from the time the amount was due until the claim is decided shall be at the rate of one-half of 1 per centum per month."

The collector contends that the proviso applies in the case at bar because here a bona fide claim in abatement was filed and consequently that interest is to be collected from the date the tax was due until paid at the rate of 6 per cent per annum, and that the provision as to demand and notice is applicable only when it is sought to collect the penalty of 5 per cent and the higher rate of 12 per cent per annum. Appellee's contention, then, is in effect that by filing a claim in abatement as to the entire deficiency tax claimed the appellant brought into effect the 6 per cent per annum proviso of section 250(e) of the Revenue Act, and precluded the collector's invoking the penalty provisions of that section by demanding the amount of the tax which was disputed by the claim in abatement. This seems to be a reasonable construction of this statute and to be in accord with the article 1003 of Regulations 45 promulgated by the Secretary of the Treasury in 1920 under the Revenue Act of 1918:

"*Interest on tax.*—Where the time for the payment of any installment of the tax is postponed at the request of the taxpayer, interest at the rate of 6 per cent per annum is added from the original due date. * * * If any tax remains due and unpaid for 10 days after notice and demand by the collector, or in the case of the first installment as computed by the taxpayer remains due and unpaid for 10 days, interest at the rate of 12 per cent per annum is added from the due date, except that the interest on any amount which is the subject of a bona fide claim for abatement shall be at the rate of 6 per cent per annum, * * *."

What we have said so far applies to the interest on the assessments of taxes for 1917, 1918, and 1920. Written demand and notice were given by the collector for the taxes for the years 1917 and 1918 which started interest at 12 per cent per annum under section 250(e) supra, of the Revenue Act of 1918, although interest at 6 per cent only was collected. Appellant's sole claim to recover the interest so paid is on the theory that section 283(h) of the Revenue Act of 1926 entirely superseded the provisions of section 250(e) of the Revenue Act of 1918, supra. It seems to us clear that Congress had no such intention in enacting section 283(h) of the Revenue Act of 1926. In that regard the report of the Senate Finance Committee on the Revenue Act of 1926 (Senate Report No. 52, [Sixty-ninth] Congress, first session, page 33) makes it clear that where notice and demand had been given by the collector under the prior Acts those Acts should apply instead of the provisions of section 283(h) of the Revenue Act of 1926. We quote from that report in part as follows:

"It is also provided in section 283(h) that in cases where the assessment was made before June 2, 1924, the interest shall begin to run from the date of the enactment of this bill and continue up to the date of notice and demand from the collector, which will be made after the Commissioner is freed from the restrictions on making the collection. In certain of these cases, however, where notice and demand was made at the time of the assessment, interest has been running ever since and section 283(h) therefore provides that the 6 per cent interest shall not be collected in such cases."

We have not undertaken to state the various interreferences of the subdivisions of section 283 of the Revenue Act of 1926 for the reason that both sides agree that the question involved herein is as to whether or not the interest provisions of section 283(h) of the Revenue Act of 1926 supersede the interest provisions of section 250(e) of the Revenue Act of 1918 where demand and notice has been given by the collector as to the taxes of 1917 and 1918, and in the case of the 1920 tax whether the filing of a bona fide claim in abatement by the taxpayer starts interest and thus brings the 1920 tax within the exception contained in the last sentence of section 283(h) of the Revenue Act of 1926, above quoted. For the reason stated we conclude that the first and second counts of the complaint do not state a cause of action because of the failure of the plaintiff to allege that no demand and notice had been given to the plaintiff by the collector prior to 1926. The third count fails to state a cause of action because there is no allegation that a bona fide claim in abatement had not been filed by the appellant. Such a claim, as we have held, would start the running of interest from the date the tax was due. The first and second counts also have the same defect.

Judgment affirmed.

# TITLE XI.—GENERAL ADMINISTRATIVE PROVISIONS.

## SECTION 1118.—PAYMENT OF AND RECEIPTS FOR TAXES.

ARTICLE 1391: Payment of tax by Treasury certificates of indebtedness and Treasury notes. XV–11–8004 T. D. 4630

Instructions with respect to acceptance of Treasury bills in payment of income taxes required to be paid on March 16, 1936.

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

*To Collectors of Internal Revenue and Others Concerned:*

In connection with the payment of the March 15, 1936 (March 16, 1936, payment date), installment of income taxes, you are requested to arrange, so far as possible, to have all checks actually placed in the hands of, or in transit to, the Federal reserve bank, branch bank or other depository on the same day in which they are received. The Federal reserve banks have been requested to cooperate to the fullest extent possible in receiving deposits of income tax checks during the heavy tax payment period in March.

The only Government securities acceptable on March 16, 1936, in payment of income taxes are the various series of Treasury bills aggregating approximately $450,000,000, which mature on March 16, 1936. These bills may be received on March 16, 1936, only, or within a reasonable time immediately prior thereto, and are acceptable (at par or face amount) only in payment of taxes which the taxpayer is required to pay on that day, that is, taxes payable for the first time on that day and which would be overdue thereafter. Treasury bills maturing on other dates are not acceptable in payment of installments of income taxes required to be paid on March 16, 1936, and Treasury bills maturing on March 16, 1936, are not acceptable in payment of installments of income taxes unless such installments are required to be paid on March 16, 1936.

The procedure prescribed with respect to the acceptance of Treasury notes or certificates of indebtedness by Treasury Decision 4347 [C. B. XI–2, 425], approved August 9, 1932 (paragraphs 19–20, pages 390–391, appendix to Regulations 86 issued under the Revenue Act of 1934) should be followed in connection with the acceptance of the above-mentioned Treasury bills in payment of income taxes payable on March 16, 1936.

In order that the Department may have a record of your receipt of these instructions, it will be appreciated if you will promptly send an acknowledgment to the Commissioner of Accounts and Deposits, room 376, Treasury Department.

By direction of the Secretary:

CHAS. T. RUSSELL,
*Acting Commissioner of Internal Revenue.*

Approved February 29, 1936.

WAYNE C. TAYLOR,
*Acting Secretary of the Treasury.*

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ARTICLE 1391: Payment of tax by Treasury certificates of indebtedness and Treasury notes. XV–15–8046 T. D. 4635

Instructions with respect to acceptance of Treasury notes of Series C–1936 in payment of income and profits taxes required to be paid on April 15, 1936.

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

*To Collectors of Internal Revenue and Others Concerned:*

These instructions are issued pursuant to the authority contained in section 1118(a) of the Revenue Act of 1926 and by virtue of all other authority of law.

In connection with the tender of Treasury notes maturing April 15, 1936, in payment of income or profits taxes, the attention of collectors is called to paragraph 19 of the appendix to Regulations 86 and particularly to the last sentence thereof reading as follows:

The amount, at par, of Treasury certificates of indebtedness or Treasury notes presented by any taxpayer in payment of income and profits taxes must not exceed the amount of the taxes to be paid by him, and collectors shall in no case pay interest on the certificates or notes or accept them for an amount less or greater than their face value.

Treasury notes of Series C–1936 were issued in denominations of $100, $500, $1,000, $5,000, $10,000, and $100,000, and will be payable in such amounts on April 15, 1936. Such Treasury notes may be received on April 15, 1936, only, or within a reasonable time immediately prior thereto, and are acceptable (at par or face amount) only in payment of income and profits taxes which the taxpayer is required to pay on that date, that is, taxes due for the first time on that date and which would be overdue thereafter. Treasury notes maturing on other dates are not acceptable in payment of installments of income or profits taxes required to be paid on April 15, 1936, and Treasury notes maturing on April 15, 1936, are not acceptable in payment of installments of income or profits taxes unless such installments are required to be paid on April 15, 1936. Since the first installment of income and profits taxes determined on a calendar year basis is due for the first time on March 15, regardless of whether an extension of time is granted to file the tax return, Treasury notes maturing on April 15, 1936, are not acceptable in payment of income or profits taxes determined on a calendar year basis. If any such notes are offered in payment of income or profits taxes subject to any condition, qualification, or reservation whatsoever, or for any greater amount than the par or face amount, they will not be deemed to be duly tendered and the collectors shall refuse any such offer and return the notes to the taxpayers immediately.

GUY T. HELVERING,
*Commissioner of Internal Revenue.*

Approved April 9, 1936.

WAYNE C. TAYLOR,
*Acting Secretary of the Treasury.*

(Filed with the Division of the Federal Register April 10, 1936)

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ARTICLE 1392: Procedure with respect to Treasury certificates of indebtedness and Treasury notes.

REVENUE ACT OF 1926.

Instructions with respect to acceptance of Treasury bills in payment of income taxes required to be paid on March 16, 1936. (See T. D. 4630, page 338.)

# MISCELLANEOUS TAX RULINGS.

## TITLE II.—ESTATE TAX. (1935)

XV–9–7980
T. D. 4627

Estate tax.—Regulations 80 amended to accord with provisions of Revenue Act of 1935.

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

*To Collectors of Internal Revenue and Others Concerned:*

Pursuant to the provisions of the Revenue Act of 1935, approved on August 30, 1935, Regulations 80, relating to the estate tax, are amended as hereinafter set forth:

SEC. 201. ESTATE TAX RATES.

(a) Section 401(b) of the Revenue Act of 1932, as amended, is amended to read as follows:

"(b) The tentative tax referred to in subsection (a)(1) of this section shall equal the sum of the following percentages of the value of the net estate:

"Upon net estates not in excess of $10,000, 2 per centum.

"$200 upon net estates of $10,000; and upon net estates in excess of $10,000 and not in excess of $20,000, 4 per centum in addition of such excess.

"$600 upon net estates of $20,000; and upon net estates in excess of $20,000 and not in excess of $30,000, 6 per centum in addition of such excess.

"$1,200 upon net estates of $30,000; and upon net estates in excess of $30,000 and not in excess of $40,000, 8 per centum in addition of such excess.

"$2,000 upon net estates of $40,000; and upon net estates in excess of $40,000 and not in excess of $50,000, 10 per centum in addition of such excess.

"$3,000 upon net estates of $50,000; and upon net estates in excess of $50,000 and not in excess of $70,000, 12 per centum in addition of such excess.

"$5,400 upon net estates of $70,000; and upon net estates in excess of $70,000 and not in excess of $100,000, 14 per centum in addition of such excess.

"$9,600 upon net estates of $100,000; and upon net estates in excess of $100,000 and not in excess of $200,000, 17 per centum in addition of such excess.

"$26,600 upon net estates of $200,000; and upon net estates in excess of $200,000 and not in excess of $400,000, 20 per centum in addition of such excess.

"$66,600 upon net estates of $400,000; and upon net estates in excess of $400,000 and not in excess of $600,000, 23 per centum in addition of such excess.

"$112,600 upon net estates of $600,000; and upon net estates in excess of $600,000 and not in excess of $800,000, 26 per centum in addition of such excess.

"$164,600 upon net estates of $800,000; and upon net estates in excess of $800,000 and not in excess of $1,000,000, 29 per centum in addition of such excess.

"$222,600 upon net estates of $1,000,000; and upon net estates in excess of $1,000,000 and not in excess of $1,500,000, 32 per centum in addition of such excess.

"$382,600 upon net estates of $1,500,000; and upon net estates in excess of $1,500,000 and not in excess of $2,000,000, 35 per centum in addition of such excess.

"$557,600 upon net estates of $2,000,000; and upon net estates in excess of $2,000,000 and not in excess of $2,500,000, 38 per centum in addition of such excess.

"$747,600 upon net estates of $2,500,000; and upon net estates in excess of $2,500,000 and not in excess of $3,000,000, 41 per centum in addition of such excess.

"$952,600 upon net estates of $3,000,000; and upon net estates in excess of $3,000,000 and not in excess of $3,500,000, 44 per centum in addition of such excess.

"$1,172,600 upon net estates of $3,500,000; and upon net estates in excess of $3,500,000 and not in excess of $4,000,000, 47 per centum in addition of such excess.

"$1,407,600 upon net estates of $4,000,000; and upon net estates in excess of $4,000,000 and not in excess of $4,500,000, 50 per centum in addition of such excess.

"$1,657,600 upon net estates of $4,500,000; and upon net estates in excess of $4,500,000 and not in excess of $5,000,000, 53 per centum in addition of such excess.

"$1,922,600 upon net estates of $5,000,000; and upon net estates in excess of $5,000,000 and not in excess of $6,000,000, 56 per centum in addition of such excess.

"$2,482,600 upon net estates of $6,000,000; and upon net estates in excess of $6,000,000 and not in excess of $7,000,000, 59 per centum in addition of such excess.

"$3,072,600 upon net estates of $7,000,000; and upon net estates in excess of $7,000,000 and not in excess of $8,000,000, 61 per centum in addition of such excess.

"$3,682,600 upon net estates of $8,000,000; and upon net estates in excess of $8,000,000 and not in excess of $9,000,000, 63 per centum in addition of such excess.

"$4,312,600 upon net estates of $9,000,000; and upon net estates in excess of $9,000,000 and not in excess of $10,000,000, 65 per centum in addition of such excess.

"$4,962,600 upon net estates of $10,000,000; and upon net estates in excess of $10,000,000 and not in excess of $20,000,000, 67 per centum in addition of such excess.

"$11,662,600 upon net estates of $20,000,000; and upon net estates in excess of $20,000,000 and not in excess of $50,000,000, 69 per centum in addition of such excess.

"$32,362,600 upon net estates of $50,000,000; and upon net estates in excess of $50,000,000, 70 per centum in addition of such excess."

(b) Section 401(c) of the Revenue Act of 1932 (relating to the exemption for the purposes of the additional estate tax) is amended by striking out "$50,000" and inserting in lieu thereof "$40,000."

(c) Section 403 of the Revenue Act of 1932, as amended (relating to the requirement for filing return under such additional estate tax) is amended by striking out "$50,000" and inserting in lieu thereof "$40,000."

(d) The amendments made by this section shall be effective only with respect to transfers of estates of decedents dying after the date of the enactment of this Act.

The second paragraph of article 6 is amended to read as follows:

If the specific exemption is applicable and the decedent died after the enactment of the Revenue Act of 1932, the net estate must be determined, for the computation of the tax imposed by the Revenue Act of 1926, on the basis of a specific exemption of $100,000, and the net estate must also be determined, for the computation of the additional tax imposed by the Revenue Act of 1932, or by the Revenue Act of 1932 as amended, on the basis of a specific exemption of $50,000 if the decedent died prior to August 31, 1935, or on a basis of a specific exemption of $40,000 if the decedent died on or after August 31, 1935.

The last two sentences of article 7 are stricken out, and in lieu thereof the following is substituted:

The rates prescribed by the Revenue Act of 1934 for the computation of the additional tax are applicable to estates of decedents dying on or after May 11, 1934, and before August 31, 1935. The rates prescribed by the Revenue Act of 1935 for the computation of the additional tax are applicable to estates of decedents dying on or after August 31, 1935.

The second sentence of the first paragraph of article 8 is amended to read as follows:

The additional tax imposed by the Revenue Act of 1932, or by the Revenue Act of 1932 as amended, is obtained by subtracting the tax imposed by the Revenue Act of 1926 from an amount computed on the value of the appropriate net estate at the rates set forth either in the Revenue Act of 1932, or in that Act as amended by the Revenue Acts of 1934 or 1935, as the case may require.

The fifth sentence of the first paragraph of article 8 is amended to read as follows:

If credits are authorized, the tax computed at the rates prescribed by the Revenue Act of 1924 and the Revenue Act of 1926 and the additional tax computed under the provisions of the Revenue Act of 1932 or the Revenue Act of 1932 as amended, is the gross tax or the tax before reduction by credits.

The portion of the heading of column (1) of "Table I (For Computation of Estate Tax)" which reads, "In effect on and after May 11, 1934," is amended to read, "In effect from May 11, 1934, to August 30, 1935, inclusive."

The heading of subparagraph (2) of article 9(a) is amended to read as follows:

Credit against additional estate tax imposed by the Revenue Act of 1932 and the Revenue Act of 1932, as amended.

In lieu of the phrase "between the date of the gift and the date of the decedent's death" at the end of the third paragraph of article 9(a) (lines 7 and 8, page 21), the phrase, "after the date of the gift" is substituted.

SEC. 202. ESTATE TAX—VALUATION.

(a) Section 302 of the Revenue Act of 1926, as amended, is amended by adding a new subdivision as follows:

"(j) If the executor so elects upon his return (if filed within the time prescribed by law or prescribed by the Commissioner in pursuance of law), the value of the gross estate shall be determined by valuing all the property included therein on the date of the decedent's death as of the date one year after the decedent's death, except that (1) property included in the gross estate on the date of death and, within one year after the decedent's death, distributed by the executor (or, in the case of property included in the gross estate under subdivision (c), (d), or (f) of this section, distributed by the trustee under the instrument of transfer), or sold, exchanged, or otherwise disposed of, shall be included at its value as of the time of such distribution, sale, exchange, or other disposition, whichever first occurs, instead of its value as of the date one year after the decedent's death, and (2) any interest or estate which is affected by mere lapse of time shall be included at its value as of the time of death (instead of the later date) with adjustment for any difference in its value as of the later date not due to mere lapse of time. No deduction under this title of any item shall be allowed if allowance for such item is in effect given by the valuation under this subdivision. Wherever in any other subdivision or section of this title or in Title II of the Revenue Act of 1932, reference is made to the value of property at the time of the decedent's death, such reference shall be deemed to refer to the value of such property used in determining the value of the gross estate. In case of an election made by the executor under this subdivision, then for the purposes of the deduction under section 303(a)(3) or section 303(b)(3), any bequest, legacy, devise, or transfer enumerated therein shall be valued as of the date of decedent's death with adjustment for any difference in value (not due to mere lapse of time or the occurrence or nonoccurrence of a contingency) of the property as of the date one year after the decedent's death (substituting the date of sale or exchange in the case of property sold or exchanged during such one-year period)."

(b) The amendment made by this section shall be effective only with respect to transfers of estates of decedents dying after the date of the enactment of this Act.

Regulations with respect to the foregoing provision, section 202 of the Revenue Act of 1935, will be promulgated at a later date.

The fourth sentence of article 48 is amended to read as follows:

The specific exemption deductible in determining the net estate upon which the additional tax is imposed by the Revenue Act of 1932 (in effect after 5 p. m., eastern standard time, June 6, 1932) is $50,000 if the decedent died prior to August 31, 1935, and $40,000 if the decedent died on or after August 31, 1935.

The first sentence of article 57 is stricken out and in lieu thereof the following is substituted:

A preliminary notice is required to be filed in the case of every resident or citizen (or of a resident only, without regard to citizenship if the decedent died prior to 11.40 a. m., eastern standard time, May 10, 1934), whose gross estate exceeded $40,000 in value at the date of death, except that if the decedent died (1) after September 8, 1916, and prior to 10.25 a. m., eastern standard time, February 26, 1926, or (2) after 5 p. m., eastern standard time, June 6, 1932, and prior to August 31, 1935, notice is required only if the gross estate exceeded $50,000 in value at the date of death, and except that if the decedent died after 10.25 a. m., eastern standard time, February 26, 1926, and prior to 5 p. m., eastern standard time, June 6, 1932, notice is required only if the gross estate exceeded $100,000 in value at the date of death. The value of the gross estate at the date of death governs with respect to the filing of the notice regardless of whether the value of the gross estate is, at the executor's election, finally determined as of a date subsequent to the date of death pursuant to the provisions of section 302(j) of the Revenue Act of 1926, as added by section 202 of the Revenue Act of 1935.

The last sentence of article 57 is amended to read as follows:

If there is doubt as to whether the gross estate exceeded $40,000, or exceeded $50,000, or exceeded $100,000, as the case may be, the notice should be filed as a matter of precaution in order to avoid the possibility of penalties attaching.

SEC. 203. ESTATE TAX—DUE DATE.

(a) Section 305(a) of the Revenue Act of 1926 is amended to read as follows:

"(a) The tax imposed by this title shall be due and payable fifteen months after the decedent's death, and shall be paid by the executor to the collector."

(b) Section 305(c) of the Revenue Act of 1926 is amended to read as follows:

"(c) If the time for the payment is thus extended there shall be collected, as a part of such amount, interest thereon at the rate of 6 per centum per annum from the expiration of three months after the due date of the tax to the expiration of the period of the extension."

(c) The amendments made by this section shall be effective only with respect to transfers of estates of decedents dying after the date of the enactment of this Act.

The first sentence of article 63 is stricken out and in lieu thereof the following is substituted:

A return on Form 706 is required in the case of every resident or citizen (or resident without regard to citizenship, if the decedent died prior to 11.40 a. m., eastern standard time, May 10, 1934), whose gross estate, as defined in the statute, exceeded $40,000 in value at the date of death, except that if the decedent died (1) after September 8, 1916, and prior to 10.25 a. m., eastern standard time, February 26, 1926, or (2) after 5 p. m., eastern standard time, June 6, 1932, and prior to August 31, 1935, the return is required only if the gross estate exceeded $50,000 in value at the date of death, and except that if the decedent died after 10.25 a. m., eastern standard time, February 26, 1926, and prior to 5 p. m., eastern standard time, June 6, 1932, the return is required only if the gross estate exceeded $100,000 in value at the date of death. The duty to file a return depends upon the value of the gross estate on the date of the decedent's death, regardless of any valuation as of a subsequent time that the executor may use by virtue of his election under subdivision (j) of section 302 of the Revenue Act of 1926, as added by section 202 of the Revenue Act of 1935, since such election may be made only upon the return.

The fourth sentence of article 63 is amended to read as follows:

The return on Form 706 must be filed in duplicate within 15 months after the date of death, if the decedent died on or after August 31, 1935, and within 1 year after the date of death, if the decedent died before August 31, 1935.

The fourth sentence of article 65 is stricken out and in lieu thereof the following is inserted:

If the decedent died subsequent to the effective date of the Revenue Act of 1932 (5 p. m., eastern standard time, June 6, 1932), the return must set forth (1) both the net estate determined in accordance with the provisions of the Revenue Act of 1926 and the net estate for the purposes of the additional tax imposed by the Revenue Act of 1932, or by the Revenue Act of 1932 as amended, which should be determined in the same manner except that in lieu of the exemption of $100,000 provided in section 303(a)(4) of the Revenue Act of 1926, the exemption is $50,000 or $40,000, as the case may be (see article 48), and (2) both the tax imposed by the Revenue Act of 1926 and the additional tax imposed by the Revenue Act of 1932, or by the Revenue Act of 1932 as amended.

The second sentence of article 68 is amended to read as follows:

An extension of time for filing the return does not in itself operate to extend the time for the payment of the tax, which is due and payable 15 months after the date of death if the decedent died on or after August 31, 1935, and 1 year after the date of death if the decedent died before August 31, 1935.

The first sentence of article 69 is amended to read as follows:

In case it is impossible for the executor to file a reasonably complete return within 15 months from the date of death if the decedent died on or after August 31, 1935, or within 1 year from the date of death if the decedent died before August 31, 1935, the Commissioner may, upon application from the executor showing good and sufficient cause, grant an extension of time not to exceed 3 months from the due date if the decedent died on or after August 31, 1935, or 6 months from the due date if the decedent died before August 31, 1935.

The fifth sentence of article 69 is amended to read as follows:

An extension of time for filing the return does not operate to extend the time for payment of the tax, which is due 15 months after the date of death if the decedent died on or after August 31, 1935, and 1 year after the date of death if the decedent died before August 31, 1935.

The third sentence of article 70 is amended to read as follows:

If the decedent died after the effective date of the Revenue Act of 1932 (5 p. m., eastern standard time, June 6, 1932), the return must set forth both the tax imposed by the Revenue Act of 1926 and any additional tax imposed by the Revenue Act of 1932 or the Revenue Act of 1932 as amended.

The fifth sentence of article 70 is amended to read as follows:

The return must be filed in duplicate and under oath within 15 months from the date of death if the decedent died on or after August 31, 1935, and within 1 year from the date of death if the decedent died before August 31, 1935, unless an extension is obtained pursuant to article 68 or 69.

The first sentence of article 78 is amended to read as follows:

The tax is due and must be paid within 15 months from the date of death if the decedent died on or after August 31, 1935, or within 1 year from the date of death if the decedent died before August 31, 1935, unless an extension of time for payment thereof has been granted by the Commissioner.

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SEC. 404. INTEREST ON DELINQUENT TAXES.

Notwithstanding any provision of law to the contrary, interest accruing during any period of time after the date of the enactment of this Act upon any internal-revenue tax (including amounts assessed or collected as a part thereof) or customs duty, not paid when due, shall be at the rate of 6 per centum per annum.

Article 84(a) is amended to read as follows:

ART. 84. (a) *Interest on tax shown on return.*—If any portion of the tax shown on the executor's return is not paid on or before the due date, and no extension of time for payment thereof has been granted, such unpaid portion bears interest from the due date until payment is received by the collector at the rate of 6 per cent per annum (except that during any part of such period of time prior to August 31, 1935, interest accrues at the rate of 1 per cent a month).

If an extension of time has been granted for paying any portion of the tax shown on the executor's return, in accordance with article 82(a), interest accrues thereon at the rate of 6 per cent per annum from the expiration of 18 months after the decedent's death to the expiration of the period of the extension. If the amount of the tax, the time for payment of which has been extended, together with any interest accrued thereon, is not paid in full on or before the date of the expiration of the extension, the total unpaid amount (tax and any accrued interest) bears interest from the expiration of the extension until payment is received by the collector at the rate of 6 per cent per annum (except that during any part of such period of time prior to August 31, 1935, interest accrues at the rate of 1 per cent a month).

Interest at 6 per cent per annum is computed on the basis of 365 days to the year, or 366 days in a leap year. Interest at the rate of 1 per cent a month is computed on the basis of a calendar month, i. e., a period (save one beginning on the first day of a calendar month) terminating with the day of the succeeding calendar month numerically corresponding with the day preceding the beginning of the period. If there is no corresponding day of the succeeding calendar month, the last day of such succeeding month is the last day of the period. If interest at the rate of 1 per cent a month is to be computed for one or more months and a fraction of a month, it should be computed for the number of whole months, and then for the fraction upon the basis of the number of days of the calendar month in which the first day of the fraction falls. Thus, for example, the elapsed period from February 14 to March 13, both dates included, is one month, and the period from February 14 to March 11, both dates included, is twenty-six twenty-eighths of a month, except that if the year be a leap year the period is twenty-seven twenty-ninths of a month.

Article 84(b) is amended by adding at the end thereof the following sentence:

However, if the amount of the tax, the time for payment of which is so postponed, together with interest accrued thereon, is not paid in full on or before the date of the expiration of the period of the postponement (six months after the termination of the precedent interest or interests in the property), the unpaid amount bears interest at the rate of 6 per cent per annum from the date of the expiration of the period of the postponement until payment is received by the collector.

Article 85 is amended to read as follows:

ART. 85. *Interest on deficiency tax.*—The statute provides that any deficiency shall bear interest at the rate of 6 per cent per annum from the due date for payment of the tax (15 months after the date of death if the decedent died on or after August 31, 1935, or 1 year after the date of death if the decedent died before August 31, 1935) to the date the deficiency is assessed, except in the case of a waiver of the restrictions against the assessment and collection of the deficiency, and that such interest shall be assessed at the same time as the deficiency of which it becomes an integral part. The deficiency in respect to which the restrictions against the assessment and collection are waived under section 308(d) bears interest at the rate of 6 per cent per annum from the due date of the tax to the thirtieth day after the filing of such waiver or to the date the deficiency is assessed, whichever is the earlier. The term "deficiency" includes any tax resulting from the correction of a mathematical error appearing upon the face of a return. (See second paragraph of article 77.)

If any portion of the deficiency assessed is not paid within 30 days from the date of the notice and demand issued by the collector (except a deficiency or any part thereof with respect to which a jeopardy assessment is made and collection is stayed by the filing of a bond), and no extension of time for payment thereof has been granted, such unpaid portion bears interest from the date of the notice and demand until payment is received by the collector at the rate of 6 per cent per annum (except that during any part of such period of time prior to August 31, 1935, interest accrues at the rate of 1 per cent a month).

If an extension of time is granted for paying any portion of the deficiency assessed, in accordance with article 83, interest accrues thereon at the rate of 6 per cent per annum for the period of the extension, i. e., from the date prescribed for the payment (30 days after the date of the notice and demand) to the expiration of the period of the extension. If the amount of the deficiency, the time for payment of which has been extended, together with interest accrued thereon, is not paid in full on or before the date of the expiration of the extension, the total unpaid amount (tax, interest and any addition thereto) bears interest from the expiration of the extension until payment is received by the collector at the rate of 6 per cent per annum (except that during any part of such period of time prior to August 31, 1935, interest accrues at the rate of 1 per cent a month).

Any addition to the tax resulting from the imposition of an ad valorem penalty under the provisions of section 3176, Revised Statutes, is subject to the same provisions of law relating to the assessment, collection, and the accrual of interest, as the deficiency tax, except that such addition to the tax is not subject to any interest between the due date for payment of the tax (15 months after the date of death if the decedent died on or after August 31, 1935, or 1 year after the date of death if the decedent died before August 31, 1935) and the date of the assessment thereof.

If a stay of the collection of a jeopardy assessment of a deficiency tax, or any addition to the tax resulting from the imposition of an ad valorem penalty, is obtained and a petition for a redetermination of the deficiency is filed with the Board of Tax Appeals, interest accrues on such unpaid portion of the deficiency or penalty, if any, determined by a decision of the Board which is made final, at the rate of 6 per cent per annum from the date of the notice and demand from the collector following the jeopardy assessment to the date of the notice and demand by the collector subsequent to the final action taken on the petition filed with the Board. If the amount which the Board determines should have been assessed is not paid in full within 30 days from the date of such notice and demand issued subsequent to the decision of the Board which has become final, interest accrues upon the unpaid amount from the date of such notice and demand until it is paid at the rate of 6 per cent per annum (except that during any part of such period of time prior to August 31, 1935, interest accrues at the rate of 1 per cent a month). If the amount (exclusive of any ad valorem penalty) determined by the Board as the amount which should be assessed is greater than the amount actually assessed the difference bears interest at the rate of 6 per cent per annum from the due date of the tax until assessment of such difference. If the collection of the jeopardy assessment is stayed, and no petition is filed with the Board for a redetermination of the deficiency, interest accrues upon the deficiency so assessed at the rate of 6 per cent per annum from the date of the jeopardy notice and demand to the date of the notice and demand made by the collector after the expiration of the 90 days from the mailing by the Commissioner of the notice of the deficiency. If such amount is not paid within 30 days from the date of such further notice and demand, interest accrues upon the unpaid amount from the date of such further notice and demand until it is paid at the rate of 6 per cent per annum (except that during any part of such period of time prior to August 31, 1935, interest accrues at the rate of 1 per cent a month).

For method of computing interest at 6 per cent per annum or at 1 per cent a month see last paragraph of article 84(*a*).

SEC. 406. FAILURE TO FILE RETURNS.

**In the case of a failure to make and file an internal-revenue tax return required by law, within the time prescribed by law or prescribed by the Commissioner in pursuance of law, if the last date so prescribed for filing the return is after the date of the enactment of this Act, if a 25 per centum addition to**

the tax is prescribed by existing law, then there shall be added to the tax, in lieu of such 25 per centum: 5 per centum if the failure is for not more than 30 days, with an additional 5 per centum for each additional 30 days or fraction thereof during which failure continues, not to exceed 25 per centum in the aggregate.

Article 92 is amended to read as follows:

ART. 92. *Penalty for failure to give notice or make and file return.*—For failure to give the notice or make and file the return within the time prescribed, the person in default is subject to a penalty not exceeding $500.

For failure to make and file the return within the time prescribed by the Commissioner, or within an extension of time granted by the Commissioner or the collector, 5 per cent will be added to the tax if the failure is for not more than 30 days, with an additional 5 per cent for each 30 days or fraction thereof during which failure continues, not to exceed 25 per cent in the aggregate, except that if the last date allowed for filing the return is on or before August 30, 1935, 25 per cent will be added to the tax, and except that if the return is filed after the time allowed and it is shown that the failure to file within the time so allowed was due to a reasonable cause and not to willful neglect, no such addition will be made to the tax.

GUY T. HELVERING,
*Commissioner of Internal Revenue.*

Approved February 24, 1936.

WAYNE C. TAYLOR,
*Acting Secretary of the Treasury.*

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## TITLE III.—ESTATE TAX. (1926)

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### SECTION 302.

REGULATIONS 80 (1929), ARTICLE 25: Taxable insurance. XV–1–7892
Ct. D. 1057

ESTATE TAX—REVENUE ACT OF 1926—DECISION OF SUPREME COURT.

1. GROSS ESTATE—PROCEEDS OF LIFE INSURANCE POLICY.

Where the decedent had taken out a life insurance policy in 1892, payable to his wife if living and if not, to his surviving children, or if none of them survived then to his legal representatives, which policy became paid up in 1912, and where no power was reserved to change the beneficiaries, to borrow on the policy, or surrender it, the proceeds of the policy paid to the three surviving children upon the death of the decedent, in 1930, were not includible in his gross estate under the provisions of section 302(g) of the Revenue Act of 1926.

2. CASE FOLLOWED.

*Bingham* v. *United States* (decided December 9, 1935) (296 U. S., —[Ct. D. 1058, page 367, this Bulletin] followed.

SUPREME COURT OF THE UNITED STATES.

*Industrial Trust Co. and Orland S. Greene, Executors of the Estate of William M. Greene, petitioners,* v. *The United States.*

On writ of certiorari to the Court of Claims.

[December 9, 1935.]

OPINION.

Mr. Justice SUTHERLAND delivered the opinion of the Court.

Petitioners, as executors of the estate of William M. Greene, who died in 1930, filed an estate tax return and paid the amount of the Federal estate tax disclosed thereby. A paid-up life insurance policy of $42,000 was omitted from the return. The Commissioner of Internal Revenue declared a deficiency and included the amount of this policy in the gross estate. Petitioners filed a claim for refund, which was rejected by the Commissioner. Thereupon, this proceeding was brought in the Court of Claims to recover the amount of the claim. That court held against the right to recover and dismissed the petition.

The policy, issued in 1892, promised to make payment to the wife of the decedent, as sole beneficiary if living; and if not living, to the surviving children of the decedent; and, in the event of none surviving, then to the executors, administrators, or assigns of the decedent. In 1912, the policy became a paid-up policy requiring no further payment of premiums. No power was reserved to change beneficiaries, borrow on the policy or surrender it. The wife of the decedent predeceased him; but he was survived by three children, to whom the proceeds of the policy were paid upon his death.

The case of *Lewellyn* v. *Frick* (268 U. S., 238 [T. D. 3715, C. B. IV-1, 322]) arose under the Revenue Act of 1918. This case arises under the Act of 1926 (section 302(g), which is the same as section 402(f) of the former Act). Subdivision (h) of the 1926 Act, however, provides that subdivisions (b), (c), (d), (e), (f), and (g) shall apply to "transfers, trusts, estates, interests, rights, powers, and relinquishment of powers, as severally enumerated and described therein, whether made, created, arising, existing, exercised, or relinquished before or after the enactment of this Act." Whether any of these terms apply to an amount receivable by a beneficiary, under a policy such as we have here, is fairly debatable. (See *Wyeth* v. *Crooks*, 33 F. (2d), 1018, 1019.) If any of them do apply, the provision is open to grave doubt as to its constitutionality, and the rule of the Frick case controls.

The foregoing facts bring the case clearly within our decision just announced in *Bingham* v. *United States* (296 U. S., — [Ct. D. 1058, page 367, this Bulletin]); and the judgment of the court below is accordingly

Reversed.

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REGULATIONS 70 (1929), ARTICLE 10: Character of interests included. XV-17-8062 Ct. D. 1109

ESTATE TAX—REVENUE ACT OF 1926—DECISION OF COURT.

GROSS ESTATE—DEDUCTION—PERSONAL PROPERTY LOCATED OUTSIDE THE UNITED STATES—ENGLISH DEATH DUTIES.

Where a citizen of the United States domiciled in New York died in England, in 1931, leaving tangible and intangible personal property both in England and in the United States, the value of the English property is includible in the gross estate, under the provisions of section 302(a) of the Revenue Act of 1926, without any deduction for English death duties paid, taxes of such nature being expressly excluded from deduction by section 303(a)1 of that Act.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

*Guaranty Trust Co. of New York, as Executor of the Estate of James Benson Kennedy, Deceased, petitioner,* v. *Commissioner of Internal Revenue, respondent.*

Petition to review a decision of the Board of Tax Appeals sustaining a deficiency in estate taxes determined by the Commissioner under the provisions of the Revenue Act of 1926. Affirmed.

Before MANTON, SWAN, and CHASE, Circuit Judges.

[August 12, 1935.]

OPINION.

CHASE, Circuit Judge: The petitioner is the executor of the American will of James Benson Kennedy who was a citizen of the United States domiciled in New York when he died in England on February 24, 1931, during a temporary visit there. He left tangible and intangible personal property both in England and in the United States. He left an American will which disposed of his property in the United States and an English will effective only as to property in England.

His property in England consisted of stocks, bonds, and securities of corporations not American and of Governments other than the United States; cash and tangible personal property of the total value of $614,987.30. The executors of his English will paid the English death duties assessed thereon to the amount of $133,582.05. The American estate of the deceased as returned for taxation was increased by the Commissioner by the value of the English estate above given, without any deduction for English death duties paid, and the resulting deficiency assessed is the one before us upon this petition to review.

Section 302(a) of the Revenue Act of 1926 provided that the gross estate of every decedent should consist of all his property wherever situated to the extent of his interest therein at the time of his death. We need not now deal with deductions which are allowable if duly claimed by nonresidents, for this decedent was a resident of this country as well as an American citizen. Nor need we be concerned with any distinction between real estate and personal property in a foreign country, for decedent owned no English real property. See, however, 31 Opinions of the Attorney General, 287, May 14, 1918, excluding foreign real estate from the scope of the estate tax.

The language of the above statute is extremely broad. It follows that of the Revenue Act of 1916 and subsequent Acts were uniform in this respect until a change was made in that of 1934. The regulation applicable, Treasury Regulations 70, article 11, provided in part, following the above mentioned opinion of the Attorney General, that, where decedent was a resident of this country, the value of all personal property wherever situated should be included in his gross estate. The regulations under previous Acts had been to the same effect. See Regulations 37, article 13; Regulations 63, article 12; and Regulations 68, article 11, promulgated respectively under the 1918, 1921, and 1924 Acts. This administrative construction of the statute is to be taken as having been approved by Congress when it reenacted the statute without change in 1921, 1924, and 1926. (*McCaughn* v. *Hershey Chocolate Co.*, 283 U. S., 488 [Ct. D. 345, C. B. X-1, 444]; *Brewster* v. *Gage*, 280 U. S., 327 [Ct. D. 148, C. B. IX-1, 274]; *United States* v. *Dakota-Montana Oil Co.*, 288 U. S., 459 [Ct. D. 655, C. B. XII-1, 243].) In view of this we can have no doubt but that Congress intended to include the value of foreign personal property in the tax base just as the language used ordinarily would imply.

The suggestion that the decision in *United States* v. *Goelet* (232 U. S., 293), in which it was held that a tax imposed on foreign built yachts did not apply to a yacht of a citizen permanently domiciled abroad is to the contrary, is too farfetched for serious consideration. It relates to what Congress intended when it enacted a different statute relating to a different tax. Nor does the possibility, even the present certainty, of double taxation, make the tax in any wise invalid. (*Burnet* v. *Chicago Portrait Co.*, 285 U. S., 1.) That is a matter within the discretion of Congress and not a limitation upon its power to tax. (See *Gibbons* v. *Ogden*, 9 Wheat., 1; *Willcuts* v. *Bunn*, 282 U. S., 216 [Ct. D. 280, C. B. X-1, 309].)

The power of Congress to put the value of foreign personal property in the estate tax base seems as plain as its intent to do so. The fact that this personal property was in the possession of the English executor is immaterial, for the tax is imposed upon the transfer, not the property. (*Reinecke* v. *Northern Trust Co.*, 278 U. S., 339 [T. D. 4261, C. B. VIII-1, 305].) The constitutional limitations upon the power of the States to tax personal property do not apply to the United States. (*Burnet* v. *Brooks*, 288 U. S., 378 [Ct. D. 648, C. B. XII-1, 362]; *United States* v. *Bennett*, 232 U. S., 299.) The United States is equally free to tax the transfer of such property. In *Cook* v. *Tait* (265 U. S., 47 [T. D. 3594, C. B. III-1, 73]), the power of Congress to tax a United States citizen, domiciled outside of this country, upon income from real and personal property located in Mexico, was upheld. Here the decedent received the governmental protection upon which the power to tax may be supported under the foregoing authorities until the moment he died. Of course his death was the event which took place to call the taxing statute into operation, and at that time he no longer needed or could be accorded protection, but the distinction the petition would put upon this ground is wholly unreal. The tax may well be supported by the benefit derived up to the instant of death.

The incidental contention that the taxable estate of the decedent should be reduced by the amount of the English death duties paid can not be sustained.

The power to tax the estate made up by including the value of the personal property situated in England is not limited by any requirement to allow deductions from that value. Whether any deductions will be allowed is for the determination of Congress. Section 303(a)1 of the 1926 Act provided for some deductions from the gross estate of a resident in arriving at the taxable net but expressly excluded from such deductions "any estate, succession, legacy, or inheritance taxes."

Affirmed.

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REGULATIONS 70(1926), ARTICLE 15: Transfers during life. XV-10-7985 Ct. D. 1089

ESTATE TAX—REVENUE ACT OF 1926—DECISION OF COURT.

1. GROSS ESTATE—TRANSFERS IN TRUST—CONTEMPLATION OF DEATH.

On June 1, 1926, the decedent, then 74 years of age, created two trusts, and executed his will whereby he gave the residue of his estate to his wife and children. The first trust instrument was irrevocable and provided for the payment of trust income to his wife for life, upon her death the corpus to be divided in equal portions among the surviving children, the share of any deceased child to go to that child's surviving issue; the second provided for payment of trust income to himself for life, with a like provision as to corpus, and with reservation of power to revoke. The decedent died on December 24, 1927. The evidence submitted as to the circumstances attending the creation of the trusts and as to the decedent's purposes in creating them persuasively indicates that the transfers were made in contemplation of death, within the meaning of section 302(c) of the Revenue Act of 1926, and the value of the trust property at the date of death was properly included in the decedent's gross estate.

2. GROSS ESTATE—PROCEEDS OF LIFE INSURANCE POLICIES.

Where the decedent, in February, 1926, bought from a corporation of which he was a stockholder and officer insurance policies on his own life, taken out prior to 1920 for the benefit of the corporation (applications for which had been signed by the decedent), and caused the beneficiary to be changed to others than his own estate, retaining the right further to change the beneficiaries, the policies are to be regarded as having been taken out by the decedent, within the meaning of section 302(g) of the Revenue Act of 1926, when he bought them from the corporation and designated new beneficiaries, and the proceeds thereof were properly included in his gross estate.

3. GROSS ESTATE—PROCEEDS OF LIFE INSURANCE POLICY—EVIDENCE—BURDEN OF PROOF.

In the absence of evidence as to the circumstances attending the taking out by the decedent, in August, 1927, of a single premium endowment policy on the life of his wife, it may be presumed that they were such as to make the value of the policy at the date of the decedent's death a part of his gross estate, within the meaning of section 302(c) of the Revenue Act of 1926, and the burden of proving that the Commissioner erred in so holding has not been sustained.

4. EXEMPTION—FEDERAL FARM LOAN BONDS.

The provisions of section 26 of the Federal Farm Loan Act (39 Stat., 360), exempting Federal farm loan bonds from taxation, are not violated by the inclusion in the decedent's gross estate of the value of such bonds owned by him. The estate tax being an excise upon the privilege of transmitting property at death, the United States may tax such transmission regardless of the character of the property.

5. Deduction—Funeral Expense—Local Law.

An amount incurred by the decedent's estate for perpetual care and maintenance of a mausoleum and cemetery lot is not an allowable deduction under the provisions of section 303(a)1 of the Revenue Act of 1926, since the law of the jurisdiction in which the estate was administered does not indicate that such expenditure comes within the meaning of funeral expenses.

6. Decision Affirmed.

Decision of the Board of Tax Appeals (28 B. T. A., 888) affirmed.

United States Circuit Court of Appeals for the Fifth Circuit.

*Edgar A. Igleheart, Executor, Cora B. Igleheart, Executrix, Estate of Addison W. Igleheart, petitioners, v. Commissioner of Internal Revenue, respondent.*

Petition for review of decision of United States Board of Tax Appeals (district of Florida).

Before Bryan, Sibley, and Walker, Circuit Judges.

[May 21, 1935.]

OPINION.

Walker, Circuit Judge: By petition for review the executrix and executor of the estate of Addison W. Igleheart, deceased, complain of the action of the Board of Tax Appeals under a petition for a redetermination of a deficiency of estate taxes assessed by the respondent against the estate of the decedent, who died on December 24, 1927.

On June 1, 1926, the decedent, then 74 years of age, the date of his birth being March 6, 1852, created two trusts, and executed his will—which superseded a will made in 1921—whereby, after a specific bequest to his wife, he gave the residue of his estate in equal shares to his wife and his four children, the will naming his wife as executrix and his son executor. One of the trusts was created by an instrument whereby the decedent transferred irrevocably to his wife corporate stock and bonds, including Federal land bank bonds, the property transferred then having a value of $498,599.88, in trust to receive for herself the net income during her life, upon her death the trust fund to be divided equally between the decedent's surviving children, the share of any deceased child of the decedent to go to that child's surviving issue. The other trust was created by an instrument whereby the decedent transferred to a named trust company described corporate stock, then having the value of $869,122.28, in trust to pay the net income of the trust property to the decedent during his natural life, and, upon the death of the decedent, the trust property to be divided equally between the decedent's children, the share of any deceased child of the decedent to go to that child's surviving issue. The decedent expressly reserved the right at any time during his lifetime to revoke, annul or amend the trust created by that instrument. In February, 1926, Igleheart Bros., an Indiana corporation, of which decedent was a stockholder and officer, sold to the decedent for the cash surrender value thereof certain policies of insurance on the decedent's life which that corporation, prior to 1920, had taken out for its own benefit, the several applications therefor having been signed by the decedent. Pursuant to provisions contained in each of the policies the decedent caused the name of the beneficiary to be changed from that of the corporation to a named beneficiary other than the estate of the decedent, under the policies the decedent having the right further to change the beneficiaries. Upon the death of the decedent $112,446 was paid under the policies to the designated beneficiaries chosen by the decedent. In August, 1927, the decedent took out a 2-year endowment policy of $100,000, on the life of his wife, paying therefor a single premium of $97,225.

The estate tax deficiency in question, in so far as it was approved by the Board of Tax Appeals, resulted from: adding to the amount shown by petitioners' return as subject to estate tax the following: the amount of the value at the date of the decedent's death of the property included in the trust created by him in favor of his wife primarily, the value of that property at that time being substantially greater than it was at the time that trust was created;

the amount of the value at the date of the decedent's death of the property included in the trust created by the decedent in his own favor for life, that value being substantially greater than the value of such property at the time that trust was created (in calculating the value or the amounts of property transferred by the decedent in creating the two trusts, an exemption of $5,000 was allowed for each of five beneficiaries)—the amount collected on policies of insurance on the life of the decedent bought by the decedent from Igleheart Bros. of Indiana, less the statutory exemption of $40,000; the amount of the cash surrender value at the date of the decedent's death of the 2-year endowment policy on the life of decedent's wife, and the amount of the value at the time of decedent's death of farm loan bonds held by the decedent and in trust in his favor; and from the disallowance of a deduction of $1,500, the amount of an obligation incurred by decedent's estate for the perpetual care and maintenance of a mausoleum and cemetery lot for the last resting place of the decedent.

From his boyhood until April, 1926, when all of the stock of Igleheart Bros. of Indiana was sold, the decedent was connected with the business of that corporation, that business being a flour milling business which was established by the father of the decedent. In the earlier years the decedent was a clerk and salesman, and from 1905 to April 1, 1926, he was vice president and treasurer. The decedent and his two brothers each had one son. The decedent and his two brothers each owned two-ninths of the common and preferred stock of Igleheart Bros., and each of the sons owned one-ninth thereof. Following negotiations, on April 1, 1926, after the preferred stock, having a par value of $810,000, had been retired, all the common stock of that corporation was sold to the Postum company for $595,000 cash and 95,000 shares of Postum company stock, the liquid assets of the corporation consisting of cash and securities being distributed pro rata to the stockholders at the same time. Contemporaneously there was organized a Delaware corporation, called Igleheart Bros., Inc., which received the 95,000 shares of the Postum company stock and in exchange therefor delivered to the former stockholders of Igleheart Bros. of Indiana its own class A stock in proportion to their respective interests. As a result of the retirement of the preferred stock of Igleheart Bros. of Indiana and the sale of the common stock to the Postum company, the decedent acquired cash and stock amounting in value to $2,424,000. Before these transactions his net worth, excluding his interest in Igleheart Bros. of Indiana, was approximately $100,000, and after the sale of the common stock of Igleheart Bros. of Indiana to the Postum company, the decedent was possessed of independent means in excess of $2,500,000.

In November, 1915, the decedent suffered a stroke described as a right-side hemiplegia, a condition brought about by the rupture of a blood vessel in the left side of the brain which might result from any one of a number of causes, such as thickening or hardening of the arteries, embolism, stomach disease, nephritis and other causes. Medical examination of the decedent after the stroke failed to disclose the cause. His urine was normal, there was no heart trouble and he had no kidney disease. Decedent was confined to his bed about four weeks and then regained normal health except that the use of his right arm and leg was seriously impaired from the time of the stroke to his death. His mind, speech, hearing and eyesight remained normal until his death, but because of lack of use of the right arm he learned to write with his left hand. Until three days before his death the decedent had general good health, his appetite remained normal and he was not attended by a physician except on two or three occasions for minor ailments unrelated to the hemiplegia. After the stroke the decedent could and did walk short distances about his house with assistance and the help of a cane, but for the most part he spent his time sitting in a chair in the house or on the veranda reading or talking with his family, friends, or business associates. In good weather he took some trips of several hundred miles. The decedent remained cheerful and optimistic to the end, was never morose, but always of a sociable nature with a sense of humor, and did not talk about the condition of his right leg and arm.

After the stroke in 1915 the decedent did not go to his office but continued as vice president and treasurer of the corporation and kept in active touch with the business through records of business, statements of daily sales, reports of the wheat market and business telegrams regularly sent to him, and in later years when at his home in Indiana the office manager called once a week and discussed the affairs of the corporation. The decedent and his two brothers were the directors and no major business policy was adopted without unanimous consent, meetings of the directors on major policies being held, after the stroke in November, 1915, at decedent's home at Evansville or Newburgh, Ind., unless he was absent from both of those places. The decedent after his stroke did not discuss with his family, his friends, or his business associates the subject of his death. In the later years of his life the decedent spent the late fall and winter months in Florida, and spent part of his time in the summer at Newburgh, Ind. After the decedent created the two trusts and made his last will he made his home in Florida, living in a residence he bought, the title to which was taken in his wife's name. Shortly after the sale to the Postum company was made the decedent returned to Indiana from Florida, and discussed with one of his brothers the investment of their capital in such manner as to relieve their wives of the burden of its care in the event of their "absence." That brother was a witness for the petitioners in the hearing before the Board of Tax Appeals. The following is an extract from his testimony: "After we merged with Postum and had received our payment, he, as well as myself, was very much concerned as to how to invest this money so that in the event of our absence our wives would not have the burden of it in the care of it. In our discussion as to how to invest his money, the decedent did not discuss the possibility of his dying any more than it was a thing that would happen to any one of us at any time, and while it might be some years ahead we ought to be prepared for any eventualities, and get all three of our estates fixed up. I discussed this with both of my brothers, Leslie and the decedent, Addison W. In discussing this matter with my brother, he just thought like you would to-day, that if you wanted to have your wife put in a position to be relieved from these things, and the way I felt with my wife, we did not know when that would take place, and we wanted to do it while we were clear headed and when there was no rush; we discussed that the first week or two after he returned from Florida, in the late spring or early summer." The lawyer who prepared the two trust instruments and the will discussed with the decedent the matter of two trusts and the preparation of the will. That lawyer was a witness for the petitioners. He testified that at the first meeting with the decedent in April, 1926, the decedent stated in effect that for the first time in his life, through the sale to the Postum company, he had become possessed of independent means which were free, and he wished first of all to make some provision for his wife that would make her independent and give her a competence consistent with what he had, and also that he thought it wise that she should begin to learn something about the care of property; that with regard to the other trust the decedent stated that he wished to withdraw a substantial part of the Postum stock or Igleheart Bros., Inc., stock from his own holdings, and put them in the hands of a competent trustee; that he wished, however, to reserve the right to call upon it if he needed to do so, to reserve the right to the income, to distinguish between his general estate and this trust, so it would go down, after the lives of his children, to the grandchildren, making a distinction between those who had issue and those who had not, and passing the entire remainder to his grandchildren only; that decedent further stated that he had been spending the winters in Florida for several years, that he proposed to go back there, and as he then felt, would probably make his legal home there, and, from what he had heard from friends and acquaintances in Florida, there had been a good deal of dissatisfaction at times with the administration of trusts and estates in Florida, through local administrators and local counsel, and that he did not care to have the trust, which would represent the major part of his estate, where it would be subject to the administration of a Florida court, if he made his legal residence there; that he wished to pick his own trustee and fix the terms of the trustee's compensation. A witness for the petitioners testified that he discussed with the decedent the matter of placing property of the latter in trust; that decedent had a two or three fold purpose in establishing the trust in favor of his wife; that his idea was to reduce income tax, and his other reason was to give his wife an independent income, and school her in investments. The witness stated: "He spoke to me about reducing income taxes in May, right after he returned to Evansville; he mentioned that his income would be much greater, and he asked me if it were possible to do that and save taxes, and I told him yes. I told him the method to be employed, the scope would be up to him."

The statute applicable to the property transfers made by the two trust instruments in question contains a provision to the effect that where within two years prior to his death, but after the enactment of that statute, the decedent had made such a transfer or transfers of any of his property or an interest therein, "not admitted or shown to have been made in contemplation of or intended to take effect in possession or enjoyment at or after his death, and the value or aggregate value at the time of such death of the property or interest so transferred to any one person is in excess of $5,000, then, to the extent of such excess, such transfer or transfers shall be deemed and held to have been made in contemplation of death within the meaning of" that statute. (Section 302(c) of Revenue Act of 1926, 44 Stat., 9.) After the death of the decedent, and after the determination by the respondent of the estate tax deficiency in question, that provision, which creates a conclusive presumption that gifts made within two years prior to the death of the donor were made in contemplation of death, was decided to be constitutionally invalid. (*Heiner* v. *Donnan*, 285 U. S., 312 [Ct. D. 473, C. B. XI-1, 324].) It appears from the opinion of the Board of Tax Appeals that that tribunal held that the petitioners must establish by a preponderance of evidence that the transfers in question were not, in fact, made in contemplation of death or to take effect in possession or enjoyment at or after the decedent's death. The petitioners challenge the correctness of that ruling. Nothing contained in the record indicates whether the respondent's determination of the estate tax deficiency in question was based on the statutory presumption referred to or on his conclusion from evidence with reference to the transfers in question. As to the respondent's determination of the estate tax deficiency in question nothing is shown by the record other than the written notice to petitioners of such determination and the accompanying statement showing the differences between the computation contained in petitioners' estate tax return and the computation upon which respondent's determination of the estate tax deficiency was based. By the terms of the statutory provision referred to the presumption thereby purported to be created applies only to a transfer or transfers by the decedent "not admitted or shown to have been made in contemplation of or intended to take effect in possession or enjoyment at or after his death." Nothing contained in the record negatives the conclusion that respondent's finding that the transfers in question were made in contemplation of death was based on evidence supporting that finding. In the indicated condition of the record it seems that it can not reasonably be inferred or presumed that the respondent, in determining the estate tax deficiency in question, acted on the invalid presumption purported to be created by the statutory provision referred to. The action of an official is presumed to be correct in the absence of a showing of its incorrectness. The burden was on the petitioners to establish the invalidity of the respondent's determination of the estate tax deficiency in question. (*Lucas* v. *Structural Steel Co.*, 281 U. S., 264, 271; *Helvering* v. *Taylor*, 293 U. S., 507, 515 [Ct. D. 912, C. B. XIV-1, 168]; *Flynn* v. *Commissioner*, — Fed. (2d), — [Ct. D. 1023, C. B. XIV-2, 186].)

The dominant purpose of the provision of the estate tax statute for including in the estate to be taxed property transferred by the decedent in contemplation of death is to reach substitutes for testamentary disposition and thus to prevent the evasion of the tax. (*United States* v. *Wells*, 283 U. S., 102, 117 [Ct. D. 340, C. B. X-1, 475]; *Nichols* v. *Coolidge*, 274 U. S., 531, 542 [T. D. 4072, C. B. VI-2, 351].) It is manifest that much property would escape the tax if one could evade it by making gifts during life instead of bequeathing property by will or permitting it to be disposed of under intestacy statutes. The words "in contemplation of death" mean that the thought of death is the impelling motive of the transfer, whether there is or is not a consciousness or belief that death is imminent. A gift is to be regarded as made in contemplation of death where the dominant motive of the donor is to make proper provision for the donee after the death of the donor. In determining whether a transfer was or was not made in contemplation of death due consideration must be given, not only to testimony as to what was said by or to the decedent with reference to the transfer at and prior to the time it was made, but also to the evidence as to the circumstances attending the making of the transfer. "There is no escape from the necessity of carefully scrutinizing the circumstances of each case to detect the dominant motive of the donor in the light of his bodily and mental condition and thus give effect to the manifest purpose of the statute." (*United States* v. *Wells*, supra, 119.) The above set out part of the testimony of the decedent's brother as to the witness and the decedent discussing the matter of being prepared for any eventualities, of getting their estates fixed up, and doing it while they were clear headed and when there was no rush, as to how to invest money received in the sale to the Postum company, "so that in the event of our absence our wives would not have the burden of it in the care of it," persuasively indicates that in executing the two trust instruments the decedent had his death in mind. It is not reasonably conceivable that some of the things said by the decedent in conversations with the lawyer who prepared the two trust instruments, as deposed to by that lawyer, particularly as to the decedent's making provision for his grandchildren, and as to the administration of trusts and estates in Florida, could have been said, if, at the time those conversations occurred, the decedent did not have in contemplation his own death. Such deposed to statements of the decedent have an enhanced tendency to prove that the two trust instruments in question were made in contemplation of death when the testimony in regard thereto is considered in the light of the circumstances attending the execution of those instruments. Those two instruments and the decedent's will, made at the same time, were parts of a comprehensive scheme or plan embracing the entire estate of the decedent, then having a value in excess of two and a half million dollars. It is manifest from the evidence that for the decedent the sale to the Postum company meant his final retirement from active participation in business. After that sale his estate consisted principally of money, bonds, and stocks of corporations to which the decedent's relation was that of an investor. By the two instruments he disposed of a substantial part of his estate, and the remainder of his estate was disposed of by will. The creation of the two trusts was not in pursuance of a preexisting plan or policy of making gifts to members of decedent's family of considerable amounts of property. Evidence showed that previously he had made no such gifts. No evidence indicated that it was contemplated or expected that decedent and his wife would be separated for any considerable period during their lives. It appeared that they were habitually together. In the circumstances attending the reference in the conversations between the decedent and his brother to the former's "absence," it is fairly inferable that the only "absence" referred to was that resulting from death. The combined effect of the three instruments executed at the same time, the two trust instruments and the will, was such an arrangement as to the maker's entire estate, not only during his life, but after his death, as reasonably might be expected to be made by one, situated as the decedent was at the time those instruments were executed, who desired to get his estate "fixed up" and to do so while he "was clear headed and when there was no rush." One of the trust instruments, the one under which the income from the property transferred was to go to the decedent during his life, had features characteristic of a will, in that during his life the decedent was to be the sole beneficiary of the property conveyed, and the instrument, like a will, was subject to be revoked by its maker. Under the evidence it is not fairly open to question that at the time the three instruments were executed the decedent had in contemplation his own death. In the circumstances disclosed it reasonably was to be inferred that each of those instruments, being a part of a comprehensive plan embracing the entire estate of the decedent, including the making of a will, was made in contemplation of death. In behalf of the petitioners it was contended that the evidence showed that the dominant motive influencing the decedent in creating the two trusts was to bring about a reduction of income taxes, and that another controlling motive for the creation of the trust under which the decedent's wife was the trustee was to enable her to become experienced in the management of property. While evidence indicated that the decedent, in creating the two trusts, was influenced by a desire to make taxes on the income from his property less than they would be if he retained title to all of it, yet, as he put into effect a comprehensive plan embracing his entire estate, providing for the disposition and handling of substantial parts of it during his life, and for the disposition of the remainder of it upon his death, it seems reasonable to infer that the arrangement as a whole was made in contemplation of death, and that each of the trust instruments was a substitute for testamentary disposition. The two trust instruments and the will were parts of what practically was a single transaction, whereby a substantial part of the decedent's estate was put into an irrevocable trust for the benefit of the decedent's wife during her life, the trust property upon her death to go to the descendants of the decedent and herself; another substantial part of the decedent's estate was put into a revocable trust, for the benefit of the decedent himself during his life, and after his death for the benefit of his descendants; and the remainder of decedent's estate was disposed of by will.

It hardly could be inferred that decedent had in contemplation his own death only when he made the will, but not when, at practically the same time, he created the two trusts. As the decedent in his will named his wife as executrix thereof, his expressed desire that she "begin to learn something about the care of property" may have had reference to her performance of her duties as executrix, as well as to the care of the property transferred to her as trustee.

The applicable statute (section 302(c) of Revenue Act of 1926) provides that there shall be included in the gross estate of the decedent the value at the time of his death of all property "to the extent of the interest therein of which the decedent has at any time made a transfer, by trust or otherwise, in contemplation of * * * his death * * *." The thing taxed is the transmission of property from the dead to the living. For the purposes of the tax property transferred by the decedent in contemplation of death is in the same category as it would have been if the transfer had not been made and the transferred property had continued to be owned by the decedent up to the time of his death. As to the property so transferred, as well as to property owned by the decedent at the time of his death, the measure of the tax is the value of that property at the time of the decedent's death. (*Heiner* v. *Donnan*, supra; *Milliken* v. *United States*, 283 U. S., 15, 23 [Ct. D. 320, C. B. X-1, 472]; *Chase National Bank* v. *United States*, 278 U. S., 327, 337, [Ct. D. 40, C. B. VIII-1, 308]; *Snyder* v. *Helvering*, 69 Fed. (2d), 377.) It follows that the Board of Tax Appeals did not err ruling that the value of the assets of the two trusts at the time of the decedent's death should be included in the gross estate in computing the tax.

Section 302(g) of the Revenue Act of 1926 provides for the inclusion in the gross estate of every decedent "of the amount receivable by the executor as insurance under policies taken out by the decedent upon his own life; and to the extent of the excess over $40,000 of the amount receivable by all other beneficiaries as insurance under policies taken out by the decedent upon his own life." The manifest purpose of that provision is to include in the decedent's estate for purposes of the tax the proceeds of all insurance on his life receivable under policies acquired through expenditure by him. (*Chase National Bank* v. *United States*, supra; *Scott* v. *Commissioner*, 69 Fed. (2d), 444.) The policies, under which the right to change the beneficiaries was reserved, having originally been taken out, for its own benefit, by a corporation of which the decedent was an officer, the applications for which were signed by the decedent, are to be regarded as having been taken out by the decedent, within the meaning of the statute, when he bought those policies from that corporation, and had new beneficiaries, chosen by himself, designated, he retaining the right under each policy further to change the beneficiary. The statute readily could be evaded if a policy, under which the beneficiary may be changed, could be taken out by a corporation or firm on the life of an official or member of that corporation or firm, and the latter could acquire the policy and have a new beneficiary designated, with the result of excluding from his gross estate the amount in excess of $40,000 receivable by the beneficiary under the policy. The ruling under consideration was not erroneous.

The record contains no evidence as to the circumstances attending the taking out by the decedent of the endowment policy on the life of his wife. In the absence of evidence on the subject, it may be presumed that that policy was taken out in such circumstances as to make the value of it, at the date of the decedent's death, part of the decedent's estate for estate tax purposes. This being so, the petitioners failed to sustain the burden of establishing the invalidity of the action of the respondent with reference to that matter.

The action of the respondent, approved by the Board of Tax Appeals, in including in the gross estate of the decedent subject to the estate tax the value, at the date of the decedent's death, of Federal farm loan bonds mentioned, was challenged on the ground that the statute (section 26, Federal Farm Loan Act, 39 Stat., 360) provides that such bonds and the income derived therefrom "shall be exempt from Federal, State, municipal and local taxation." The statute imposed a tax on the transfer of the net estate of every decedent, and provided in substance that, to the extent of his interest therein at the time of his death, the value of all the decedent's property, real or personal, tangible or intangible, wherever situated, shall be included in his gross estate, in computing the tax imposed. (Sections 301(a) and 302(a) of Revenue Act of 1926, 26 U. S. C. A., sections 1092, 1094(a).) The estate tax is not a tax on property. It is an excise on the privilege of transmitting property of a decedent upon his death, the amount of the tax being measured by the value of the property transmitted. (*Chase National Bank* v. *United States*, 278 U. S., 327; *New York Trust Co.* v. *Eisner*, 256 U. S., 345; *Knowlton* v. *Moore*, 178 U. S., 41.) The provision exempting from taxation Federal farm loan bonds and the income therefrom is not violated by measuring the estate tax by the value, at the time of the decedent's death, of all of his property, including such bonds, as the United States may tax the transmission of property upon the death of its former owner, regardless of the character of that property. (*Plummer* v. *Coler*, 178 U. S., 115; *Murdock* v. *Ward*, 178 U. S., 139; *Greiner* v. *Lewellyn*, 258 U. S., 384, 387 [T. D. 3326, C. B. I-1, 467].) In support of the contention that the farm loan bonds were taxed by the inclusion of them in the gross assets of the decedent in computing the estate tax, counsel for the petitioners refer to statements contained in the opinion rendered in the case of *First National Bank* v. *Maine* (284 U. S., 312). In that case it was decided that corporate stock could not be made the basis of an inheritance tax in a State other than that of the domicile of its deceased owner. The opinion contained statements to the effect that real property can not be taxed, or made the basis of an inheritance tax, except in the State in which it is located, and that certain kinds of intangibles, namely, bonds, notes and credits, are subject to the imposition of an inheritance tax only by the domiciliary State. Those statements had reference to the effect of the location of property upon the taxability by States of the transfer of it at death. Nothing contained in that opinion indicates an intention to depart from previous decisions to the effect that the United States may tax the transmission of property upon the death of its owner, whether that property itself is or is not exempt from taxation. The question of such transmission being or not being taxable by the United States was not involved in that case.

The petitioners unsuccessfully sought the allowance of a deduction from decedent's gross estate of $1,500 for an obligation in that amount incurred by decedent's estate for the perpetual care and maintenance of a mausoleum and cemetery lot for the remains of the decedent. The statute (section 303(a)1 of Revenue Act of 1926, 26 U. S. C. A., section 1095) authorizes a deduction from the gross estate of " Such amounts for funeral expenses, * * * as are allowed by the laws of the jurisdiction * * * under which the estate is being administered * * *." A Florida statute (section 5541, Laws of Florida) provides: " Executors and administrators shall be allowed all reasonable charges on account of disbursements for funeral expenses, * * *." The language used imports charges or expenditures incident to the burial or interment of the remains of the decedent. Nothing indicates that the lawmakers had in mind expenditures for the care and maintenance, after the completion of the burial and sepulture, of the place where the body of the decedent was intended to remain. So far as we are advised no Florida court has construed the statute as covering expenditures for the perpetual care and maintenance of the place where the decedent is interred. The language of the statute falls short of showing that it was intended to enable executors or administrators to obligate the decedent's estate for the cost of the perpetual care and maintenance of a mausoleum and cemetery lot for the remains of the decedent. We conclude that the disallowance of the deduction in question was not erroneous.

The Board of Tax Appeals refused to comply with a request of the petitioners that judicial notice be taken of the case of *Cora B. Igleheart* v. *Commissioner*, pending before that tribunal. It appears that the purpose of the proposal that the other case referred to be considered was to disclose that in that case the respondent took a position inconsistent with a position taken by him in the instant case, in that in the former he contended that the abovementioned trust instrument under which Cora B. Igleheart was the trustee and a beneficiary was not made in contemplation of death, while in the instant case he contended that that instrument was made in contemplation of death. Neither of the petitioners in her or his executional capacity was a party to the other case referred to. It was not made to appear that the fact as to what position was taken by the respondent in the other case referred to, that case and the instant one not being between the same parties, had any pertinency to the issues in the instant case. The fact, if it was a fact, that in the other case the respondent took a position inconsistent with one taken by him in the instant case would not justify or excuse a failure of the Board of Tax Appeals, or of this court, to sustain a correct position taken by the respondent in the instant case. Furthermore, if in the other case referred to the respondent contended that the trust instrument under which Cora B.

Igleheart was the trustee was not made in contemplation of death, that contention was overruled by the decision of the Circuit Court of Appeals for the Seventh Circuit in passing on a petition for review of the decision of the Board of Tax Appeals in that case. (*Commissioner* v. *Cora B. Igleheart Trust Estate*, 75 Fed. (2d), 151.) It is apparent that the ruling now under consideration was not substantially harmful to petitioners, and is not a ground of reversal.

The record showing no reversible error, the petition is denied.

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## REGULATIONS 70(1926), ARTICLE 19: Power to change enjoyment. XV-25-8137 Ct. D. 1129

ESTATE TAX—REVENUE ACT OF 1926—DECISION OF COURT.

1. GROSS ESTATE—TRANSFER IN TRUST—RESERVATION OF POWER TO ALTER, AMEND, OR REVOKE.

The decedent and his wife in 1926 executed a trust instrument by the terms of which the net income was to be paid monthly to designated beneficiaries for their respective lives, the trustors reserving the right to name other beneficiaries, except themselves, and to change the amounts, times and periods of payment, and also reserving the right to designate by written direction or by will to whom the corpus should be conveyed upon the termination of the trust. The trust was operative during the lifetime of the decedent, who died in 1927. Under these facts, the value of the trust property transferred by the decedent was includible in his gross estate under the provisions of section 302(d) of the Revenue Act of 1926.

2. DEDUCTION—CONDITIONAL BEQUEST TO CHARITY.

Where the decedent bequeathed all his property to his wife for life, with plenary and exclusive discretion as to its use and disposal during her lifetime, and directed that upon her death and upon the termination of the trust executed by himself and his wife in 1926 his remaining property be used to establish a foundation devoted to charity, the value at the date of the decedent's death of such contingent bequest can not be estimated with sufficient certainty to allow any deduction therefor under the provisions of section 303(a)3 of the Revenue Act of 1926.

UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF CALIFORNIA, CENTRAL DIVISION.

*Nella Wilde Mead, Individually and as Executrix of the Estate of William Mead, Deceased, and Nella Wilde Mead Exercising the Power to Collect the Claim here Involved Duly Conferred upon and Vested in her by the last will of William Mead, Deceased, and by Decree of Distribution heretofore duly made and entered in this Estate, plaintiff,* v. *Galen H. Welch, United States Collector of Internal Revenue for the Sixth District of California, defendant.*

[March 11, 1936.]

OPINION.

MCCORMICK, District Judge: According to the briefs in this case, but two issues remain unsettled and undecided: First, whether or not the Commissioner of Internal Revenue erred by including in the gross estate of William Mead, deceased, the sum of $115,400 transferred by decedent to others under the "Mead 1926 Trust," and, second, whether or not the Commissioner of Internal Revenue erred by including in the gross estate and subject to tax the sum of $959,638.97, representing the alleged market value of a bequest in the will of William Mead to the "Mead Housing Trust."

By a written instrument executed December 22, 1926, denominated "Deed of Trust," William Mead, the deceased, and Nella Wilde Mead, husband and wife, created the trust that is the subject matter of the first of the two questions for decision. The pertinent provisions of this trust instrument are:

"*Fourth:* From the net income received or derived from the trust estate and available for distribution hereunder, and if necessary from the principal, there shall be by the trustees, paid monthly to Ida M. Herman, Alice Hansborough, Dorothy Hansborough, Carrie M. Wyckoff, John Wilde, Lucina Wilde, Jessie Wilde Cooper, and Edith Wilde Parker, and to such other person or persons now living, other than the trustors or either of them, hereinafter called beneficiaries, for and during their respective lifetimes, or for such period less than the lifetime of any designated beneficiary, as to such beneficiary, such amounts as said trustors, by written instrument directed to said trustees, direct and appoint; no payment shall be made to any beneficiary except and only for the amounts and at the times and for the period set forth and directed in a written instrument executed by both trustors and filed with the trustees, which amounts and times and periods may be in like manner changed from time to time in the same manner by like written instrument.

* * * * * * *

"*Ninth:* This trust shall *ipso facto* cease and terminate at the time of the demise of the last living of the beneficiaries, or at the time of the termination of the period of payment to the surviving beneficiary; on such termination, or upon its failure or termination for any cause or reason, or in any manner whatsoever, in whole or in part, the trustees shall then first fully pay from the income, and/or principal, of the trust estate, any and all inheritance tax, and/or taxes, estate and/or other taxes which may then or thereafter be required to be paid from said trust estate, and all accrued and accruing costs and expenses of the trust; as often and when this trust terminates, in whole or in part, as aforesaid, then the portion or whole or part of the trust estate as to which this trust is terminated as aforesaid, shall be by the trustees conveyed, assigned and delivered as follows, to wit:

"(*a*) One-half to such person or persons, other than to or for the benefit of trustors, or either of them, in such proportion, manner and event, and for such uses and purposes, as said trustor, William Mead, may by duly executed written direction designate and appoint, and the other one-half to such person or persons, other than to or for the benefit of the trustors, or either of them, in such proportion, manner and event, and for such uses and purposes, as said trustor, Nella Wilde Mead, may by duly executed written direction designate and appoint.

"(*b*) Should both or either of said trustors fail to execute written direction in their lifetimes as aforesaid, and be deceased when this trust terminates as aforesaid, then the said one-half thereof subject to said written direction of said deceased trustor, to such person or persons in such proportion, manner and event, and for such uses and purposes, as such deceased trustor, may by his or her last will and testament designate and appoint.

"(*c*) Should trustors, or either of them, fail to exercise the powers of appointment as aforesaid, then the one-half subject to such written direction of said trustor so failing, to the heirs at law of such trustor according to the law of succession of the State of California then in force."

This 1926 trust was operative during the lifetime of William Mead. He died November 23, 1927. On March 12, 1927, he made and executed a holographic will. It contains the following statements:

"*4th.* I direct the trustees of the trust executed in December, 1926, by myself and wife to William Mead, Nella Wilde Mead and Edith Wilde Parker, as trustees to pay the amounts hereinafter named at the times specified to the following named persons, and to continue to pay the same for the period of their natural life: To my sisters Ida M. Herman, Carrie M. Wyckoff and Alice Hansborough and my niece Dorothy Hansborough each three hundred ($300) dollars per month, payable monthly. To my nieces Helen Herman, Katherine Herman McLaughlin and my nephew Eugene J. Herman each one hundred ($100) dollars per month payable monthly, until January 1, 1937, and after January 1, 1937, each three hundred ($300) dollars per month payable monthly; the sums above directed to be paid monthly are not in addition to the amounts being paid at my death to the said persons or any of them by said trust or any other provision made by me, but include the amounts then being so paid.

"I direct the trustees of said trust, at such time as they deem best, but within five years of my death to pay the sum of five thousand ($5,000) dollars each to said Eugene J. Herman, Helen Herman, Katherine Herman Mc-

Laughlin, and Dorothy Hansborough. I further direct the trustees of said trust to pay all property in said trust subject to my will and written direction and not directed by me to be paid otherwise, to my said executrix and wife for the uses and purposes in this will expressed."

Section 302(d) of the Revenue Act of 1926, which establishes and determines the method of ascertaining the value of the gross estate of a decedent for Federal estate tax purposes, as far as applicable to our present inquiry, reads:

"The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property * * * to the extent of any interest therein of which the decedent has at any time made a transfer by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power, either by the decedent alone or in conjunction with any person, to alter, amend or revoke, or where the decedent relinquished any such power in contemplation of his death."

It is clear from the terms of the fourth and ninth paragraphs of the trust instrument that the enjoyment of beneficial interests in the trust estate resides and is retained in the trustors. They have reserved expressly the right and the power to change the beneficiaries and also the amounts and periods to which a beneficiary shall be entitled to share in the trust estate. Nothing could be more clearly expressed than the absolute control reserved by the trustors during their life times as to whom, and in what amount, and for what times, persons might become beneficiaries of the bounty of the two persons who created the trust.

Not only does the certain wording of the trust instrument bring into effect section 302(d) of the Revenue Act of 1926 so as to require the inclusion in the gross estate of William Mead, deceased, of the sums transferred by the decedent under the 1926 trust to others, but the Supreme Court, in *Porter* v. *Commissioner* (288 U. S., 436 [Ct. D. 647, C. B. XII-1, 354]), has definitely settled the requirement of including such transfers in the gross value of a decedent's estate under the statute in question in this matter. In that case, the Court said:

"The net estate upon the transfer of which the tax is imposed is not limited to property that passes from the decedent at death. Subdivision (d) requires to be included in the calculation all property previously transferred by decedent, the enjoyment of which remains at the time of his death subject to any change by the exertion of a power by himself alone or in conjunction with another. Petitioner argues that as decedent was without power to revoke the interests or to alter or modify the trusts in favor of himself or his estate, the property is not governed by subdivision (d). But the disjunctive use of the words 'alter,' 'modify,' and 'amend,' negatives that contention. We find nothing in the context or in the policy evidenced by this and prior estate tax laws, or in the legislative history of subdivision (d) to suggest that conjunctive use of those words was intended, or that 'alter' or 'modify' were used as equivalents of 'revoke,' or are to be understood in other than their usual meanings. We need not consider whether every change, however slight or trivial, would be within the meaning of the clause. Here the donor retained until his death power enough to enable him to make a complete revision of all that he had done in respect of the creation of the trusts even to the extent of taking the property from the trustees and beneficiaries named and transferring it absolutely or in trust for the benefit of others. So far as concerns the tax here involved, there is no difference in principle between a transfer subject to such changes and one that is revocable. The transfers under consideration are undoubtedly covered by subdivision (d)."

The same application of the corresponding section of the Revenue Act of 1924 has been made by the Court of Appeals of the District of Columbia in *Dort* v. *Helvering* (69 Fed. (2d), 836 [Ct. D. 859, C. B. XIII-2, 378]), in the following language:

"The plain language of this subdivision makes its terms apply in the case of every trust where the right is reserved on the part of the grantor to affect the enjoyment of the property transferred by 'any change,' either by alteration, amendment or revocation."

See also *Foster* v. *Commissioner, etc.* (31 B. T. A., 148).

Overpayment must appear before refund is authorized, and as this case is in the nature of an action for money had and received, the taxpayer must show that the United States has money which belongs to him. (*Lewis* v. *Reynolds*, 284 U. S., 282 [Ct. D. 443, C. B. XI-1, 130].) This does not appear, and accordingly the Commissioner did not err by including the $115,400 in the gross estate of William Mead, deceased.

The second question for decision is whether the alleged present value at the time of the death of William Mead of a certain contingent bequest that he made in his will to a charity described in the will as "Mead Housing Trust" is deductible under section 303 (a) and (3) of the Revenue Act of 1926 and articles 44 and 47 of Regulations 70 promulgated pursuant to and as an aid to the construction and enforcement of said section of said Revenue Act. The section of the Act in question reads:

"SEC. 303. For the purpose of the tax, the value of the net estate shall be determined—(a) in the case of a resident by deducting from the value of the gross estate—(3) the amount of all bequests, legacies, devises or transfers * * * to a trustee or trustees * * * but only if such contributions or gifts are to be used by such trustee or trustees * * * exclusively for * * * religious, scientific, literary or educational purposes or for the prevention of cruelty to children or animals. The amount of the deduction under this paragraph for any transfer shall not exceed the value of the transferred property required to be included in the gross estate;"

And the part of article 44, Regulations 70, that is pertinent to our present inquiry, reads:

"Where a trust is created for both a charitable and a private purpose deduction may be taken of the value of the beneficial interest in favor of the former only in so far as such interest is presently ascertainable and hence severable from the interest in favor of the private use;"

And article 47 of the same regulations is as follows:

"*Conditional bequests.*—Where the transfer is dependent upon the performance of some act or the happening of some event in order to become effective, it is necessary that the performance of the act or the occurrence of the event shall have taken place before the deduction can be allowed."

These regulations have the force of statutes (*Tyson* v. *Commissioner, etc.*, 68 Fed. (2d), 584); and are proper aids of construction of tax and Revenue Acts of Congress (*Skinner* v. *Eaton, etc.*, 45 Fed. (2d), 568; *Tyson* v. *Commissioner*, supra).

The terms of the will of William Mead that pertain to the matter under consideration are as follows:

"I, William Mead, make this my last will and testament. *1st*, I appoint my wife, Nella Wilde Mead, sole executrix hereof, without bond, and will and direct that there be paid and distributed to her all my property, real, personal, and mixed, for and during her natural life, and for her own use, with power to sell, convey, assign, transfer, collect, invest, and reinvest the same, or any part thereof, or the proceeds thereof, or any part thereof. *2nd*, Of the property constituting my estate at her death, I will and direct that the sum of two hundred thousand ($200,000) dollars in money or property be transferred to the trust executed by myself and wife in December, 1926, to William Mead, Nella Wilde Mead, and Edith Wilde Parker, as trustees, the income on which may be used by said trust for the purposes of said trust and the principal shall at the termination of said trust be transferred to the 'Mead Housing Trust' hereinafter described. *3rd*, All the remaining property constituting my estate at her death I will and direct to be paid and distributed to the Security Trust & Savings Bank, a corporation of Los Angeles, Calif., and Edith Wilde Parker, Lucien Gray, Nathaniel P. Conrey, and Albert Lee Stephens as trustees, in trust (said bank being considered as one trustee), without bond, for the purpose of providing a fund or foundation devoted to charity, which may be known as the 'Mead Housing Trust' to improve the health, safety and welfare of the inhabitants of Los Angeles County, Calif., by providing homes on easy payments and without profit for wage earners, and people with small and moderate salaries, and business and professional people with small capital who might otherwise be unable to become home owners."

It has been held by the Supreme Court in *Humes* v. *United States* (276 U. S., 487 [T. D. 4185, C. B. VII-2, 378]), that where the value of a charitable bequest is uncertain and can not be estimated by any known data it is not deductible under a Federal tax statute substantially analogous to section 303(a)3 of the Revenue Act of 1926.

Nevertheless, it is earnestly argued by plaintiff that the evidence in this case shows that the value of the bequest to the "Mead Housing Trust" at the time of the death of the testator William Mead was not uncertain and that it can be estimated as of that time by known data that is established by the evidence and by resort to tables of mortality experience.

Reliance is placed upon *Ithaca Trust Co.* v. *United States* (279 U. S., 151 [Ct. D. 61, C. B. VIII-1, 313]), but that case is clearly distinguishable from the one at bar. In the Ithaca case, the Court said:

"The principal that could be used was only so much as might be necessary to continue the comfort then enjoyed. The standard was fixed in fact and capable of being stated in definite terms of money. It was not left to the widow's discretion."

The restrictions upon Mrs. Mead, the plaintiff, which are contained in the will of Mr. Mead, are not so precise or stringent as those imposed upon Mrs. Stewart in the Ithaca Trust case, and even if it be assumed that Mrs. Mead is invested with nothing more than a life estate in the property devised to her, she nevertheless has plenary and exclusive discretion as to its use and disposal during her lifetime, and is not circumscribed by any joint vestee or fiduciary in her sole control of the estate, as far as any part of it pertains to the "Housing Trust." This was not the situation of the widow in the Ithaca case.

It is true that the evidence shows Mrs. Mead to be the owner in her own right of a large separate estate, the income from it being sufficient to meet her present living requirements, and that she is earnestly interested in carrying out the "Mead Housing Trust" idea expressed in the will of her deceased husband, but these facts are not sufficient, in the light of her broad and unrestricted right of possession and use of all of the property and her undefined and prospective life estate requirements, to enable anyone to find in definite terms of money the value of the "Mead Housing Trust" at the death of William Mead. The value of the thing to be taxed, the "Mead Housing Trust," must be estimated as of that time. (*Ithaca Trust Co.* v. *United States*, supra.)

When consideration is given to the expectancy of Mrs. Mead at the time of Mr. Mead's death in 1927, which, according to the American Experience Table of Mortality, was 18.79 years, the uncertainty and conjectural aspect of estimating any then present value of the "Housing Trust" is strengthened. Moreover, it has been over eight years since the trust was created, but nothing of an active or operative character has occurred in it to date, and no possession of any property has been delivered or vested in the trustees. They have not yet commenced to function, and it is entirely speculative as to whether or not this laudable charity of Mr. Mead will ever become an existing organization to carry out the will of its creator. It is not improbable that Mrs. Mead may be disposed to use, or may deem it necessary to use, during her lifetime, the entire estate devised to her and of which she is invested by the will and by the decree of distribution in her husband's estate with sole and exclusive possession and control.

There is no immediate transfer of the property that may ultimately comprise the corpus of the "Mead Housing Trust" if, as or when it comes into the possession of the trustees who might later receive it, subsequent to the death of Mrs. Mead.

These uncertainties and contingencies, in my opinion, operate under the Humes case to prevent the deduction claimed by the plaintiff.

It is only by speculation and conjecture that any definite value for tax purposes can be placed upon the "Mead Housing Trust" as of the date of Mr. Mead's death, and such being the case, no error was committed by the Commissioner in refusing the deduction.

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## SECTION 303.

REGULATIONS 80(1934), ARTICLE 50: Situs of property. XV-7-7958 G. C. M. 16164

> Where a nonresident alien died possessed of an interest in a French partnership which owned property in the United States, the nonresident alien's interest in such property is includible in his gross estate for Federal estate tax purposes.

An opinion is requested whether the interest of a nonresident alien decedent in the property of a French partnership attributable to such partnership's interest in a New York partnership constitutes property situated in the United States which is includible in the decedent's gross estate for Federal estate tax purposes.

Section 303 of the Revenue Act of 1926, continued in effect by all subsequent Revenue Acts, provides for the inclusion in the gross estate of a nonresident decedent of all property of the nonresident which at the time of his death is situated in the United States.

At the time of his death the decedent was a citizen and resident of France and was a member of a French civil law partnership engaged in business in France. The American branch of the partnership's business was conducted in New York by a domestic partnership composed of the French civil law partnership and a number of residents of New York.

Under the partnership laws of New York a partner has no interest in specific partnership property other than the right to have it applied for partnership purposes, and a partner's interest in the partnership is defined to be his share of the profits and surplus thereof and is personal property. (Cahill's Consolidated Laws of New York, sections 40, 51, 52, page 1591.) It results that the interest of any partner in the New York partnership at any time is personal property of the character ordinarily referred to as a credit. The partnership laws of New York also provide that individuals, partnerships, corporations, and other associations may become members of a partnership. (Laws of New York, supra, section 40.) Under the laws of France, the French civil law partnership was authorized to become a member of other partnerships such as the New York partnership herein involved.

With reference to intangible property, such as credits, this office has held that such property has a situs in the United States for Federal estate tax purposes where the debtor is legally domiciled in the United States at the time of death. (G. C. M. 15773, C. B. XIV-2, 353.) The rationale of the principle thus established is that, since the source of the credits has a situs in the United States, over which source the United States may and does exercise an effective legal control, the credits necessarily have a taxable situs at the source as property of the person entitled to such credits. (See *Blackstone* v. *Miller*, 188 U. S., 189; *DeGanay* v. *Lederer*, 250 U. S., 376; *Blodgett* v. *Silverman*, 277 U. S., 1; *Farmers' Loan & Trust Co.* v. *Minnesota*, 280 U. S., 204; *Burnet* v. *Brooks*, 288 U. S., 378; *Sanchez* v. *Bowers*, 70 Fed. (2d), 715.) While it was stated in G. C. M. 15773, supra, that credits have a taxable situs in the United States because the debtor is legally domiciled in the United States at the time of death, it was not intended thereby to lay down a requirement that the debtor must be so legally domiciled in order to give the credits a taxable situs in the United States. For the purpose of that case it was deemed sufficient to point out that the control of the United States over the credit represented by the corporate bond, which afforded a taxable situs within the United States, was established by the legal domicile of the debtor corporation in the United States.

The French partnership was not only actively engaged in carrying on business within the United States by reason of its membership in the New York partnership, but, in view of the principles above expressed, also had valuable property situated in the United States (represented by its credit in the New York partnership) by reason of such membership. The decedent had at least an equitable interest in that property of the French partnership to the extent of the valuation placed thereon in the inventory filed in France by the representative of the decedent for inheritance tax and probate purposes. It, therefore, follows that the interest of the decedent in the property of the French partnership situated in the United States was also situated therein at the time of his death and had a situs in the United States for Federal estate tax purposes. (See *Commissioner of Internal Revenue* v. *Nevius*, 76 Fed. (2d), 109, Ct. D. 1049, C. B. XIV-2, 350; certiorari denied, 56 Sup. Ct., 104, in which it was held that the value of the equitable interest of a nonresident alien decedent in shares of corporate stock which had a taxable situs in the United States could be regarded as property of the decedent situated in the United States for Federal estates tax purposes, irrespective of the status of the legal title to such shares.) This result follows even though the French partnership should be recognized in this country as a separate legal entity for tax purposes. Under the French civil law recognition of the French partnership as an entity might result in establishing the entity as the legal owner of the credit in the New York partnership, but it would also clearly establish the individual partners therein as the owners of the beneficial or equitable interest in the credit. Moreover, since the French partnership, if a separate legal entity or juristic person, could not have rights against itself, it results that the credit of such partnership in the New York partnership must be regarded as a right enforceable against the other members of the New York partnership, all of whom were residents of the United States. Article 50 of Regulations 80(1934) provides that intangible personal property has a taxable situs within the United States if consisting of a property right issuing from or enforceable against a corporation organized in the United States or a person who is a resident of the United States.

In view of the foregoing, it is the opinion of this office that the decedent's interest in the property of the French partnership situated in the United States at the date of his death is includible in his gross estate for Federal estate tax purposes.

HERMAN OLIPHANT,
*General Counsel for the Department of the Treasury.*

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## TITLE IV.—ESTATE TAX. (1921)

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### SECTION 402(c).—TRANSFERS BY DECEDENT IN HIS LIFETIME.

REGULATIONS 63, ARTICLE 17: Nature and time of transfer. XV-18-8067 Ct. D. 1111

ESTATE TAX—REVENUE ACT OF 1921—DECISION OF SUPREME COURT.

GROSS ESTATE—TRANSFER IN TRUST—CONTEMPLATION OF DEATH—BURDEN OF PROOF—REVIEW OF EVIDENCE BY CIRCUIT COURT OF APPEALS.

Where a transfer in trust of a substantial portion of the de-
two years of his death, was held by

the trial court to have been made in contemplation of death within the meaning of section 402(c) of the Revenue Act of 1921, on the ground that the executors had failed to show that the motive that induced the transfer was not of the sort which leads to testamentary disposition and consequently had failed to meet the burden of proof placed upon them by the statute, the ultimate question for decision by the trial court was one of fact, and, a jury trial having been waived, a general verdict found by the court was conclusive, and the circuit court of appeals was without authority to weigh the evidence and to make its own findings.

SUPREME COURT OF THE UNITED STATES.

*Blakely D. McCaughn, Collector of Internal Revenue for the First District of Pennsylvania, petitioner,* v. *Real Estate Land Title & Trust Co. and Douglas MacFarlan, Executors of Estate of Malcolm MacFarlan, Deceased.*

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

[March 30, 1936.]

OPINION.

*Per curiam:* On February 9, 1920, Malcolm MacFarlan, a physician of Philadelphia, Pa., made a transfer of real estate and securities, of the value of upwards of $670,000, in trust for the benefit of his children and their wives and descendants. He died on December 8, 1921. As his death occurred within two years after the transfer, it fell within the terms of the statute creating a presumption that the transfer was made in contemplation of death. (Revenue Act of 1921, ch. 136, section 402(c), 42 Stat., 227, 277, 278.) The remaining estate of the decedent, of which disposition was made by will (executed on the same day as the transfer in trust) was worth about $13,000. The Commissioner of Internal Revenue included the property transferred as part of decedent's gross estate, and demanded payment of an estate tax upon that basis. The payment was made, claim for refund was rejected, and this suit was brought by the executors of the decedent against the collector to recover the amount paid.

A jury was waived. After the evidence had been received, both parties submitted requests for conclusions of law and plaintiffs also requested special findings of fact. The court refused plaintiffs' requests and affirmed certain conclusions of law requested by defendant, and plaintiffs were allowed exceptions.

Referring to decedent's physical condition, the court said in its opinion that the evidence showed that at the time of the transfer decedent was 78 years old, unusually vigorous and clear-minded and, except for a condition common in men of his age, in good health. The court said that the most that could be claimed for that evidence was that it established, and the court specifically found, that the transfer was not made "under any consciousness or belief or apprehension that death was imminent." The substance of the court's conclusion on all the evidence was that "the plaintiffs have failed to show that the motive that induced this transfer, whatever it was, was not of the sort which leads to testamentary disposition, and, consequently have failed to meet the burden of proof placed upon them by the statute." The court then found a general verdict in favor of the defendant and directed judgment accordingly. (7 F. Supp., 742.)

The circuit court of appeals reviewed the evidence, decided that the transfer was not made in contemplation of death, and reversed the judgment. (79 F. (2d), 602.)

The principles governing the determination whether a gift *inter vivos* is made "in contemplation of death" are set forth in *United States* v. *Wells* (283 U. S., 102 [Ct. D. 340, C. B. X-1, 475]), and need not be restated. The instant case is controlled by the established rules relating to appellate review in actions at law where a jury trial has been waived. (R. S., 649, 700; 28 U. S. C., 773, 875.) Where a general verdict is found by the trial court, it has the same effect as the verdict of a jury. The appellate court can not pass upon the weight of evidence. (*Norris* v. *Jackson*, 9 Wall., 125, 128; *British Queen Mining Co.* v. *Baker Silver Mining Co.*, 139 U. S., 222; *Lehnen* v. *Dick-*

*son*, 148 U. S., 71, 73; *St. Louis* v. *Western Union Telegraph Co.*, 166 U. S., 388; *Law* v. *United States*, 266 U. S., 494; *Fleischmann Co.* v. *United States*, 270 U. S., 349, 356, 357; *Harvey Co.* v. *Malley*, 288 U. S., 415, 418, 419; *Eastman Kodak Co.* v. *Gray*, 292 U. S., 332, 336, 337.)

Here, plaintiffs' exceptions to the conclusions of law of the trial court, and to the refusal of the court to reach other conclusions as requested, raised no question save the one of law, whether the court's verdict was wholly without evidence to sustain it. That question does not appear to be substantial. The ultimate question for the decision of the trial court was one of fact and its general verdict was conclusive. The circuit court of appeals was without authority to weigh the evidence and to make its own findings.

The judgment of the circuit court of appeals is reversed and that of the district court is affirmed.

It is so ordered.

# TITLE IV.—ESTATE TAX. (1918)

## SECTION 402.

REGULATIONS 37, ARTICLE 32: Taxable insurance. XV-1-7893 Ct. D. 1058

ESTATE TAX—REVENUE ACT OF 1918—DECISION OF SUPREME COURT.

1. GROSS ESTATE—PROCEEDS OF LIFE INSURANCE POLICIES—RETROACTIVITY OF STATUTE.

The decedent, who died in 1921, his wife surviving, had taken out policies of insurance on his own life, one having been issued in 1883 payable to his wife, or, if she predeceased him, then to the surviving children or their descendants, otherwise to decedent's legal representatives, and the others of such policies having been assigned by the decedent to his wife in 1904, the proceeds of which being payable to her should she survive him. The decedent had no power, none being reserved, to change the beneficiaries, to revoke the assignments, or to pledge or surrender the policies. Under these facts, the proceeds of none of the policies constituted a part of the gross estate under the provisions of section 402(f) of the Revenue Act of 1918, since that provision is not to be construed as having retroactive effect. *Lewellyn* v. *Frick* (268 U. S., 238) followed.

2. GROSS ESTATE—PROCEEDS OF LIFE INSURANCE POLICIES—POSSIBILITY OF REVERTER.

No interest passed as the result of decedent's death, which, at most, put an end to the possibility that the proceeds of any of the policies would become payable to his legal representatives. *Helvering* v. *St. Louis Union Trust Co. et al.* (Ct. D. 1047, C. B. XIV-2, 339) and *Becker* v. *St. Louis Union Trust Co. et al.* (Ct. D. 1046, C. B. XIV-2, 337), both decided November 11, 1935 (296 U. S., — and —), followed.

SUPREME COURT OF THE UNITED STATES.

*Norman W. Bingham, Jr., et al., etc., petitioners,* v. *The United States of America.*

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

[December 9, 1935.]

OPINION.

Mr. Justice SUTHERLAND delivered the opinion of the Court.

This case involves the construction and constitutionality, as applied, of section 402(f) of the Revenue Act of 1918, which provides that the value of the gross estate of the decedent shall be determined by including the value, at the time of his death, of all property "(f) to the extent of the amount receivable by the executor as insurance under policies taken out by the decedent upon his own life; and to the extent of the excess over $40,000 of the amount receivable by all other beneficiaries as insurance under policies taken out by the decedent upon his own life."

Petitioners are the executors of the will of King Upton, who died in 1921 while the Act of 1918 was in force. His wife survived him. Long prior to the passage of the Act, a number of life insurance policies were issued to the decedent, among them four issued by the Berkshire Life Insurance Co. of Massachusetts, originally payable to his estate; and one issued in 1883 by the Connecticut Mutual Life Insurance Co. of Connecticut, payable to the wife of the decedent with a condition that in case of the predecease of the wife the amount of the policy should be payable to his children; or, if there be no children or descendants of children then living, to the legal representatives of the insured. In 1904, decedent assigned the four Berkshire policies to his wife, "provided she survives me." The decedent had no power, none being reserved, to change the beneficiaries, to pledge or assign the policies after the assignment to his wife, or revoke that assignment, or surrender the policies without the consent of the beneficiaries. (*Washington Central Bank* v. *Hume*, 128 U. S., 195, 205; *Miles* v. *Connecticut Life Insurance Co.*, 147 U. S., 177, 181, 182, 183, compare dissent, page 188; *Commonwealth* v. *Whipple*, 181 Mass., 341, 343; *Pingrey* v. *National Life Insurance Co.*, 144 Mass., 374, 382.)

After having deducted the specific exemption of $40,000, the Commissioner of Internal Revenue included the proceeds of these five policies in the decedent's gross estate, for the purpose of the Federal estate tax. An action was brought in a Federal district court to recover the amount of the tax resulting from the inclusion of these proceeds. That court rejected the view of the Commissioner and awarded judgment to the taxpayers upon the authority of *Lewellyn* v. *Frick* (268 U. S., 238 [T. D. 3715, C. B. IV-1, 322]. 7 F. Supp., 907.)

The court of appeals reversed, holding that the Frick case was distinguishable. (76 Fed (2d), 573.) We think the view taken by the district court is the correct one.

1. Eleven policies were involved in the Frick case, all antedating the passage of the Act. Among them was one issued by the Berkshire company and another issued by the Connecticut Mutual. These policies in terms were identical with the corresponding policies in question here. The assignment of the Berkshire policy there was the same as the assignments here. This Court applied the rule that Acts of Congress are to be construed, if possible, so as to avoid grave doubts as to their constitutionality; and said that such doubts were avoided by construing the statute as referring only to transactions taking place after it was passed. In that connection we invoked the general principle "that the laws are not to be considered as applying to cases which arose before their passage" when to disregard it would be to impose an unexpected liability that, if known, might have been avoided by those concerned. The court below sought to distinguish the decision on the ground that this Court did not refer to those specific provisions set forth in the policies and assignments which are pertinent here. The Government makes the same point, and contends that since this Court did not allude to these provisions in the opinion, the decision can not be regarded as having passed on their effect. It is true that questions which merely lurk in the record, neither brought to the attention of the court nor ruled upon, are not to be considered as having been so decided as to constitute precedents. (*Webster* v. *Fall*, 266 U. S., 507, 511.) That, however, is not the situation in the present case. In *Lewellyn* v. *Frick* the policies and assignments, in their entirety, were definitely before the court; and this necessarily included each of the provisions which they contained. Moreover, both in the appendix to the Government's brief and in the main brief of the taxpayers, the attention of the court was distinctly called to all of the provisions which are now invoked. The latter brief summarized and described the provisions of the four classes of policies which were involved—one class being policies, it was pointed out, made payable to the Frick estate "subsequently assigned by Mr. Frick to his wife or daughter if she survived him, without reserving power to revoke the assignments." This Court, without stopping to recite the various specific provisions that were thus clearly brought to its attention, held that the proceeds of none of the policies were subject to the estate tax under section 402(f). It fairly must be concluded that in reaching that result these provisions were considered, and that such of them as bore upon the problem, there as well as here presented, were

found not to require a different determination. We think the points now urged by the Government were decided in the Frick case, and find no reason to reconsider them.

2. The principles so recently announced by this Court in *Helvering* v. *St. Louis Union Tr. Co. et al.* (November 11, 1935) (296 U. S., — [Ct. D. 1047, C. B. XIV-2, 339] and *Becker* v. *St. Louis Union Tr. Co. et al.* (November 11, 1935) (296 U. S., — [Ct. D. 1046, C. B. XIV-2, 337]) are decisive of the case in favor of the taxpayers. Those principles establish that the title and possession of the beneficiary were fixed by the terms of the policies and assignments thereof, beyond the power of the insured to affect, many years before the Act here in question was passed. No interest passed to the beneficiary as the result of the death of the insured. His death merely put an end to the possibility that the predecease of his wife would give a different direction to the payment of the policies.

Judgment reversed.

## TITLE III (PART II).—GIFT TAX. (1924)
## TITLE III.—GIFT TAX. (1932)

### SECTION 319 OF THE REVENUE ACT OF 1924.—SECTION 501(a) OF THE REVENUE ACT OF 1932.

Regulations 67(1924), Article 1; Regulations 79(1936), Article 2: Transfers reached. XV-15-8038 G. C. M. 16460

The gift of a donor's own check is not complete until the check is paid or is negotiated for value to a third person.

The gift of a donor's own note is not complete until the note is paid or is transferred for value.

Advice is requested whether certain gifts are subject to the gift tax.

Section 319 of the Revenue Act of 1924 imposed a tax for the calendar year 1924 and for each calendar year thereafter upon the transfer by gift of any property wherever situated valued in excess of $50,000. That section was repealed by section 1200 of the Revenue Act of 1926 as of January 1, 1926. No gift tax was in force in the year 1926 but it again became effective for the calendar year 1932 and for each calendar year thereafter under the provisions of section 501(a) of the Revenue Act of 1932.

The gifts in question were made under the following circumstances:

(*a*) On December 25, 1925, A, the donor, presented B with a check for a sum in excess of $50,000. A requested B not to deposit or cash the check for a few days as he was not certain his bank balance was sufficient to cover the check. B held the check until January 2, 1926, when it was cashed by the drawee bank. The record shows that A's bank account was sufficient to cover the check from the date the check was presented to B until it was cashed by the bank. It is contended that the gift was not made until January 2, 1926, after the repeal of the gift tax provisions of the Revenue Act of 1924, and is, therefore, not subject to gift tax.

(*b*) On August 29, 1935, C, the donor, transferred to a trustee an interest-bearing note executed by him on August 15, 1935, for a sum in excess of $100,000. The note is payable within one year upon C's order, is indorsed by him in blank, and bears interest at the rate of 4 per cent. The note was paid by C in 1936. The date of the gift is material inasmuch as the higher rates imposed by section 301 of the Revenue Act of 1935 will apply if the gift was made in 1936 when the note was paid.

It is well settled that a gift is not consumated by the mere delivery of the donor's own check or note. The gift of a check does not become complete until it is paid, certified, or accepted by the drawee, or is negotiated for value to a third person. Prior to payment, certification, or negotiation, a check is nothing more than an order on the drawee bank which may be revoked at any time by stopping payment and is revoked *ipso facto* by the death of the drawer. (*Edwards* v. *Guaranty Trust & Savings Bank*, 190 Pac., 57 (Cal. App., 1920); *Provident Institution for Savings, Etc.*, v. *Sisters of the Poor, Etc.*, 87 N. J. Eq., 424, 100 Atl., 894 (1917); *Bainbridge* v. *Hoes*, 149 N. Y. S., 20 (1914).) The gift of the donor's own note is not complete until the note is paid or transferred for value. (*Shaw* v. *Camp*, 160 Ill., 425, 43 N. E., 608 (1896); *Bowers* v. *Alexandria Bank*, 130 N. E., 808 (Ind. App., 1921); *Dougherty* v. *Salt*, 227 N. Y., 200, 125 N. E., 94 (1919).) In the Dougherty case the court said:

> * * * The transaction thus revealed admits of one interpretation, and only one. The note was the voluntary and unenforceable promise of an executory gift. * * *

In view of the foregoing, it is the opinion of this office that in the first case the gift by A was completed on January 2, 1926, the date on which the check was cashed. Since the check was cashed subsequent to the effective date of the repeal of the gift tax provisions of the Revenue Act of 1924, the gift is not subject to the gift tax. In the second case, the gift of the note by C was effected in 1936 when the note was paid. The tax should be computed upon the amount of the principal and the interest thereon at rates in effect for that year.

HERMAN OLIPHANT,
*General Counsel for the Department of the Treasury.*

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## TITLE III. PART II.—GIFT TAX. (1924)

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### SECTION 319.

REGULATIONS 67, ARTICLE 1: Transfers reached. XV-17-8059
Ct. D. 1110

GIFT TAX—REVENUE ACT OF 1924—DECISION OF COURT.

1. TRANSFER BY GIFT—COMMUNITY PROPERTY—CALIFORNIA LAW.

A gift which the taxpayer made to his wife on October 2, 1925, of all his right, title, and interest in certain real property in California, acquired with community funds in 1910 and 1924, was subject to the tax imposed by section 319 of the Revenue Act of 1924 to the extent of the fair market value of the entire property, since under the local law the wife had no proprietary interest or estate in the community property, beyond a mere expectancy, before the gift was made.

2. CERTIORARI DENIED.

Petition for certiorari denied March 30, 1936.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

*Robert C. Gillis, appellant,* v. *Galen H. Welch, United States Collector of Internal Revenue for the Sixth District of California, appellee.*

Upon appeal from the District Court of the United States for the Southern District of California, Central Division.

Before WILBUR, GARRECHT, and DENMAN, Circuit Judges.

[November 18, 1935.]

OPINION.

GARRECHT, Circuit Judge: An action was brought by appellant Gillis, as plaintiff, against appellee, herein to recover the sum of $7,292.70, with interest, claimed to have been collected as an excessive assessment of the Federal gift tax, upon a gift by plaintiff to his wife of certain community property. Plaintiff and his wife acquired, as community property, a five-ninths interest in certain real property in California, known as Topango Canyon lands. At all times involved in this proceeding plaintiff and his wife were residents of the State of California. Two-fifths of this five-ninths interest in the Topango Canyon lands was purchased with community funds in 1910, and the remaining three-fifths of the said five-ninths was purchased with community funds in 1924. On October 2, 1925, plaintiff made a gift of all of his right, title and interest in the said property to his wife, Frances L. Gillis. On that date the property was of the reasonable market value of $389,166.66. On the 15th of March of the following year plaintiff filed a return for Federal gift tax for the year 1925, setting forth the value of the gift to his wife as one-half of the value of the property—$194,583.33, and computing the tax upon that amount, paid the tax to the collector in the sum of $2,381.66. The Commissioner of Internal Revenue computed a deficiency in the tax, basing the tax upon the full value of the property and assessed a deficiency in the tax for the year 1925 in the sum of $6,685.01. Plaintiff was notified and paid the assessed deficiency of $7,292.70 ($6,685.01 plus $607.69 interest). Plaintiff thereafter filed a claim for refund, which was rejected. The present action was brought to recover the claimed refund. A general demurrer was interposed and sustained and judgment of dismissal entered, from which this appeal is taken.

To use appellant's words, "The ultimate issue involved is whether, under the gift tax statute the 'fair market value' of a gift of community property by a husband to his wife is less than the entire value of said property."

By section 319 of the Revenue Act of 1924 (43 Stat., 253; 26 U. S. C. A., section 1131 (repealed, Act of February 26, 1926)) a tax was imposed upon the transfer by a resident by gift of any property, etc. By the following section of said Act, it was provided that if the gift was made in property, the fair market value thereof at the date of the gift should be considered the amount of the gift.

In California, a husband may make a gift of the community property to the wife, and it is not necessary for the wife to join in the deed. (*Logan* v. *Thorne*, 205 Cal., 26, 28; *Kaltschmidt* v. *Weber*, 145 Cal., 596, 599.)

The Supreme Court of California has said that "The respective rights of husband and wife in community property are determined by the law in force at the time of its acquisition." (*Trimble* v. *Trimble*, 219 Cal., 340, 26 P. (2d), 477, 479. See also *McKay* v. *Lauriston*, 204 Cal., 557, 566.)

The interest of the wife in the property which was the subject of the gift must be determined, for it is clear that the husband could not give to the wife more than that which he had. In this inquiry we must look to the state of the law at the time of the acquisition of the property. The question of the interest of the wife in the community property has been the source of much litigation in the courts of California.

It is well settled by the decisions that the interest of the wife in the property acquired in 1910 is no more than a "mere expectancy," to borrow the term used in the decisions. The decisions of the Supreme Court of the State of California as to the nature of the wife's interest in the community property are binding upon this court. (*Talcott* v. *United States*, 23 F. (2d), 897 (C. C. A. 9) [T. D. 4137, C. B. VII-1, 319].)

The "* * * supreme court in *Stewart* v. *Stewart* (204 Cal., 546 (269 Pac., 439)), referring to a previous appeal of the same case, said: 'In that opinion we held that the long-established doctrine of this State was, as reiterated and confirmed by this court in *Spreckels* v. *Spreckels* (172 Cal., 775 (158 Pac., 537)), that the husband was during marriage "The sole and exclusive owner of all the community property, and that the wife had no title thereto, nor interest or estate therein, other than a mere expectancy as heir, if she survived him." We further pointed out what was declared in more recent decisions of this court that legislation enacted subsequent to the rendition of said last-mentioned decision had not in any manner changed or modified said doctrine as to the wife's right in community property acquired in, or prior to, the year 1918, the year the parties hereto purchased the real property described in the complaint herein. * * *' * * * Hence, it was further held that 'the interest of the wife during marriage in the community property is a mere expectancy to be realized only upon her surviving her husband, or upon the earlier dissolution of the marriage by divorce proceedings.' * * *" (*Moore, etc.*, v. *Neighbours et al.*, 95 Cal. App., 628, 631. See also *Lahaney* v. *Lahaney*, 208 Cal., 323, 325; *Blethen* v. *Pacific Mutual Life Insurance Co.*, 198 Cal., 91, 98.)

After citing authorities, *Stewart* v. *Stewart*, supra, goes on to say, at page 553, "These authorities hold uniformly and consistently that during the marriage the husband is the sole and exclusive owner of all the community property and the wife has no title thereto, nor interest or estate therein other than a mere expectancy as heir, if she survive him." (See also *Estate of Moffitt*, 153 Cal., 359.)

No need to multiply citations. We have seen, at least so far as the property acquired in 1910 is concerned, that the wife has no estate or interest in the common property. The wife's interest or estate in the community property did not materialize until dissolution of the marriage relationship, either by death or divorce. (*Chance* v. *Kobsted*, 66 Cal. App., 434, 437.) "The estate in expectancy of the wife in the common property is dependent upon her survivorship; and in the event of her death before her husband, it is deemed never to have existed. * * *" (*In re Rowland*, 74 Cal., 523, cited in *McKay* v. *Lauriston*, supra, at page 568.) Therefore, as to the 1910 acquisition, the entire value of the property was taxable.

With regard to the property acquired in 1924, unless the changes in the law relating to community property made in 1923 were basic changes, the same rule must apply. In 1923, section 1401 of the Civil Code of California (now section 201, Probate Code) was amended to provide that upon the death of either husband or wife, one-half of the community property was subject to the testamentary disposition of the decedent. But here, again, the wife's interest in the community property does not materialize until dissolution of the marital relationship. Further, section 1401 does not relate to ownership or to estate, but to descent and succession. (*Estate of Phillips*, 203 Cal., 106, 109.)

Dean McMurray, in his article on Community Property, 1930 Supplement to Cal. Jur., section 66, at page 99 of the article, says:

"The general form of statement in the opinions is that the wife, at least prior to the adoption of section 161a of the civil code in 1927, took no 'vested interest' or 'estate' in the community property. The husband has been said to be the owner of the community property, and to have the unqualified right to dispose of it, except for such restrictions as may have been imposed by the legislature. The wife, on the other hand was held to have a mere expectancy, and not a title or interest that she could convey."

No case has been pointed out to us involving community property acquired after 1923 and before 1927,[1] wherein the wife was held to have an interest of more than a "mere expectancy." (Cf. concurring opinion of Judge Preston in *Cutting* v. *Bryan*, 206 Cal., 254, 259.)

It follows, therefore, that the wife, having no proprietary interest or estate in the community property beyond a mere expectancy before the gift by the husband, and thereafter having the entire interest in the property as a part of her separate estate, was properly assessed a gift tax upon the whole value of the property under the Act.

Judgment affirmed.

[1] In 1927 an amendment to the Civil Code of California (section 161a) provided that the wife was to have a vested interest in the community property equal to that of the husband, although he was still left with the possession and control thereof.

# TITLE IV.—EXCISE TAXES. (1934)

## SECTION 602½.—PROCESSING TAX ON CERTAIN OILS.

REGULATIONS 48, ARTICLE 3: Imposition of the tax. XV–22–8104 Ct. D. 1122

EXCISE TAX—REVENUE ACT OF 1934—REVISED STATUTES—DECLARATORY JUDGMENT ACT—DECISION OF COURT.

1. PROCESSING TAX ON COCONUT OIL—CONSTITUTIONALITY.

The processing tax on coconut oil produced in the Philippine Islands, imposed by section 602½ of the Revenue Act of 1934, is valid as an excise tax and within the taxing power of Congress. The Philippine Islands do not attain complete sovereignty under the independence statute of 1933 until 10 years after the enactment of the statute, and Congress retains jurisdiction to legislate or to make appropriations for their benefit.

2. INJUNCTION—RESTRAINT UPON COLLECTION OF TAX—JURISDICTION OF COURT OF EQUITY.

A court of equity is without jurisdiction to grant an injunction to restrain collection of any constitutional tax or to render a declaratory judgment, in view of the prohibitions of section 3224 of the Revised Statutes and the declaratory judgment Act, as amended.

DISTRICT COURT OF THE UNITED STATES, SOUTHERN DISTRICT OF CALIFORNIA, CENTRAL DIVISION.

*Los Angeles Soap Co., a Corporation, plaintiff,* v. *Nat Rogan, Individually and as Collector of Internal Revenue for the Sixth Collection District of California, defendant.*

[March 16, 1936.]

OPINION.

YANKWICH, District Judge: Section 602½ of the Revenue Act of 1934 (26 U. S. C. A., section 999) levies a processing tax of 3 cents per pound on certain oils including coconut oil, sesame oil, palm oil, palm kernel oil, and sunflower oil. It also levies an additional tax of 2 cents per pound on coconut oil. This tax, however, does not apply to coconut oil produced in the Philippine Islands.

The plaintiff by its bill of complaint attacks the processing tax of 3 cents and seeks a determination both under the equity powers of the court and under the declaratory judgment statute (28 U. S. C. A., section 400) that it is an unconstitutional exaction and penalty and not a tax. Injunctive relief is sought.

The complaint discloses the following facts: The plaintiff is a manufacturer of soaps, operating a manufacturing plant in the city of Los Angeles where the process of manufacturing is carried on wholly in intrastate commerce. It has a large establishment representing a large investment, and for 37 years prior to the year 1935, its business was conducted at a substantial profit. In 1934, the bill states, it was able to make a profit merely because it has on hand large quantities of vegetable oil which had been purchased before the enactment of section 602½ of the Revenue Act of 1934. In the conduct of its business, which is exclusively that of the manufacture of soaps and allied products, plaintiff must use large quantities of coconut oil which is the only important commercial source of lauric acid. It uses a large quantity of coconut oil originating in the Philippine Islands. Its business is that of a processor within the meaning of the Revenue Act of 1934. Between May 1, 1934, and December 31, 1935, it paid under the Act a total of $485,642.56 as processing tax on the processing of Philippine Islands oil. Processing taxes will continue to be levied by the defendant, who is the collector of internal revenue for the district, unless he is enjoined from collecting the tax. A temporary restraining order was issued. A temporary injunction is now sought. The defendant has filed objections to its issuance. He has also filed a motion to dismiss the bill upon the ground that it does not state facts sufficient to constitute a cause of action, that the court is without jurisdiction to restrain the collection of the tax or to entertain an action in declaratory relief relating to it, and that the plaintiff has a plain, speedy and adequate remedy at law.

Plaintiff's attack upon the constitutionality of the statute is grounded upon the contention that it is not a tax under Article I, section 8, clause 1, of the Constitution of the United States, but a penalty, the effect of which is to penalize the plaintiff for the benefit of certain producers of domestic oils and of the Philippine Islands.

The plaintiff, by paraphrasing certain general language of the Supreme Court in *United States* v. *Butler* (1936) (80 L. Ed., 287 [Ct. D. 1070, page 421, this Bulletin]), insists that this tax is subject to the same constitutional frailty as the Agricultural Adjustment Act.

It is well to bear in mind that the real basis for the decision in that case is the fact that the Congress had attempted to regulate agriculture and to achieve that result by means of moneys obtained through a tax. Whatever language of general character may have been used in the majority opinion must be read in the light of this main principle which lay at the foundation of the decision. The decision establishes the principle that, irrespective of any question of interstate commerce, the Congress of the United States has the power to levy a processing tax. The minority opinion, written by Mr. Justice Stone, emphasizes this fact by stating:

"The constitutional power of Congress to levy an excise tax upon the processing of agricultural products is not questioned." (See *United States* v. *Butler* (1935), 80 L. Ed., at 301.)

Another significant matter to be borne in mind is the fact that the Court adopted the Hamiltonian view on the meaning of the phrase "general welfare" contained in the taxing clause of the Constitution. Hamilton's view was contained in his Report on Manufactures made by him in 1791, while he was Secretary of the Treasury. He there wrote:

"The phrase is as comprehensive as any that could have been used, because it was not fit that the constitutional authority of the Union to appropriate its revenues should have been restricted within narrower limits than the 'general welfare,' and because this necessarily embraces a vast variety of particulars which are susceptible neither of specification nor of definition. It is, therefore, of necessity left to the discretion of the National Legislature to pronounce upon the objects which concern the general welfare and for which, under that description, an appropriation of money is requisite and proper. *And there seems to be no room for doubt that whatever concerns the general interests of learning, of agriculture, of manufacture, and of commerce, are within the sphere of the national councils, as far as regards application of money.*" [Italics added.]

The processing tax on coconut oil appears to be a revenue measure. It is not tied, as was the processing tax under the Agricultural Adjustment Act, to any scheme, voluntary or coercive, to control intrastate activities which are beyond the power of the Congress. A reading of the measure and a comparison with other provisions would indicate that the object of the Congress may have been to make the tax replace the custom duty which applies to coconut oil originating elsewhere than in the Philippines. (19 U. S. C. A., section 1001, paragraph 54; 19 U. S. C. A., section 1301.) Coconut oil so originating must pay in addition to this duty the processing tax of 3 cents per pound. The net result is that the processor who uses coconut oil not originating in the Philippine Islands is subject to a tax of 7 cents per pound while those who, like the plaintiff, use oil originating in the Philippine Islands, pay only the 3 cents per pound processing tax. In effect, a protective tariff is thus given to the Philippine product. There is no direct discrimination between persons using one product instead of another. But even if there were, that in itself would not render the tax invalid. Courts have held repeatedly that a tax can not be invalidated merely because its effect might be to discourage the use of a product, such as oleomargarine, or even the destruction of a business. (See *Veazie Bank* v. *Fenno* (1869), 8 Wall., 533, 19 L. Ed., 482; *McCray* v. *United States* (1904), 195 U. S., 56; *Alaska Fish Co.* v. *Smith* (1921), 255 U. S., 44; *Miller* v. *Standard Nut Margarine Co.* (1932), 259 U. S., 20; *Magnano Company* v.

*Hamilton* (1934), 292 U. S., 40; *Fox* v. *Standard Oil Co.* (1934), 294 U. S., 87, 100.) *In Alaska Fish Co.* v. *Smith*, supra, Mr. Justice Holmes said:

"Even though a license tax should destroy a business, it would not be invalid or require compensation upon that ground alone. Those who enter upon a business take that risk."

Plaintiff quotes from certain of the debates which occurred during the discussion of the adoption of the coconut oil processing tax from which it may be inferred that the object of the Congress was to discourage the use of coconut oil and to force the use of domestic oil substitutes. Assuming this to have been the object, the answer is in the decisions just cited which state clearly that where the power to tax is not limited, the mere fact that the legislative body in exercising it may have sought to repress the use of one product or to foster the use of another does not make the exercise of the taxing power constitutionally vulnerable. (See *Fox* v. *Standard Oil Co.*, supra.) Few tax measures could stand the test if the courts, disregarding the presumption of constitutionality, were to scrutinize apparently proper exercises of power with the view of discovering a hidden purpose to achieve an unlawful end. The instances in which courts have done so (such as *Hill* v. *Wallace* (1922), 259 U. S., 44; *Bailey* v. *Drexel Furniture Co.* (1922), 259 U. S., 20 [T. D. 3346, C. B. I–2, 337]; *United States* v. *Constantine* (1935), 296 U. S., 287; *United States* v. *Butler*, supra) were those in which the unlawful regulation sought to be attained, under the guise of taxation, was apparent to the court. They were instances in which the taxing power was used merely as a cloak to achieve an unauthorized end.

The contention here that the real aim was to aid indirectly domestic products and that for that reason the tax is, in reality, a penalty, is of the same character as that made in *Miller* v. *Standard Nut Margarine Co.*, supra. There it was argued that the tax on oleomargarine was in reality a penalty imposed for the purpose of eliminating competition with butter. The Supreme Court declined to invalidate the tax upon that ground.

But it is insisted that in view of the requirement of clause A of section 999, Title 26, that the taxes collected with respect to coconut oil wholly of Philippine product or produced from materials wholly of Philippine growth be held as a separate fund and be paid to the treasurer of the Philippine Islands, the object of the tax has failed with the establishment of the Philippine Commonwealth. The date of the establishment of the Philippine Commonwealth was subsequent to the enactment of the Act. By the treaty concluded with Spain on November 7, 1900, the Philippines "came under the complete and absolute sovereignty and dominion of the United States and so became territory of the United States over which civil government could be established." (See *Fourteen Diamond Rings* v. *United States* (1901), 183 U. S., 176; *Porto Rico Brokerage Co.* v. *United States* (1935) (C. C. P. A.), 76 F. (2d), 605, 610.)

There is no limitation upon the power of the Congress to appropriate money to use in any portion of its Territories, whether the Territories are States, possessions or protectorates. (See *Balzac* v. *Porto Rico* (1922), 258 U. S., 298.) The power to govern possessions implies the power to spend money for their benefit. The power to govern implies the power to tax. And it can not be contended that a tax from a particular source may not be ear-marked for the use of a particular territory of the United States. The establishment of the Philippine Commonwealth in 1935 under the independence statute of 1933 (48 U. S. C. A., sections 1231–1236) has not severed completely the ties between the Philippines and the United States. Until the complete withdrawal of the sovereignty of the United States over the Philippines, which will not occur until the expiration of a period of 10 years from the date of the inauguration of the new Philippine Government, the United States retains certain rights of possession, supervision, jurisdiction, control and sovereignty over the territory and people of the Philippines. This is evidenced by the reservations contained in the independence statute. The character of the constitution is prescribed. Pending the final and complete withdrawal of the sovereignty of the United States, all citizens of the Philippine Islands owe allegiance to the United States. Every officer of the government of the Commonwealth upon entering the discharge of his duties must take and subscribe an oath of office declaring, among other things, that he recognizes and accepts the supreme authority of the United States and will maintain true faith and allegiance to it. Certain fundamental rights are made mandatory in the new constitution. The decisions of the courts of the Commonwealth are subject to review by the Supreme Court of the United States. The United States may, by presidential proclamation, exercise the right to intervene for the maintenance or preservation of the government of the Commonwealth of the Philippines or for the protection of life, property and individual liberty, and for the discharge of government obligations under and in accordance with the provisions of the constitution. Pending complete withdrawal, the trade relations between the United States and the Philippines are to be governed by existing law. Certain levies on imports are established. The United States Government exercises, in other ways, supervisory powers. Every amendment to the constitution of the Commonwealth of the Philippines must be submitted to the President of the United States for approval. The President of the United States has the authority to suspend the taking effect of or the operation of any law, contract, or executive order of the government of the Philippines when, in his judgment, it will result in disabling the government of the Commonwealth to fulfill its contracts or to meet its bonded indebtedness or is likely to impair the reserves established for the protection of the currency of the Philippines or which in his judgment will violate the national obligations of the United States. He has a representative in the Philippine Islands in the person of the United States High Commissioner who holds office at his pleasure. Restrictions are placed upon immigration.

And, *what is most important*, in view of the discussion to follow on the tests of sovereignty, *the foreign affairs of the islands are under the direct supervision and control of the United States.*

In many fields, therefore, the will of the United States is still the law of the Philippine Islands.

To that extent the United States is still sovereign. For, as stated by Mr. Justice Holmes in *American Banana Co.* v. *United Fruit Co.* (1909) (213 U. S., 347, 358):

"The very meaning of sovereignty is that the decree of the sovereign makes law."

Moore says:

"A state is sovereign from the point of view of the law of nations, when it is independent of every other state in the exercise of its international rights externally and in the manner in which it lives and governs itself internally." (John Bassett Moore, Digest of International Law (1906), volume 1, page 18.)

(And see Wilson on International Law (1927), second edition, page 16; *DeLima* v. *Bidwell* (1900), 182 U. S., 1; *Downes* v. *Bidwell* (1901), 182 U. S., 244.) A state may exercise certain limited extraterritorial rights over its citizens or on certain subjects within the domain of another state—as in the case of the extraterritorial courts maintained by the United States in China and the mixed courts of certain European powers in Egypt. The exercise of these rights do not affect sovereignty. But when one state demands allegiance of the citizens of another state and an oath of allegiance of its officials, retains appellate jurisdiction over its courts, gives its chief executive officer the right to suspend the operation of any law or governmental order by mere executive fiat, and the right to veto amendments to the state's constitution, retains the right to intervene (*by force of arms, we assume*) in order to maintain the government or to make it fulfill its obligations or for the purpose of protecting life and liberty—we have a quasi independence only.

We do not have either that internal or external independence of one state toward another which is the essence of sovereignty, and which would justify an executive or judicial characterization of the territory of the subject state as foreign territory. (*DeLima* v. *Bidwell*, supra; *Downes* v. *Bidwell*, supra.)

Rather do we have that state of dependence which is designated in international relations as a protectorate. (See *The Ionian Ships* (1855), 2 Spinks, 212; Scott's Cases on International Law (1922), page 21; *Rex* v. *The Earl of Crewe*, L. R. K. B., 576, 619, 620 (1910); *The Charkieh*, L. R., 4 Adm. and Ecc., 59 (1873), Scott's Cases on International Law (1922), page 22.)

But, in the last analysis, it is unimportant what term we apply to the suzerainty which the United States still exercises over the Philippines.

On the whole, it is apparent that by the establishment of the Philippine Commonwealth, the Philippines have not ceased to become a possession of the United States. The Government of the United States exercises powers over them which are those of a sovereign. It will not surrender its complete sovereignty until the 4th of July immediately following the expiration of a period of 10 years from the inauguration of the new Philippine Government. The United States, having, therefore, retained certain sovereignty, although limited, over the Philippines, and having assumed certain binding obligations towards them, they may continue to pay to them moneys which have been collected for their benefit during the time when the United States exercised complete sovereignty over them.

But even if we assume that complete independence has already been achieved, and that the moneys which have accumulated from the processing tax on coconut oil originating in the Philippines, can no longer be paid to the Philippine Islands, the only result we can conceive would be that the money will go, as do other moneys derived from the processing tax established by the Revenue Act of 1934, into the Treasury of the United States and become a part of the general funds of the United States.

No authority has been called to our attention which holds that under such circumstances courts can relieve the taxpayer of its payment. We know of no legal doctrine sanctioning such result. Clearly it is for the Congress to say, assuming the original object to have failed, what shall be done with the money collected for the use of the Philippine Islands. It alone can determine that the money accumulated shall now be put to a different use, or be returned to the taxpayer or that the taxpayer be, in the future, relieved of the tax.

We conclude that the processing tax on coconut oil is a proper exercise of the taxing power of the Congress of the United States and that the present status of the Philippines does not render invalid its exercise, so as to relieve the processors of its payment.

We are also of the view that the complaint fails to state a cause for the intervention of this court, in view of the provisions of section 3224 of Revised Statutes (26 U. S. C. A., section 154) and of the declaratory judgment Act, as amended (28 U. S. C. A., section 400), which prohibit the institution of suits seeking to enjoin the collection of taxes and of actions seeking declaratory judgments in tax matters. In *Rieder* v. *Rogan* (1935) (12 Fed. Supp., 307) I discussed very fully the validity of these provisions. The decision of the Supreme Court in the *Reichert Rice Mills* v. *Fontenot* (1936) (80 L. Ed., 353) does not weaken the authority of the long list of cases cited in my opinion and in which the Supreme Court has sustained consistently the validity of restraints upon the power to sue the Government in tax matters. All that the Court ruled in *Reichert Rice Mills* v. *Fontenot*, supra, was that the Agricultural Adjustment Act having been declared unconstitutional, the uncollected taxes which had been impounded by the district court pending the determination of the validity of the Act were returnable to the taxpayer. This upon the ground that any attempt to collect them now would be an unlawful trespass. So ruling, the Court did not either directly or indirectly, question the validity or propriety of congressional limitations upon suits relating to taxation. Two recent cases have so interpreted this decision. (See *Simonin's Sons, Inc.*, v. *Rothensies* (D. C. Pa.), decided in December, 1935, by Kirkpatrick, district judge; *Mellon* v. *Mertz*, decided on February 24, 1936, by the Court of Appeals of the District of Columbia and reported in full in Prentice-Hall 1936 Tax Service at paragraph 817.) Restrictions upon the right to institute actions relating to a tax do not apply to penalties. (See *Lipke* v. *Lederer* (1922), 259 U. S., 557; *Regal Drug Corporation* v. *Wardell* (1922), 260 U. S., 386; *United States* v. *Glidden Co.* (1935) (C. C. A. 6), 78 F. (2d), 639; *Graham* v. *DuPont* (1923), 262 U. S., 235 [T. D. 3486, C. B. II-1, 226]; *Coletti* v. *Cassidy* (1933) (D. C. Wy.), 12 Fed. Supp., 21.) But, as already stated, the statute under attack is not a penalty, nor have the defendants brought themselves within the exception declared in *Dodge* v. *Brady* (1916) (240 U. S., 1221), *Bailey* v. *George* (1922) (259 U. S., 161 [T. D. 3347, C. B. I-2, 342]), and *Miller* v. *Standard Nut Margarine Co.*, supra, which allows the court to take jurisdiction despite the statutory prohibition if extraordinary and exceptional circumstances exist. Of course mere illegality or unconstitutionality is not sufficient. (See *Cruickshank* v. *Bidwell* (1900), 176 U. S., 174; *Dodge* v. *Osborne* (1916), 240 U. S., 113; *Child Labor Tax Case* (1922), 259 U. S., 20; *Fisher Flouring Mills* v. *Vierhus* (1935) (C. C. A. 9), 78 Fed. (2d), 889.) At best, the bill of complaint merely shows that Philippine coconut oil is an essential ingredient to the business of the plaintiff, that the tax is onerous and might result in the depletion of the assets and property of the plaintiff, that the remedy for recovery through administrative channels is dilatory, that if payment is refused, distress warrants might be levied and if suit for recovery were instituted, a multiplicity of suits would result. It has been held repeatedly that no question of multiplicity arises when one action by the taxpayer would determine the entire question. (See *Boise Artesian Water Co.* v. *Boise City* (1909), 213 U. S., 276; *Mathews* v. *Rodgers* (1932), 284 U. S., 521; and note to same on "Multiplicity as ground for injunction against alleged unconstitutional tax" (76 L. Ed., 455–456); *Moor* v. *Texas & H. O. R. Co.* (1935) (C. C. A. 5), 75 F. (2d), 386, 389; *Reider* v. *Rogan*, supra.) Nor is the trespass incidental to the collection of the tax considered an extraordinary circumstance. (See *Shelton* v. *Platt* (1891), 139 U. S., 591; *Dalton Adding Machine Co.* v. *Virginia* (1915), 236 U. S., 699.) The fact that the money collected might be paid over to the Philippine Government is not a ground for the intervention of equity. Should this happen and should the law ultimately be declared unconstitutional, a situation would arise as in the case of the failure of the Congress to appropriate money out of which refunds of taxes should be paid. And it has been held that such failure does not make the remedy provided through administrative channels inadequate. (See *Cohen* v. *Durning* (1935) (D. C. N. Y.), 11 Fed. Supp., 825, 828; *Frye & Co.* v. *Vierhus* (1935), 12 Fed. Supp., 697; *Fisher Flouring Mills* v. *Vierhus*, supra.) We add that the declaratory judgment Act (28 U. S. C. A., section 400) while remedial in nature, can not be, even in the absence of the amendment of August 30, 1935, which excludes from its provisions controversies relating to tax matters, so interpreted as to allow us to entertain suits for injunction in tax matters under circumstances under which they were not entertained before. For, as stated by the Supreme Court, in *United States* v. *West Virginia* (1935) (295 U. S., 463, 476):

"It (the declaratory judgment Act) does not purport to alter the character of the controversies which are the subject of the judicial power under the Constitution."

And as more recently stated by the Circuit Court of Appeals of this Circuit (*Southern Pacific Co.* v. *McAdoo*, No. 7954, decided March 9, 1936):

"The mere fact that a declaratory judgment is sought is not, of itself, a ground of Federal jurisdiction."

We conclude that the validity of the enactment under attack and the prohibitions which the Congress has placed upon the right to institute actions relating to taxation, stand in the way of granting the relief sought by the bill, and that this court is without jurisdiction to entertain it. The temporary restraining order will, therefore, be vacated; a preliminary injunction will be denied and the bill will be dismissed. An exception to each of the rulings made is allowed.

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## REGULATIONS 48, ARTICLE 3: Imposition of the tax.

XV–22–8106
S. T. 836

Denatured palm oil is subject to the tax imposed by section 602½ of the Revenue Act of 1934.

Advice is requested whether palm oil treated with a denaturant which makes it unfit for edible use is subject to the tax imposed by section 602½ of the Revenue Act of 1934, it being stated that palm kernel oil is subject to an import tax under the Tariff Act of 1930 which is removed when the oil is so treated as to make it unfit for edible use.

Section 602½ of the Revenue Act of 1934 imposes a tax of 3 cents per pound upon the first domestic processing of palm oil and certain other oils specified therein, with the exception that the use of palm oil in the manufacture of tin plate is not subject to the tax.

Paragraph 1732 of the Tariff Act of 1930 exempts from duty upon importation palm kernel oil rendered unfit for use as food. However, the import tax under the Tariff Act of 1930 has no connection with the tax imposed under the provisions of section 602½ of the Revenue Act of 1934. The oils enumerated under section 602½ are subject to tax regardless of whether they are fit for edible use.

It is held, therefore, that palm oil treated with a denaturant which renders it unfit for edible use is subject to the tax imposed by section 602½ of the Revenue Act of 1934 upon the first domestic processing thereof in the United States after the effective date of the Act, with the exception that the use of palm oil in the manufacture of tin plate, whether or not denatured, is not subject to tax.

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# TITLE IV.—MANUFACTURERS' EXCISE TAXES. (1932)

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## SECTION 601(c)1 OF THE REVENUE ACT OF 1932, AS AMENDED BY THE ACT OF JUNE 16, 1933 (PUBLIC, NO. 73, SEVENTY-THIRD CONGRESS), AND BY SECTION 603(a) OF THE REVENUE ACT OF 1934.

REGULATIONS 44(1934), ARTICLE 40: Use of terms. (Also Article 43.) XV–26–8145 S. T. 839

Taxability of crude neatsfoot oil, refined and deodorized neatsfoot oil, and transformer oil.

S. T. 558 (C. B. XI–2, 450) modified.

Advice is requested whether crude neatsfoot oil, refined and deodorized neatsfoot oil, and transformer oil are subject to the tax imposed by section 601(c)1 of the Revenue Act of 1932, as amended by the Act of June 16, 1933 (Public, No. 73, Seventy-third Congress), and by section 603(a) of the Revenue Act of 1934.

Section 601(c)1 of the Revenue Act of 1932, as amended, imposes a tax of 4 cents per gallon upon the sale of lubricating oils by the manufacturer or producer.

Article 40 of Regulations 44(1934) reads in part as follows:

* * * The term "lubricating oil" as used in these regulations includes all oils, regardless of their origin, which are sold as lubricating oils and all oils which are sold or used for lubrication.

It was held in S. T. 558 (C. B. XI–2, 450) that neatsfoot oil, transformer oil, and certain other oils were not subject to tax under section 601(c)1 of the Revenue Act of 1932 when sold under a name identifying them for purposes other than lubrication, or when used as the component material in the manufacture of other articles taxable under Title IV of the Revenue Act of 1932, provided the manufacturer obtained from the purchaser a certificate to the effect that the oil so sold would not be used for lubrication.

Crude neatsfoot oil is not sold or used for lubricating purposes and is, therefore, not subject to tax as lubricating oil. Accordingly, such oil may be sold by the manufacturer without the necessity of obtaining exemption certificates from the purchasers. *Refined and deodorized* neatsfoot oil is normally sold and used for lubricating purposes, and, when so sold, is taxable under section 601(c)1 of the Revenue Act of 1932, as amended. If, however, it should be sold for nonlubricating purposes by the manufacturer or producer direct, it may be sold free from tax under exemption certificates in accordance with the provisions of article 43 of Regulations 44(1934), as amended by Treasury Decision 4604 (C. B. XIV–2, 379).

Oil manufactured and sold specifically for use in electrical transformers and large outdoor oil circuit breakers as an insulating agent, generally known as transformer or insulating oil, is not sold for lubrication within the meaning of article 40 of Regulations 44(1934), and is, therefore, not (when so sold) subject to tax under section 601(c)1 of the Revenue Act of 1932, as amended. Exemption certificates need not be obtained with respect to such sales.

S. T. 558 (C. B. XI-2, 450) is modified in so far as inconsistent with the conclusions reached herein.

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REGULATIONS 44(1934), ARTICLE 43: Sales of oil for nonlubricating uses.

XV-6-7951
S. T. 828

The sale of lubricating oil by the manufacturer or producer to a dealer or consumer who is not a producer of gasoline for use in mixing small quantities thereof with gasoline is taxable.

Advice is requested whether the sale of lubricating oil by the manufacturer or producer to a dealer or consumer who is not a producer of gasoline for the purpose of mixing small quantities thereof with gasoline is subject to tax under section 601(c)1 of the Revenue Act of 1932, as amended.

Section 601(c)1 of the Revenue Act of 1932, as amended, imposes a tax of 4 cents a gallon upon the sale of lubricating oil by the manufacturer or producer. Sales of an oil having both lubricating and nonlubricating uses by the manufacturer or producer for nonlubricating purposes are not subject to tax, provided the oil is put into a channel of consumption or distribution for use other than that of lubrication and the manufacturer or producer obtains the exemption certificate required by article 43 of Regulations 44(1934), as amended by Treasury Decision 4604 (C. B. XIV-2, 379).

Where lubricating oil is sold by the manufacturer or producer to such a dealer or consumer for the purpose of mixing small quantities of such oil with gasoline, it is evident that the oil is intended to serve the purpose of lubrication and is not sold for a nonlubricating use within the meaning of article 43 of Regulations 44(1934), as amended. Accordingly, a dealer or consumer who is not a producer of gasoline within the meaning of section 617 of the Revenue Act of 1932, as amended, may not purchase lubricating oil tax-free for such use, and no refund or credit may be allowed to the manufacturer or producer for the tax paid by him on such sales.

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## SECTION 603.—TOILET PREPARATIONS, ETC.

REGULATIONS 46, ARTICLE 22: Scope of tax. (Also Article 4.)

XV-11-7999
G. C. M. 16223

The X Company, which controls the fabrication by the Y Company of cosmetics sold as the products of the former company, is the manufacturer or producer thereof within the meaning of section 603 of the Revenue Act of 1932.

G. C. M. 11522 (C. B. XII-1, 387) modified.

Advice is requested whether the X Company or the Y Company should be regarded as the manufacturer or producer of toilet preparations, under the circumstances hereinafter stated, within the meaning of section 603 of the Revenue Act of 1932.

The Act imposes a tax at specified rates upon the sale by the manufacturer, producer, or importer of certain enumerated articles and similar articles which are used or applied, or intended to be used or applied, for toilet purposes.

The Y Company fabricated cosmetics at the request of, and expressly for, the X Company according to the X Company's specifications. In so doing, it used perfumes specified by the X Company and at the direction of the X Company placed the cosmetics in containers bearing the X Company's name or trade mark. The products are presumably bought by customers because of the X Company's name and the distinctive perfumes used in their manufacture. The X Company has a monopoly on toilet preparations marketed under its name.

Upon careful consideration of the various factors involved in this class of cases, this office is of the opinion that no general rule can be formulated which will be controlling under all circumstances. In the final analysis the decision must necessarily rest upon the particular facts in each case.

In advertising campaigns for the promotion of sales of various products, a trade name and, in respect of toilet preparations, a distinctive perfume are very important factors. In the recent decision of the United States District Court for the Eastern District of New York in *Bourjois* v. *McGowan* (12 Fed. Supp., 787 [Ct. D. 1074, page 383, this Bulletin]), the court had occasion to consider such factors. In the course of the decision the following language was used:

> * * * The evidence shows that the retail prices of perfumes and cosmetics made by different producers vary largely in amount and that such prices also vary largely from the cost of manufacture. One witness testified that there were large variances in such prices where only perfume was added to a cream and a container had been changed, both involving little additional cost. This witness explained such differences on the theory that the prices are dictated by one who has a monopoly on the sale. Bourjois products are bought, because they are Bourjois made. Bourjois has a monopoly on the cosmetic and perfume business under that name. It is true the initial cost of manufacture is comparatively small, but people buy Bourjois products on their reputation with slight regard to prices paid. Bourjois products doubtless can be duplicated by other manufacturers. Their parts and proportions are easily determinable. Other manufacturers may put on the market the same products as Bourjois, Inc., but they can not be sold under the names Bourjois and Barbara Gould. While they may sell the same article in so far as constituent parts are concerned, they are not the same articles as sold by the plaintiff by reason of the fact that they are not represented to be plaintiff's products. * * *

The term "manufacturer" or "producer" may well be considered not only as applicable to him who actually makes an article but also to him who causes it to be made. The legal doctrine *facit per alium facit per se* is applicable. See decision in *Foss-Hughes Co.* v. *Lederer* (287 Fed., 150), in which the following language was used:

> * * * There is no claim that the plaintiff imports, and none that he is a manufacturer, except in the sense in which one who has something made for him by others, to be sold by him, may be said to be a manufacturer. This is doubtless the sense in which Congress used the word "producer," and was also doubtless the occasion for its use. * * *

Upon careful consideration of the facts presented, it is the opinion of this office that the X Company, which controlled the production and disposition of the products in question, was the manufacturer or producer thereof within the meaning of section 603 of the Revenue Act of 1932.

G. C. M. 11522 (C. B. XII–1, 387) is modified to agree with the views expressed herein.

HERMAN OLIPHANT,
*General Counsel for the Department of the Treasury.*

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REGULATIONS 46, ARTICLE 22: Scope of tax.

XV–3–7914
S. T. 825

Tax liability involved in the addition of water to tax-paid toilet preparations by beauty parlors and barber shops and the use or sale thereof by them.

Advice is requested whether a beauty parlor or barber shop incurs liability for the tax imposed under section 603 of the Revenue Act of 1932 by adding water to tax-paid toilet preparations and by using such solutions or mixtures as aids in giving shampoos and wave sets and in rendering similar personal services to patrons.

Section 603 of the Revenue Act of 1932, as amended, imposes a tax on the sale by the manufacturer, producer, or importer of toilet preparations and similar articles used or applied, or intended to be used or applied, for toilet purposes. Section 622 of the same Act imposes an equivalent tax on the use of taxable articles by the manufacturer, producer, or importer thereof, except a use in the production of another article on the sale or use of which a tax will be incurred under Title IV of the Revenue Act of 1932, as amended.

It appears that some beauty parlors and barber shops purchase a lathering preparation in a form suitable for application to the head without dilution while others purchase soap tax-paid in the form of bars, a semiliquid soap base, or a partially diluted liquid soap, add the desired amount of water, and place the liquid in bottles or containers for use when needed in serving patrons. In small shops this use is ordinarily a very trivial and incidental activity, not sufficient in scope to warrant the conclusion that the user is a producer within the meaning of the law. Moreover, such liquid solutions are not of a type customarily sold to individual users. However, in some large establishments, or in the case of several shops under one management, such dilutions or solutions are often made in substantial quantities, or on a commercial scale, and are sold to individual consumers or to others in competition with manufacturers regularly engaged in producing shampoo preparations for retail sale. Somewhat similar practices and conditions have been found to exist with respect to the diluting by beauty parlors of finger wave set solutions or powders, permanent wave solutions, and other substances. In most cases no accurate basis exists for determining the amount mixed or the selling price of like articles.

Upon consideration of the various factors involved, the Bureau has reached the conclusion that where, as a part of the business of rendering personal services to patrons, barber shops, beauty parlors, and similar institutions prepare for their own use liquid shampoos, hair waving solutions, etc., through the addition of water to soap bases and other substances, or by similar dilution, such barber shops or beauty parlors do not thereby acquire the status of producers of articles taxable under section 603 of the Revenue Act of 1932. Consequently, such barber shops or beauty parlors will not be held liable for a tax under section 603 on such shampoo preparations, hair waving solutions, etc., prepared for incidental use in their shops as a part of the business of rendering personal services to patrons. It follows that barber shops or beauty parlors producing such liquid shampoos, hair waving solutions, etc., for use in rendering personal services to patrons are not entitled to purchase articles enumerated in section 603 of the Revenue Act of 1932 tax-free under section 620(1) of the Revenue Act of 1932, as amended. Where, however, a barber shop or beauty parlor produces shampoo preparations, hair waving solutions, etc., for sale and not for use in its business, the status of a producer is established and liability for the tax on toilet preparations imposed under section 603 is incurred upon the sale by them of such products.

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REGULATIONS 46, ARTICLE 22: Scope of tax. XV-10-7991
(Also Section 619 and Article 15.) Ct. D. 1074

MANUFACTURERS' EXCISE TAX—REVENUE ACT OF 1932—DECISION OF COURT.

1. SALE OF MANUFACTURED ARTICLE—COMPUTATION OF TAX—BASIS—STATUTE APPLICABLE.

If the basis for computing the tax upon the sale of an article by the manufacturer or producer thereof may be determined under the provisions of section 619(b)3 of the Revenue Act of 1932, section 601(a) of the Revenue Act of 1926 is not applicable.

2. TOILET PREPARATIONS—SALE BY MANUFACTURER TO SUBSIDIARY CORPORATIONS—ARM'S-LENGTH TRANSACTION—PRESUMPTION.

A corporation engaged in the manufacture of toilet preparations and cosmetics sold the greater part of its production to two sales corporations, which it had organized in August, 1932, at cost plus 1½ per cent, plus 10 per cent, plus the tax. It owned all the stock of the sales corporations and the brand names, trade-marks, and formulas used in connection with the manufacture of the articles, controlled the policies of the subsidiaries, and dictated the prices at which they should resell the products. Practically all the business of the new corporations was the sale of these products to the public, the sale price being substantially the same as that for which they had been sold prior to the organization of the sales corporations. Sales between a manufacturing company and wholly-owned subsidiaries are prima facie "not at arm's length," and, that presumption not having been met or overcome by the facts shown in this case, section 619(b)3 of the Revenue Act of 1932 is applicable in determining the tax, if the sales were made at less than the fair market price.

3. FAIR MARKET PRICE.

Where the manufacturer of toilet preparations, selling its products under well-established trade-marks and brands, had what amounted to a monopoly upon their sale by virtue of such trade-marks and brands, and marketed substantially all its production through wholly-owned sales corporations whose policies and sales prices were dictated by the manufacturing company, the fair market price of the products can not be determined by comparison with prices at which articles containing the same or similar ingredients were sold by other manufacturers, but is the price fixed by the manufacturer as their value in an open market. Under such circumstances, the Commissioner correctly determined that the price at which the manufacturing company sold to its subsidiaries was less than the fair market price, and that the price at which the sales corporations sold to the public constituted the price for which the articles were sold in the ordinary course of trade by manufacturers and producers, within the meaning of section 619(b)3 of the Revenue Act of 1932.

4. Inclusion of Tax in Selling Price—Refund—Proof Required.

The tax having been included in the price at which the products were sold, and the requirements of section 621(d) of the Revenue Act of 1932, as to proof of repayment of the tax to the ultimate purchaser, not having been met, the taxpayer is not entitled to recover an alleged overpayment of tax.

United States District Court, Eastern District of New York.

*Bourjois, Inc., plaintiff,* v. *George T. McGowan, Individually and as Collector of Internal Revenue, defendant.*

[November 12, 1935.]

OPINION.

Knight, District Judge: This suit is brought to recover $13,918.39 paid by the plaintiff as additional tax on cosmetic and toilet preparations for the month of September, 1932.

The plaintiff was incorporated in 1929, under the name of International Perfume Co. A change to the present name was made in 1930. Barbara Gould, Ltd., a corporation engaged in manufacturing beauty and treatment lines, was legally merged with plaintiff on August 9, 1932. On the last-mentioned day, Bourjois Sales Corporation and Barbara Gould Sales Corporation were incorporated. The plaintiff at all times since August 9, 1932, has been the owner of all the issued and outstanding stock of Bourjois Sales Corporation and Barbara Gould Sales Corporation and the owner of all of the brands, trade-marks and formulas used and employed in connection with its business of manufacturing toilet preparations and cosmetics. The greater part of plaintiff's production was sold to the above-named sales corporations, the balance being sold to a limited number of foreign corporations operating in foreign markets. The plaintiff sold its products to the two sales corporations at the cost of manufacturing, including the cost of containers, labels and things of like nature, plus 1½ per cent, plus 10 per cent, plus the tax.

Under section 603 of the Revenue Act of 1932, a tax is imposed on articles of the type manufactured by the plaintiff equivalent to 10 per centum of the price for which such goods are sold. On certain items the tax is reduced to 5 per centum of the selling price, but for convenience the tax will be referred to as a tax of 10 per centum. Plaintiff paid such tax computed on the price at which it sold its products to the domestic and foreign sales corporations.

Section 619(b)3 of the above-mentioned Act provides as follows: "If an article is sold (otherwise than through an arm's length transaction) at less than the fair market price, the tax under this title shall (if based on the price for which the article is sold) be computed on the price for which such articles are sold, in the ordinary course of trade, by manufacturers or producers thereof, as determined by the Commissioner." The Commissioner of Internal Revenue determined that the plaintiff's sales were made at less than the fair market price, through transactions at less than arm's length. He thereupon determined that the price at which the sales corporations sold the plaintiff's products constituted the price for which such articles are sold in the ordinary course of trade, by manufacturers or producers thereof. He computed the additional tax, now in litigation, by applying the rate of tax, fixed by section 603, to the difference between the amount secured by the plaintiff as the result of its sales and the amount received by the sales corporation on resale of the goods. Plaintiff paid this tax, subsequently filing a claim for refund. It is asserted that such additional tax was not collected by plaintiff from its customers.

Plaintiff claims that its sales to the sales corporation were at a fair market price inasmuch as articles made up of similar ingredients are sold at that price, in the ordinary course of trade, by other manufacturers and producers and, therefore, that section 619(b)3 has no application to its transactions and the

Commissioner erred in levying the additional tax. The Government contends that the alleged sales to the sales corporations were not "arm's length" transactions; that they were made at less than the "fair market price," and that the Commissioner properly determined the price at which such products are sold, in the ordinary course of trade by manufacturers and producers thereof, and properly computed the tax on that basis.

The Government cites sections 601(a) and 240 of the Revenue Act of 1926 as supporting the position taken by the Commissioner. Section 601(a) of the Revenue Act of 1926 provided that when the manufacturer sells articles of the kind in question here to a corporation affiliated with it within the meaning of section 240 of such Act "at less than the fair market price obtainable therefor, the tax shall be computed on the basis of the price at which such article is sold * * * by such affiliated corporation." Section 240 of the same Act brings these two sales corporations within the term "affiliated" as included in section 601(a). The Government claims that these sections of the Act of 1926 are not inconsistent with section 619 of the Act of 1932 and therefore were not repealed; that section 619 of the last-mentioned Act was intended to cover not only transactions covered by section 601(a) but also other transactions arising from time to time not specifically falling within the narrower provisions of the latter Act. If the sections are not inconsistent one with the other, the earlier ones are not repealed. Section 627 specfically so provides with respect to all provisions of law applicable in respect of the taxes imposed on articles enumerated in section 600 of the Act of 1926. Neither section 601(a) nor 240(c) of the 1926 Act has been specifically repealed by the Act of 1932.

Section 601(a) and section 619(b)3 provide different methods for computing the tax. One makes the price at which the article is sold by the affiliated company the basis; the other uses for a base the price charged by manufacturers or other producers, in the ordinary course of trade. There was no reason to retain the old provisions unless it was intended to impose the tax as theretofore and that is denied by the fact that the Act of 1932 fixes a new basis of taxation. The ruling of the Treasury Department in 1932 (S. T. 617, C. B. XI–2, 513) recognized that section 619(b)3 is applicable to the sales between corporations such as those involved here. Under this ruling the Department held that these corporations were recognized as separate entities and assessable the same as though not affiliated, and it would then follow, if the transaction was at arm's length between corporations or at a fair market price, sections 603 and 619(a) only would apply and if not at arm's length and not at a fair market price, section 619(b)3 would also apply. Sections 240(c) and 601(a) of the Act of 1926 must stand or fall with respect to their consistency with the provisions of the Act of 1932. Under the Act of 1932, there would be no distinction made between corporations such as those involved here and corporations not so related where the transactions were not at arm's length. Since the Act of 1932 is broad enough to include transactions between corporations such as these, it seems to me it was the intent to include transactions of the kind involved, and, if that is so, the tax must be imposed as provided by 619(b)3. It is my view that section 601(a) of the Revenue Act of 1926 is not applicable to the taxes imposed in this case, since section 619(b)3 is intended to cover transactions formerly covered by section 601(a).

If a sale is at a fair market price, or if it is at arm's length, the tax is assessed, under section 603, at 10 per cent, of the sale price, allowing for the modification made by subdivision (a) of 619 (that is, including packing and less the tax charge), and also allowing deduction for transportation etc., as determined by the Commissioner. If the sale is not at arm's length, section 619 subdivision (b)(3) applies, but only in the event that such sale is at less than the fair market value.

Sales between a manufacturing company and sales corporations in which such manufacturing company owns all of the stock are not ipso facto "not at arm's length." Whether they are not at arm's length raises a question of fact. That such sales are prima facie "not at arm's length" is recognized by the ruling of the Treasury Department on the Revenue Act of 1932 (S. T. 617, C. B. XI–2, 513). Pointing out the purpose of 619(b)3 and that Congress "apparently foresaw the probability of the creation of corporations having identical interests," it is stated: "Viewing the statute in this light, it must be presumed that Congress did not intend to have two or more affiliated corporations recognized as a single entity for manufacturers' excise tax purposes." However, upon the facts shown in this suit, it seems to me that there is a presumption that the transactions in question were not at arm's length.

Prior to the merger plaintiff and Barbara Gould, Ltd., manufactured articles having established and well known trade names and had an extensive business built upon such, its distinctive name. Price lists of both Bourjois, Inc., and Barbara Gould, Ltd., were put out effective June 21, 1932. After the merger plaintiff held the ownership and title to all of the brand names, trade-marks and formulas used and employed in connection with the articles manufactured by both Bourjois, Inc., and Barbara Gould, Ltd. In August, 1932, two sales corporations were organized, and the business done by them was almost entirely the sale of the plaintiff's product. In September, 1932, the sales corporations sold the same articles theretofore advertised and sold by Bourjois, Inc., and Barbara Gould, Ltd., at the same prices at which they were previously advertised and sold by the latter two corporations. Sales to the sales companies were at a price fixed by taking the cost of manufacture plus 1½ per cent of such cost, plus 10 per cent, plus the tax. Except for the keeping of separate books of account, the business of the three corporations was carried on largely as the business had been prior to September, 1932. The same business location and quarters were utilized, the same employees as theretofore continued in employment. The sales manager for both sales corporations continued as assistant treasurer of the three corporations. It seems to me that the presumption that these transactions were not at arm's length has not been met or overcome. In law it resulted in nothing more than carrying on the old business by a changed method.

Were the sales to the sales corporations made at a fair market price? It is claimed by the Government that these articles are highly specialized, that they have a price peculiar to themselves by reason of plaintiff's monopoly of them and by virtue of their trade names, Bourjois and Barbara Gould, and that the fair market price, as it must be arrived at under the circumstances shown, is the price for which they were sold by the sales companies and the price at which, shortly prior to September, 1932, they had been sold by the plaintiff. Plaintiff claims not only that the sales were made at a fair market price but also that the price at which its products were sold was the price at which such articles are sold, in the ordinary course of trade, by manufacturers and producers thereof.

Market price is often defined as the price at which a seller is ready and willing to sell and a buyer ready and willing to buy in the ordinary course of trade. This rule of value is the same as provided in section 619, subdivision (b)(3). Several manufacturers of cosmetics and perfumes testified as to the fair market price of plaintiff's products and fixed such price as less than or comparable with the price charged the sales corporations by the plaintiff. The testimony of these witnesses is, in effect, that articles made for a similar purpose by various manufacturers are composed of substantially the same ingredients and that the cost of manufacture is substantially the same. Having in mind these costs and the item of reasonable profit they are able to say what they think the fair market prices are. Whether these articles are such that a comparative estimate of market prices can be made or whether no such comparison can be made as a basis of fixing fair market price, where plaintiff sells under well established trade-marks and brands and has what, for all practical purposes, is a monopoly by virtue of such trade-marks and brands, the court will take judicial notice that a great volume of business is done in reliance upon or belief in the product of particular producers. Initial reliance is often shaken by results, but where a concern has manufactured a useful and pleasing article for a number of years under the same brand name or trade-mark, public satisfaction with the article is demonstrated. People do not long do business at a loss. Continued business must mean continued sales. Bourjois, Inc., is a well known and well recognized manufacturer of perfumeries and cosmetics. The sale of its products reached such proportions that in September, 1932, assessment of the tax in question disclosed a business of upwards of $100,000 for a single month. The evidence shows that the retail prices of perfumes and cosmetics made by different producers vary largely in amount and that such prices also vary largely from the cost of manufacture. One witness testified that there were large variances in such prices where only perfume was added to a cream and a container had been changed, both involving little additional cost. This witness explained such differences on the theory that the prices are dictated by one who has a monopoly on the sale. Bourjois products are bought, because they are Bourjois made. Bourjois has a monopoly on the cosmetic and perfume business under that name. It is true the initial cost of manufacture is comparatively small, but people buy Bourjois products on their reputation with slight regard to prices paid. Bourjois products doubtless can be duplicated by other manufacturers. Their parts and proportions are easily determinable. Other manufacturers may put on the market the same products as Bourjois, Inc., but they can not be sold under the names Bourjois and Barbara Gould. While they may sell the same article in so far as constituent parts are concerned, they are not the same articles as sold by the plaintiff by reason of the fact that they are not represented to be plaintiff's products. There is no evidence that any one else sold articles of the same ingredients as those manufactured by the plaintiff. It was stated by one witness that articles, similar in nature, which cost the same amount to manufacture may, on account of the trade names or brands under which they are sold, bring widely divergent prices, and further that when a manufacturer has built up a demand through the acquisition of a clientele or following, the price charged may be "whatever the traffic will bear."

Plaintiff's monopoly on the use of its trade name is a valuable right. Testimony introduced by the plaintiff indicates that the value of such right is predicated on advertising. Because of the highly competitive condition of the market, if advertising of the goods were discontinued, sales and the value of the monopoly of the use of the trade names would rapidly approach the vanishing point. Plaintiff itself does no advertising. It is merely a manufacturing corporation. The price at which it sells to the sales corporation includes no charge to offset advertising and promotional expense. For this reason plaintiff asserts that it is in a class with manufacturers who produce similar articles regardless of trade name. It was not intended that the cost of advertising and promotion of sales should be included in arriving at the price on which the tax should be computed. It would seem, therefore, that the fair market price of the plaintiff's products should be arrived at by comparison with prices charged by other manufacturing companies not engaged in sales promotion. Other manufacturing companies' prices being similar and similarly arrived at, the plaintiff's selling price would seem to be the fair market price and the proper basis for computing the tax. On such a finding, it would not matter that the sales was not at arm's length and we would have no further concern with the price charged by the sales companies on resale of the goods.

Moreover, the preceding finding fails to take into consideration the fact that the plaintiff is the sole stockholder in the sales corporations, controls the policies thereof and dictates the prices at which they shall resell the plaintiff's products. A corporation and its stockholders are generally to be treated as separate entities. (*Cannon Manufacturing Co.* v. *Cudahy Co.*, 267 U. S., 333; *Burnet* v. *Commonwealth Improvement Co.*, 287 U. S., 415 [Ct. D. 622, C. B. XII-1, 277].) Ordinarily corporations are to be regarded as separate entities even though their stockholders are the same or when one corporation owns all of the stock of the other. However, the fiction of separate identity will not be adhered to when one corporation, organized, owned and controlled by another, is so managed as to make it merely an instrumentality or adjunct of such other corporation. (*Gregory* v. *Helvering*, 293 U. S., 465 [Ct. D. 911, C. B. XIV-1, 193]; *Northern Securities Co.* v. *United States*, 193 U. S., 197; *Martin* v. *Development Co.*, 240 F., 42; and *In re Watertown Paper Co.*, 169 F., 252.) "The objects of the statute are not to be defeated by mere forms of transactions." (*Metropolitan Holding Co.* v. *Snyder*, 79 F. (2d), 263.) Such is the situation in the instant case. The sales corporations were organized and all stock therein is owned by the plaintiff. There could be no other finding than that the plaintiff controls the policies of the sales corporations and dictates the prices at which their sales are made. The sales corporations were merely agents of the plaintiff. (*Palmolive Manufacturing Co.* (*Ontario*), *Ltd.*, v. *The King*, Canada Law Reports, 1933, 131.) Sales by the sales companies were really sales of the plaintiff. Advertising and sales promotion, ostensibly carried on by the sales corporation, were, indirectly, the work of the plaintiff. Bourjois, Inc., from whom alone Bourjois and Barbara Gould products can be obtained, is thus found to be selling its products at the prices charged by the sales corporations.

Many staple articles have market values which may be established as the result of sales of similar articles. The market value of Bourjois, Inc., products can not be determined by comparison with the values of other perfumes and cosmetics. Their market value is the value which they bring in the market. As was said in *Poppenberg* v. *Owen & Co.* (84 Misc., 126, affirmed, 231 N. Y., 569): "The price the defendant established was the price that controlled. So we have a special article of manufacture handled only by, and exclusively by, the defendant." There is no market price for plaintiff's product other than the price fixed by the plaintiff. In such cases that price must be said to be the "fair market price" for the purpose of taxation. (*The Pierce Arrow Motor Car Co.* v. *United States*, Ct. Cls., June 3, 1935 [Ct. D. 1007, C. B. XIV-2, 276].)

What was the price fixed by plaintiff for its products? Was it the price charged to the sales corporations or the price charged by the sales corporations? The plaintiff sold goods at the former price only to the sales corporations, which were owned by plaintiff and whose profits were profits of plaintiff, and to a limited number of foreign corporations operating in limited foreign markets. At no time did plaintiff offer to sell its merchandise to the wholesale trade generally at the prices charged to its sales corporations. The plaintiff itself made no sales in the open market. Thus there is no basis for determining the market value of its products except by looking to the price at which the goods were sold by the sales corporations. Such prices were determined by the plaintiff, since plaintiff, the owner of such sales corporations, must necessarily dictate its policies and prices. The plaintiff, therefore, made the first offer of its goods to the public at the prices charged by the sales corporations. This was the selling price fixed by the plaintiff, the manufacturer. This was the price which must be regarded as the fair market value for the purpose of taxation. The price at which the plaintiff sold to the sales corporations was less than the fair market price. The Commissioner having reached that determination, it devolved upon him, under section 619, subdivision (b)(3), to determine the price for which such articles are sold in the ordinary course of trade by manufacturers or producers thereof. The Commissioner properly determined that the price at which the goods were sold by the sales corporations was the price at which the goods are sold in the ordinary course of trade, by manufacturers or producers thereof, and the price on which the tax should be computed.

The law is well settled by a long line of decisions that, in the absence of fraud, a taxpayer may utilize any legal method to escape payment of a tax. (*Gregory* v. *Helvering*, supra; *United States* v. *Isham*, 84 U. S., 496; *Chisolm* v. *Commissioner*, 79 F. (2d), 14, certiorari denied, November 11, 1935; *Jones* v. *Helvering*, 71 F. (2d), 214; *Eaton* v. *White*, 70 F. (2d), 449; and *Iowa Bridge Commission* v. *Collector of Internal Revenue*, 39 F. (2d), 777.) Plaintiff had the right to organize the sales corporations in an attempt to lessen the taxes assessable against it. The fact that plaintiff owned all of the stock of the sales corporations does not affect their right to incorporation and separate existence. The purpose behind their organization is of no moment. The court is interested in determining what the statute was intended to reach and, having found on that point, in determining whether the acts of the taxpayer, designed to carry it without the operation of the statute, were sufficient to accomplish such a result. (*Gregory* v. *Helvering*, supra.) Section 603 was designed to tax the actual manufacturers selling price. Section 619(b)3 was passed to prevent taxpayers from dodging payment of the tax by means of artificial transactions designed solely for that purpose. Sections of the Revenue Act of 1926, cited hereinbefore, are evidence that the intent of the Congress was to reach the actual manufacturer's selling price regardless of any attempt of the taxpayer to hide such price through transactions with dummy affiliates or artificial price manipulations.

This litigation arises from plaintiff's attempted concealment of its selling price through the organization of the sales corporations. Having found that the transactions in question between the plaintiff and the sales corporations were not at arm's length and that the price at which the articles were sold to the sales corporation was not the fair market price, the conclusion follows that the method by which the plaintiff determined its selling price was a mere cover and a fraud upon the Government. In fact, a part of the plaintiff's actual selling price was included in the sales price of the sales corporations. In collecting such portion of the plaintiff's selling price, the sales corporations were mere agents of the plaintiff.

As heretofore pointed out, section 619 defines certain things to be included in the price and certain things which are or may be excluded. Packaging and charges incident to it are added. The amount of the tax is excluded. "Transportation, etc., or 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 Commissioner in accordance with the regulations." When the Act of 1932 was being considered in Congress, it was stated by the introducer that the selling cost was not intended to be added. This was in answer to an inquiry as to whether the manufacturer's price included salesmen's commissions. If the sales corporations are to be construed as a salesman selling on commission, the corporations' extra charge might be excluded from the tax. Sales by these sales corporations mean more than sales by single salesmen. Sales corporations themselves employ salesmen. Sales corporations take a profit on the sales made by salesmen. What was meant by this declaration was that commissions of salesmen selling for the manufacturer in the ordinary way were not to be included. Many other items enter into the sales price of the sales corporation. To allow salesmen's commissions and costs and expenses of advertising and selling to be excluded from the sale price, the amount thereof under section 619(a) supra must be established to the satisfaction of the Commissioner, and that means there must be some basis on which a deduction can be made on account of such expenses. There is nothing in the record to show the amount of such commissions and costs or what the actual expenses were. We, therefore, are not required to determine whether any deduction should be made. The determination as made by the Commissioner without any proof of actual expense of sales is right.

Plaintiff asserts that it has not collected these additional taxes. After the merger the catalogues of the sales corporations listed the goods at the same prices at which they had previously been listed in the catalogues of Bourjois, Inc., and Barbara Gould, Ltd., and stated that the prices indicated included the tax, as had the previous catalogues. The tax included in making up the price lists for the previous catalogues undoubtedly was computed on the basis of the selling prices of Bourjois, Inc., and Barbara Gould, Ltd., which prices would correspond closely to the present selling prices of the sales corporations less the amount added to cover the tax. It is to be assumed, therefore, that the prices now charged by the sales corporations include an amount equal to the tax computed on the selling price of the sales corporations, which price has been determined to be the selling price of the plaintiff, the manufacturer. It is evident that the sales corporations have collected the tax not only on the price at which the plaintiff sold to them but also on the difference between such price and the price at which the goods were offered for resale by them. Bourjois, Inc., itself has not collected the additional tax. The sales corporations have. The effect is the same as though plaintiff had collected it.

Section 621 of the Act of 1932 provides: "No overpayment of a tax * * * shall * * * be refunded * * * unless the person who paid the tax establishes * * * (1) that he has not included the tax in the price of the article, * * * or that he has repaid the tax to the ultimate purchaser." The purchaser having paid the tax, the plaintiff sustained no loss. (*United States* v. *Jefferson Electric Light Co.*, 291 U. S., 386 [Ct. D. 803, C. B. XIII-1, 393].)

For the reasons hereinbefore given, the complaint should be dismissed. Findings of fact and law are affixed hereto and are to be considered to be for and as a part of this opinion to meet the requirements of equity rule 61½.

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## REGULATIONS 46, ARTICLE 22: Scope of tax. XV-26-8146 Ct. D. 1132

### EXCISE TAX—REVENUE ACT OF 1932—REVISED STATUTES—DECISION OF COURT.

#### TOILET PREPARATION—YEAST USED AS COSMETIC—INJUNCTION TO RESTRAIN ASSESSMENT AND COLLECTION OF TAX—EVIDENCE.

**The taxpayer is not entitled to an injunction restraining the assessment and collection of an excise tax on yeast manufactured and sold by it for use as a cosmetic, where the facts fail to show (1) any real and imminent injury, (2) special and extraordinary circumstances such as to render section 3224 of the Revised Statutes inapplicable, or (3) are insufficient to justify a ruling on nontaxability as a cosmetic.**

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

*Red Star Yeast & Products Co., appellant,* v. *O. A. La Budde, Individually and as Collector of Internal Revenue for the District of Wisconsin, appellee.*

Appeal from the District Court of the United States for the Eastern District of Wisconsin.

Before EVANS and SPARKS, Circuit Judges, and LINDLEY, District Judge.

[April 13, 1936.]

OPINION.

EVANS, Circuit Judge: Appellant brought this suit to enjoin appellee, the collector of internal revenue, from attempting to assess and collect excise taxes on yeast by it manufactured and sold, or from imposing a lien for said tax upon its property. It also asked the court to find and enter a declaratory decree that yeast by it sold was not subject to the tax imposed by section 603[1] of the Revenue Act of 1932, which imposes an excise tax upon cosmetics, etc.

Appellant asserts its belief to be that, unless restrained, appellee will assess the tax and resort to remedies provided by law to enforce its payment, and the amount will be so large that payment can only be made through a liquidation of its assets.

The court issued a temporary restraining order. Thereafter, it vacated this order and denied an application for a temporary injunction. The present appeal is from the refusal to grant the temporary injunction.

Appellee's answer raised the defense presented by section 3224 (26 U. S. C. A., section 1543),[2] which prohibits the bringing of a suit to restrain the assessment or collection of any tax. It also asserted that the Commissioner had ruled that some yeast sold by appellant was subject to a tax under section 603, but no tax had as yet been assessed. It further answered that the purpose for which the yeast, upon which the tax, if assessed, would be levied, was manufactured and sold by appellant, as declared in the public radio advertisement, was for cosmetic use. It denied that the tax would be so large as to interfere with the conduct of appellant's business.

Affidavits were filed in support of the pleadings which dealt with the subject of advertising and the use of yeast for facials. Appellant argued that many articles, such as lemons, milk, flax, oatmeal, eggs, vinegar, honey, olive oil, etc., were extensively advertised and used to a certain extent, as cosmetics. On the other hand there were copies of advertisements showing that appellant's yeast was extensively sold for facials. In addition there appears in the record numerous articles extolling the benefits of yeast facials, not marked as advertisements, which were taken from newspapers.

The ruling of the district court must be sustained on any of several grounds.

(*a*) In order to justify the issuance of a temporary injunction, there must be a showing of a threatened injury. The injury must be real, not imaginary. (14 R. C. L., page 354.) Ordinarily, it must be of irreparable character, for which a money award would be inadequate. In the instant case, the Government has not yet assessed any tax against the taxpayer. Should such a tax be assessed and an attempted enforcement greatly prejudice the appellant in the conduct of its business, *pendente lite,* the court may again be appealed to. It will always be open to hear any application which may be addressed to it. Temporary injunctions differ in their finality from the final or permanent injunctions. Denial of an application for a temporary injunction does not prevent another application by the same party in the same suit, if new facts warrant it. In a suit for either injunction, however, the party seeking the relief must make a fact showing that the threatened injury is imminent.

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1 *Tax on toilet preparations, etc.*—There is hereby imposed upon the following articles, sold by the manufacturer, producer, or importer, a tax equivalent to 10 per centum of the price for which so sold: Perfumes, essences, extracts, toilet waters, cosmetics, petroleum jellies, hair oils, pomades, hair dressings, hair restoratives, hair dyes, tooth and mouth washes (except that the rate shall be 5 per centum), dentifrices (except that the rate shall be 5 per centum), tooth pastes (except that the rate shall be 5 per centum), aromatic cachous, toilet soaps (except that the rate shall be 5 per centum), toilet powders, and any similar substance, article, or preparation, by whatsoever name known or distinguished; any of the above which are used or applied or intended to be used or applied for toilet purposes.

2 No suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court.

It is unnecessary to consider the effect of the statute which permits a court to grant declaratory decrees, because the section, which authorizes suits for a declaratory decree (28 U. S. C. A., section 400), expressly excepts suits involving Federal taxes.

(*b*) Appellant has not brought its case within the rule set forth in *Miller* v. *Standard Nut Margarine Co.* (284 U. S., 498 [Ct. D. 457, C. B. XI-1, 370]); *Hill* v. *Wallace* (259 U. S., 44) so as to avoid the consequences of section 3224, Revised Statutes (26 U. S. C. A., section 1543). In the Miller case, the court was dealing with a tax on oleomargarine. There the court said:

"This is not a case in which the injunction is sought upon the mere ground of illegality because of error in the amount of the tax. The article is not covered by the Act. A valid oleomargarine tax could by no legal possibility have been assessed against respondent, and therefore the reasons underlying section 3224 apply, if at all, with little force. * * * Respondent commenced business after the product it proposed to make had repeatedly been determined by the Commissioner and adjudged in courts not to be oleomargarine or taxable under the Act, and upon the assurance from the Bureau that its product would not be taxed. * * * It is clear that, by reason of the special and extraordinary facts and circumstances, section 3224 does not apply. The lower courts rightly held respondent entitled to the injunction."

In view of the plain language of section 3224, which prohibits such suits as the instant one, we are not justified in extending the rule announced in the Miller case.

A third objection to the granting of the temporary injunction may be found in the fact showing which is insufficient to jutisfy a ruling on the nontaxability of appellant's product as a cosmetic. The fact controversy, in other words, is not closed.

If we eliminate the fact knowledge of which the court may take judicial notice, we still could not hold, in the face of the other evidence, that the appellant's product is not a cosmetic. The advertisements so describe it. The district court could hardly be expected to find that the product was not what appellant said it was in its advertisements.

Appellant argues that the court must take judicial notice of the fact that compressed yeast cakes are used primarily in bread making and beer production. True, we will take judicial notice of the use of yeast in these two industries. It by no means follows, however, that appellant's product was made for either or both of said purposes. Likewise, the statute imposing the tax, also the rules and regulations of the Department, call for information as to the percentage of appellant's yeast production used for facials. Such figures and other information are necessary to the determination of the vital question in the case—the taxability of any of appellant's product as a cosmetic.

The order is affirmed.

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## SECTION 604 OF THE REVENUE ACT OF 1932 AND SECTION 608 OF THE REVENUE ACT OF 1934.—FURS.

REGULATIONS 46, ARTICLE 25: Repairs. (Also Section 619(b), Revenue Act of 1932, and Article 15.) XV-23-8116 S. T. 837

Determination of fair market price for tax purposes in the case of sale or use of articles of fur by manufacturers who deal at retail only.

S. T. 821 (C. B. XIV-2, 367) modified.

Advice is requested relative to the proper method of determining tax liability under section 604 of the Revenue Act of 1932 and section 608 of the Revenue Act of 1934 with respect to sales of articles of fur by manufacturers who sell at retail only and in retail fur repair jobs.

Under the provisions of section 604 of the Revenue Act of 1932 and section 608 of the Revenue Act of 1934, a tax of 10 per cent of the sale price is imposed upon the sale on and after May 11, 1934, for $75 or more, by the manufacturer, producer, or importer of articles made of fur on the hide or pelt, or of which any such fur is the component material of chief value.

Section 619 of the Revenue Act of 1932 provides in part:

(b) If an article is—
(1) sold at retail:,

*   *   *   *   *   *   *

the tax under this title shall (if based on the price for which the article is sold) be computed on the price for which such articles are sold, in the ordinary course of trade, by manufacturers or producers thereof, as determined by the Commissioner.

Article 15 of Regulations 46 reads in part:

Where a manufacturer sells articles at retail, the tax on his retail sales ordinarily will be computed upon a price for which similar articles are sold by him at wholesale. * * * If he has no such sales at wholesale, a fair market price will be determined by the Commissioner.

It was held in S. T. 821 (C. B. XIV–2, 367) with respect to a retail fur repair job, that is, where a repair job is performed by a repairer directly for the consumer, that the tax should be computed upon the fair market price of the fur; and that 75 per cent of the amount charged the consumer for the job will be considered to be the fair market price of the fur, except that in localities west of the Rocky Mountains the tax should be computed upon the basis of 70 per cent of the retail sale price charged the consumer for the fur. In either case no tax would attach unless the wholesale fair market price of the fur was $75 or more.

These same percentages have been applied in determining the wholesale fair market price in cases where a manufacturer sells, at retail only, articles made of fur or of which fur is the component material of chief value.

After careful investigation and consideration of the wholesale fair market prices of articles made of fur or where fur is used in retail repair fur jobs by manufacturers who sell at retail only, it is held that 65 per cent of the retail sale price of such articles correctly reflects the wholesale fair market price in such cases within the meaning of section 619(b) of the Revenue Act of 1932 and article 15 of Regulations 46. Accordingly, manufacturing retail furriers and retail fur repairers who have no substantial sales of fur articles at wholesale are subject to tax on their retail sales on the basis of the fair market price as above determined, regardless of where their places of business are located.

With respect to fur repairs, article 25 of Regulations 46, as amended by Treasury Decision 4449 (C. B. XIII–2, 402), reads as follows:

* * * *Repairs.*—Ordinary repairs to an article made wholly or in part of fur on the hide or pelt are not taxable, but where new fur is supplied the tax attaches to the sale of such new fur. The price paid for the repair job will be presumed to be the price for which such fur is sold unless the labor and new fur are billed as separate items. Where the price attributable to the new fur is shown as a separate item on the invoice furnished to the customer, the tax will attach to the sale price of the new fur only. New fur furnished in repair jobs completed or delivered prior to May 11, 1934, is subject to tax regardless of the price charged for such fur. No tax will attach to new fur furnished in repair jobs completed on and after May 11, 1934, where the price charged for such fur is less than $75.

A person liable for the tax with respect to a retail fur repair job must maintain certain records and keep them available for examination by representatives of the Bureau for a period of four years from the date liability for the tax was incurred. A retail repairer of fur articles who invoices the price of the repair job as a lump sum will be subject to the tax based upon the price charged for the entire repair job, if $75 or more, unless he can correctly establish the sale price of the new fur used in the job by the following records—(1) an authentic job ticket, prepared at the time the article was actually repaired, showing the name, quality, size, and value of the new fur used in the repair job; (2) a copy of the invoice given to the customer at the time the article was repaired or delivered, containing the name and address of the customer, and in some manner identified with the job ticket covering the particular transaction; and (3) adequate inventory records, as well as purchase bills, covering cash and/or credit purchases of the fur materials used.

S. T. 821, supra, is modified in so far as inconsistent herewith.

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**SECTION 605 OF THE REVENUE ACT OF 1932, AS AMENDED BY SECTION 609 OF THE REVENUE ACT OF 1934.—JEWELRY, ETC.**

REGULATIONS 46, ARTICLE 15: Fair market price in case of retail sales, consignments, etc. XV-3-7915 S. T. 826

Method to be used in determining the fair market price of jewelry sold exclusively at retail.

Advice is requested relative to the proper method to be used in determining the fair market price of articles taxable under section 605 of the Revenue Act of 1932, as amended by section 609 of the Revenue Act of 1934, which are sold exclusively at retail.

Section 605 (Title IV) of the Revenue Act of 1932, as amended, imposes a tax upon articles commonly or commercially known as jewelry sold by the manufacturer, producer, or importer. Section 619(b)1 of the Revenue Act of 1932 provides in part that if an article is sold at retail the tax under Title IV shall (if based on the price for which the article is sold) be computed on the price for which such articles are sold in the ordinary course of trade by manufacturers or producers thereof, as determined by the Commissioner.

It appears that considerable confusion and lack of uniformity exists in the jewelry trade as to the proper basis under section 619(b)1 on which producers selling exclusively at retail should pay tax incurred under section 605 of the Revenue Act of 1932, as amended. This is particularly true with respect to ring mountings, precious stones, watch cases, and watch movements purchased by retail jewelers from the producers thereof and later assembled and sold to customers.

Manufacturers of rings and watches, fully assembled, often sell them in the ordinary course of trade to retail jewelers and pay tax on the actual wholesale price, but more frequently they sell to such jewelers stones, mountings, watch movements, and watch cases ready for assembly but not actually assembled in order that the retail jeweler may offer to his customers a wider selection of possible combinations. The labor involved in assembling such completed parts is not very material but by assembling them the retail jeweler becomes a *producer* of rings and watches and is, therefore, subject to tax on his sales. If he sells at retail, section 619(b)1 provides that the tax shall be computed on the price at which such articles are sold in the ordinary course of trade by manufacturers, producers, or importers thereof. This provision is construed as relating to the price at which fully assembled articles are normally sold at wholesale in the open market by manufacturers, producers, or importers.

Some retail jewelers have purchased unassembled parts tax-paid from the producers or their jobbers, but have paid no tax on their sales of rings or watches assembled by them from such tax-paid parts on the ground that the price to the retail jeweler is deemed to be the same whether the purchase is made in assembled or unassembled form. Other retail jewelers have purchased these unassembled parts tax-free in accordance with regulations promulgated under authority of section 620 of the Revenue Act of 1932, as amended, with respect to articles intended for further manufacture. On their sales at retail of articles assembled from such parts, they have paid tax on the price which they paid for the parts without including any amount to cover the cost of assembly, overhead, or profit. In some cases rings and watches assembled by retail jewelers have been sold for various reasons at less than the cost.

In attempting to fix a basis on which the tax should be paid by persons selling at retail, it has been found desirable to fix the open market wholesale price as a definite percentage of the actual retail price. However, this plan requires the application of a different percentage or formula where the jeweler selling at retail is not using the ordinary merchandising method of selling for cash or on open account. Examples of such exceptions to the general rule are sales under installment contracts and sales of class rings and pins.

In accordance with the authority conferred upon the Commissioner by section 619(b) of the Revenue Act of 1932, as amended, it has been determined that on and after June 21, 1932, the tax on sales of rings and watches by manufacturers, producers, or importers selling at retail who do not sell like articles at wholesale shall be computed as follows:

(1) The tax is due on an amount equivalent to 55 per cent of the actual retail price for which the article was sold during the period June 21, 1932, to June 2, 1933, inclusive, and on an amount equivalent to 60 per cent of the actual retail price on or after June 3, 1933 (when the percentage rate was changed from the former rate to the latter), except that—

(*a*) Where rings and watches are sold under installment contracts and where 60 per cent of the actual retail price is less than cost plus 15 per cent, the tax is due on the sum of the actual cost of all the parts and materials used plus 15 per cent (which percentage covers the charge, if any, for assembling, overhead, profit, and that portion of the selling and administrative expenses applicable to a fair wholesale price); and except that—

(*b*) Where goods are sold for less than original cost because of changed market conditions or other reasons, the tax may be computed on the sum of the current replacement value of the parts (instead of on the original cost of such parts) plus 15 per cent; or, if sold at less than such current replacement value, the tax is due on the actual sale price.

(2) Where watch parts, diamonds, and mountings are purchased tax-paid by the retailer who assembles them, such retailer may, in computing the tax due the Government on the sale of the completed articles, take credit for the tax paid by the prior manufacturers from whom such articles were purchased. In such cases, however, it is necessary that the retailer have in his possession evidence showing the amount of the tax the manufacturer actually paid to the Government on the sale of the watch parts, diamonds, and mountings.

(3) Where school class rings and pins, not tax-paid, were sold by the retailer during the period June 21, 1932, to May 21, 1933, inclusive, the tax is due on an amount equivalent to 55 per cent of the retail sale price; and when sold on and after May 22, 1933 (when the rate of percentage was changed, S. T. 672, C. B. XII-1, 395), the tax is due on 67 per cent of the retail sale price.

The taxes due on all sales taxable under section 605, as amended, which were made on or before December 31, 1935, may be computed at 10 per cent of the fair market price determined in accordance with the rules specified hereinbefore and thereafter, until further notice, on the basis of one-eleventh of the fair market price as so determined.

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REGULATIONS 46, ARTICLE 29: Jewelry. XV-5-7933
S. T. 827

**Taxability of charges for engraving articles subject to tax under section 605 of the Revenue Act of 1932, as amended.**

Advice is requested whether charges for engraving articles taxable under section 605 of the Revenue Act of 1932, as amended by section 609 of the Revenue Act of 1934, should be included in computing the tax imposed by those Acts.

Section 605 of the Revenue Act of 1932 imposes a tax equivalent to 10 per cent of the price for which articles commonly or commercially known as jewelry, whether real or imitation, and other specified articles, are sold by the manufacturer, producer, or importer, provided such price is $3 or more. Under the amendment of section 605 by section 609 of the Revenue Act of 1934, effective on and after May 11, 1934, the tax attaches only where the selling price is $25 or more.

If the order provides that the article will be sold for a certain price and such price includes the amount charged for engraving, it is held that the tax imposed under section 605 of the Revenue Act of 1932, as amended, attaches to the entire price, provided it is $3 or more where the sale was made prior to May 11, 1934, or $25 or more where the sale was made on or after that date. If, however, after agreeing upon the price of the article, the retail jeweler requests that it be engraved, it is held that the amount charged for engraving is not a part of the price of the article, and that if such amount is shown on the invoice as a separate item, the tax imposed under section 605, as amended, will not attach to the price so charged.

## SECTION 606.—AUTOMOBILES, ETC.

REGULATIONS 46, ARTICLE 41: Definition of parts or accessories. XV–19–8080 S. T. 834

Baby auto seats, auto beds, and auto hammocks are taxable as automobile accessories.

Advice is requested whether baby auto seats, auto beds, and auto hammocks are automobile accessories within the meaning of section 606(c) of the Revenue Act of 1932.

That Act imposes a tax equivalent to 2 per cent of the price for which automobile parts or accessories are sold by the manufacturer, producer, or importer.

Article 41 of Regulations 46 provides in part as follows:

* * * The term "parts or accessories" for an automobile truck or other automobile chassis or body, or motor cycle, includes * * * (b) any article designed to be attached to or used in connection with such vehicle or article to add to its utility or ornamentation, or (c) any article the primary use of which is in connection with such vehicle or article whether or not essential to its operation or use.

The baby auto seats, auto beds, and auto hammocks in question are of steel frame construction covered with duck or other suitable material. The seats and beds are equipped with rubber covered hooks or arms which may be bent or adjusted to hang over the back of any automobile seat. Some of the seats and beds also have rubber covered steel legs which rest upon the automobile seat cushion. The baby auto hammocks are of the same general construction but are equipped with straps, safety springs, and snaps, rather than with hooks or arms, and are suspended from the top of the automobile instead of from the back of the seat. All of the articles are primarily designed to be attached to, and used in, automobiles.

It is held that baby auto seats, auto beds, and auto hammocks so designed and used are automobile accessories within the meaning of section 606(c) of the Revenue Act of 1932 and article 41 of Regulations 46 and as such are subject to the tax imposed by that Act.

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## SECTION 609.—SPORTING GOODS.

REGULATIONS 46, ARTICLE 53: Scope of tax. XV–19–8081 S. T. 835

Taxability of certain types of shoes under section 609 of the Revenue Act of 1932. S. T. 811 (C. B. XIV–1, 409) modified.

Advice is requested whether shoes which are readily usable for general outdoor wear and are not especially designed, advertised, and sold by the manufacturer, producer, or importer for use in specific sports are subject to the tax imposed by section 609 of the Revenue Act of 1932 on the sale of sporting goods.

That section imposes a tax on the sale by the manufacturer, producer, or importer of specified articles, including certain types of shoes, and all similar articles commonly or commercially known as sporting goods, equivalent to 10 per centum of the price for which sold.

Article 53 of Regulations 46 reads in part as follows:

The term "sporting goods" includes all articles of the same general character as those specifically named, the purpose of which is primarily for use either indoors or outdoors in connection with a game or sport.

As a general rule, shoes having soles and heels equipped with spikes, cleats, or caulks will be regarded as being designed for use in specific sports, such as baseball, football, track, or golf, and, therefore, subject to tax, unless it clearly appears that the purpose of the spikes, cleats, or caulks is to adapt the shoes to use for purposes other than sports.

It is held, however, that shoes which are readily usable for general outdoor wear and are not especially designed, advertised, and sold by the manufacturer, producer, or importer for use in specific sports are not subject to the tax imposed by section 609 of the Revenue Act of 1932.

S. T. 811 (C. B. XIV-1, 409) is modified accordingly.

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REGULATIONS 46, ARTICLE 55: Games. XV-11-8000
G. C. M. 16347

A coin-operated machine designed to afford sport, recreation, or amusement is taxable as a game regardless of any vending feature.

An opinion is requested whether a coin-operated machine designed to afford sport, recreation, or amusement, the operation of which involves an element of chance or skill, is taxable as a game under section 609 of the Revenue Act of 1932 where the machine at the same time provides a vending service.

Section 609 of the Revenue Act of 1932 imposes a tax of 10 per cent upon the price for which games and parts of games are sold by the manufacturer, producer, or importer.

Article 53 of Regulations 46 provides in part as follows:

The term "game" includes games of skill or chance and every contrivance, device or combination of articles which is designed to furnish sport, recreation, or amusement. * * *

The following described machines are representative of the types of machines involved:

(*a*) The X machine permits the player upon the insertion of a coin to receive an amount of money if the spinning reels of the machine come to rest on certain combinations, the result depending upon the combination obtained.

(*b*) Upon the insertion of a coin, the Y machine delivers to the player a small quantity of gum or mints and, in addition, affords the player a chance of receiving a number of tokens should the spinning reels come to rest on certain combinations. These tokens may be used in replaying the machine. Also, the reels contain "Fortunes" or "Witty Sayings" which are designed to furnish a certain amount of amusement to the player.

(*c*) The Z machine operates a miniature crane. After the insertion of a coin the player by turning a knob may, if he manipulates the claws of the crane successfully, secure a premium or candy from the glass-inclosed compartment in which the device is installed.

Coin-operated machines used for gambling purposes have been held taxable as games under section 609 of the Revenue Act of 1932. (*Mills Novelty Co.* v. *United States*, 72 Ct. Cls., 443, 50 Fed. (2d), 476, certiorari denied, 285 U. S., 547.) The court stated that "* * * Congress used the words 'games and parts of games' as a sort of 'catch all' or 'basket clause,' that is, it was intended to catch and bring within the revenue net all kinds of articles used in playing games whether they were included in the list that preceded or not. * * *"

It is not seriously contended that the Y and Z machines, which release to the player a small amount of gum, mints, or other merchandise upon the insertion of a coin, are operated primarily for their vending service. The amount of gum, mints, or merchandise dispensed by the machines is usually much less than can normally be purchased with the coin inserted. It follows that the player is operating the machine, not for the vending service, but chiefly for sport, recreation, or amusement. Moreover, most of the machines are equipped with vending attachments which do not affect their operation when the vending compartment is empty. This is indicative of the fact that the machines are not designed primarily as vending machines.

There are some devices of this character which are *bona fide* vending machines, that is, the one who deposits a coin receives a *quid pro quo* in the form of merchandise of some sort. Such a device, even though novel in operation, would be a vending machine and not a game. However, where, as in the instant case, the vending feature is merely incidental, this feature should not govern in classifying the article for tax purposes.

In view of the foregoing, it is the opinion of this office that where a machine is designed to afford sport, recreation, or amusement, and involves either chance or skill (features involved in all three of the machines described herein), it is taxable as a game under section 609 of the Revenue Act of 1932, even though the machine at the same time furnishes an incidental vending service.

In view of the fact that the Bureau has previously taken different positions with respect to such machines and that many of them have been sold in reliance upon such rulings, it is recommended, under the authority of section 1108(a) of the Revenue Act of 1926, as amended by section 506 of the Revenue Act of 1934, that this opinion be applied without retroactive effect in respect of sales of such machines made in reliance upon rulings to the effect that the sales were not taxable.

HERMAN OLIPHANT,
*General Counsel for the Department of the Treasury.*

Approved.

GUY T. HELVERING,
*Commissioner.*

STEPHEN B. GIBBONS,
*Acting Secretary.*

**SECTION 620 OF THE REVENUE ACT OF 1932, AS AMENDED BY SECTION 4 OF THE ACT OF JUNE 16, 1933 (48 STAT., 254), AND BY SECTION 401 OF THE REVENUE ACT OF 1935.—TAX-FREE SALES.**

XV-8-7968

Excerpts from an opinion rendered by the Comptroller General of the United States to the Secretary of the Navy on January 7, 1936, relative to the inclusion or exclusion of the manufacturers' excise tax in the sales price of articles sold for the exclusive use of the United States.

The Secretary of the Navy requested the Comptroller General of the United States to render a decision concerning the methods which should be adopted in making specifications, bids, and purchases for the Navy in respect of excise taxes normally due on certain articles but which under recent legislation may be sold by the manufacturer, producer, or importer for the use of the United States free from tax. Pertinent extracts from the Comptroller General's opinion are as follows:

Section 401 of the Revenue Act of 1935, Public, No. 407, August 30, 1935, amended section 620, "Tax-free sales," of the Revenue Act of 1932, as amended by section 4 of the Act of June 16, 1933 (48 Stat., 255), so as to provide in substance that under regulations prescribed by the Commissioner of Internal Revenue with the approval of the Secretary of the Treasury, no tax under said Title IV shall be imposed with respect to the sale of any article for the exclusive use of the United States, any State, Territory of the United States, or any political subdivision of the foregoing, or the District of Columbia.

Section 621, "Credits and returns," of the 1932 Act, as amended by section 4 of the Act of June 16, 1933 (48 Stat., 255), was further amended by the Act of August 30, 1935, to provide that a credit against tax under the title or a refund, may be allowed or made to a manufacturer, producer, or importer in the amount of the tax paid by him under the title with respect to the sale of any article to any vendee, if the manufacturer, producer, or importer has in his possession such evidence as the regulations may prescribe that on or after the 1st day of the second month following the date of the enactment of the Revenue Act of 1935, such article was, *by any person*, resold for the exclusive use of the United States, any State, Territory of the United States, or any political subdivision of the foregoing, or the District of Columbia.

The Commissioner of Internal Revenue has issued regulations and amendments to existing regulations to meet the provisions of the Revenue Act of 1935. Those regulations were approved by the Acting Secretary of the Treasury November 12, 1935, are designated Treasury Decisions 4604 and 4605, * * *.

These regulations and the regulations which they amend prescribe in detail the procedure to be followed by the manufacturer, producer, or importer to obtain a credit against the tax or a refund thereof, both where a sale is made by the manufacturer, producer, or importer, direct to the United States, or to others who resell to the United States. The whole procedure is dependent upon the production by the manufacturer, producer, or importer of evidence satisfactory to the Commissioner of Internal Revenue that the articles involved have in fact been sold either directly or through other purchasers, for the exclusive use of the United States and that the United States has not paid the amount of the tax as a part of the purchase price or otherwise.

* * * * * * *

In view of the terms of the law and the regulations of the Commissioner of Internal Revenue, it appears desirable in future specifications to require only that where the bidder is manufacturer, producer, or importer of any article subject to excise tax under Title IV of the Revenue Act of 1932, as amended, the bidder state whether the amount of such tax has been considered in fixing the amount of his bid and whether he has claimed or will claim exemption from, credit for, or refund of such tax with respect to the sale of said articles. There is suggested the following, which would appear adequate:

"*To be executed only where the bidder is manufacturer, producer, or importer of any article bid on which is subject to excise tax under Title IV of the Revenue Act of 1932, as amended.* The amount of Federal taxes paid or payable on articles subject to tax under Title IV of the Revenue Act of 1932, as amended, are (included/excluded) in the prices bid herein, and the bidder (has/has not) claimed and/or (will/will not) claim exemption from, credit for, or refund of such tax with respect to sale of said articles, as provided by law."

No other provision with respect to any existing Federal tax should appear in the bid or contract.

* * * For the purpose of payment under a Government contract, the contractor may be presumed to have *included* in his bid price all necessary elements of cost, but where the interests of the Government are concerned it may not be presumed that a bidder has *excluded* an unauthorized item. It is to be observed further, that in order to obtain a credit or refund of the tax in the event it is not included, that fact must be established by a contractor or the manufacturer, producer, or importer entitled thereto. In order to obtain such relief there must be furnished an affidavit by a responsible representative of the Government to that effect. It would seem, therefore, both in the interests of the contractor and the United States that it be definitely established in every instance that the tax has or has not been included in the bid price, as the case may be. However, the ultimate result will be same in either event. If the bid price included the tax the contract price should be paid but no representative of a department or agency of the Government should make any affidavit or statement whereby a contractor may obtain relief. If, on the other hand, it be established that the tax was excluded in submission of the bid, the contractor would be entitled upon establishment of that fact, to claim a refund from the Commissioner of Internal Revenue.

* * * * * * *

In view of the conclusion reached above, no adjustment in price by reason of the inclusion of the tax in connection with deliveries of material on or after October 1, 1935, on contracts based on bids opened prior to August 30, 1935, appears necessary. Where a bidder in submitting a bid certified that the prices included Federal tax, payment should be made at the contract price and no possible undertaking to obtain relief from the taxes should be considered.

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## SECTION 620 OF THE REVENUE ACT OF 1932, AS AMENDED BY SECTION 4 OF THE ACT OF JUNE 16, 1933 (48 STAT., 254), AND BY SECTION 401 OF THE REVENUE ACT OF 1935.—TAX-FREE SALES. (ALSO SECTION 619 OF THE REVENUE ACT OF 1932.)

XV–18–8070

Opinion rendered by the Comptroller General of the United States to the Administrator of Veterans' Affairs on April 14, 1936, relative to the inclusion or exclusion of the manufacturers' excise tax in the price of articles sold for the exclusive use of the United States.

A–67334 April 14, 1936.

The Administrator of Veterans Affairs,
Veterans' Administration.

Sir: There were received your letters of February 5 and March 3, 1936, in regard to your letter of December 12, 1935, as follows:

Receipt is acknowledged of your letter of November 29, 1935 (A–67334), relative to deduction of Federal excise tax under the provision of section 401 of the "Revenue Act of 1935," Public, No. 407, Seventy-fourth Congress.

In my letter of November 4, 1935, reference was made to Veterans Administration contracts VAs-1599, VAs-1600 and VAs-1605, covering requirements for toilet soap and request was made that you indicate procedure to be followed in deducting excise tax, to which you have responded in your letter of November 29, 1935, as follows:

"Articles delivered under the contracts in question on and after October 1, 1935, are exempt from the taxes imposed by section 603 of the Revenue Act of 1932. Such taxes were imposed as a percentage of the selling price and may be determined definitely by simple calculations. An amount equal to the taxes in effect and applicable to the articles in question at the time contracts were executed should be deducted from the contract price on all articles delivered under the contracts in question after September 30, 1935. It will be for the contractors to make such showing to the Bureau of Internal Revenue as may be necessary to secure exemption from such taxes on the articles in question delivered after October 1, 1935, or if the taxes are paid, to secure refund thereof."

The rate of tax imposed on toilet soap by section 603, Title IV of the Revenue Act of 1932 is a certain percentage of the manufacturer's sale price and the basis of computation is as outlined in articles 8 to 15 inclusive of Bureau of Internal Revenue Regulations 46. Article 12 of these regulations states that "Charges for transportation, delivery, insurance, installation, and other charges which have no connection whatever with the manufacturing process or with placing the article in a finished condition packed and ready for shipment are to be excluded in computing the tax." The contract prices of the toilet soap covered by the contracts above referred to include transportation charges f. o. b. railroad destinations of Veterans Administration facilities, also include applicable tax, and there may be other items not subject to tax included in the contract prices. It is inferred from the statements in the above quoted paragraph of your decision of November 29, 1935, that the amount to be deducted as tax shall be determined by applying the rate of tax to the contract prices, deducting therefrom the result, but it appears that such procedure would be improper in view of the basis prescribed by the Bureau of Internal Revenue for determining tax.

In view of the conditions governing the computation of tax, as above outlined, it appears that it will be impossible for the Veterans Administration to readily determine the amount deductible as tax from the contract prices of toilet soap or other taxable commodities covered by contracts which include tax, whether purchased directly from a manufacturer or from a dealer where title passes through one or more persons in a chain of sales from the manufacturer to the Veterans Administration, and your further consideration of the matter presented in my letter of November 4, 1935, and advice as to data required on vouchers involving taxable commodities delivered under contracts which include tax is requested and will be appreciated.

The "selling price" referred to in decision of November 29, 1935, has reference to the manufacturer's sale price, which is the basis of the tax. Bureau of Internal Revenue Regulations 46, approved June 18, 1932, referred to in your letter, among other things provide:

ART. 8. *Basis of tax on sales generally.*—The tax is imposed on each sale by the manufacturer of the articles enumerated in these regulations. The provisions of the Act quoted embody the rules for determining the sale price, which is the basis of the tax. In general, this should be the manufacturer's actual price at the factory or place of production. In determining the sale price, for tax purposes, there shall be included any charge incident to placing the article in condition packed ready for shipment. There shall be excluded (1) the amount of tax imposed by Title IV, whether or not billed as a separate item, and (2) (subject to the provisions of article 12) transportation, delivery, insurance, installation, or other charges (not required by the preceding sentence to be included).

ART. 10. *Charges for coverings, containers, etc.*—Any charges for coverings, containers, etc., incident to placing the article in condition packed ready for shipment shall be included as a part of the sale price for the purpose of computing the tax. Therefore, the amount paid for the article and its covering or container is the basis for computing the tax even though a separate charge for such covering or container is billed on the invoice. * * *

ART. 12. *Exclusion of charges for transportation, delivery, etc.*—Charges for transportation, delivery, insurance, installation, and other charges which have no connection whatever with the manufacturing process or with placing the article in a finished condition packed and ready for shipment, are to be excluded in computing the tax. Any additional charge which a purchaser would not be required to pay if he accepted delivery of the article at the factory may be so excluded.

Pursuant to the Revenue Act of 1935 (49 Stat., 1025), the Commissioner of Internal Revenue has issued regulations and amendments to existing regulations to cover the right to tax exemption from, and refund or credit of, certain excise taxes on articles sold for the exclusive use of the United States, etc. Those regulations and amendments were approved by the Acting Secretary of the Treasury November 12, 1935, the relevant parts of which are quoted in 15 Comp. Gen., 588, 590, and repetition here is unnecessary.

Where the manufacturer's actual price at the factory or place of production, that is, the basis of the tax, is not known or is difficult to determine, the itemization of the tax in the certified voucher of a contractor may be accepted as the correct amount of such tax. In such cases, the amount of the tax deducted should be stated in the administrative certificate, or affidavit by the representative of the department or agency of the Government or other evidence furnished in order to enable the manufacturer, producer, or importer, to obtain credit or refund of the tax.

While the contracts involved authorize deduction from the contract price of an amount equal to the excise taxes in effect at the time the contracts were executed which said taxes were made inapplicable to the articles covered by the contracts and delivered on and after October 1, 1935, by the act of August 30, 1935, such action is not required. (See decisions of January 7, 1936, A-67600, 15 Comp. Gen., 588, supra; February 3, 1936, A-69751, 15 Comp. Gen., 686; February 11, 1936, A-68693, 15 Comp. Gen., 694; and February 25, 1936, A-70629, 15 Comp. Gen., 728.)

If the amount is deducted, it will be refunded by the Commissioner of Internal Revenue; if it is not deducted and the full contract price is paid, no administrative certificate, or other evidence, upon which a claim for refund or credit might be established should be furnished. The net result to the United States is the same in either case. If for administrative reasons, deduction of an amount equal to the excise taxes in effect at the time the contract was entered into and not now for imposing, is impracticable, there is no legal objection to payment of the full contract price for articles delivered under the contracts subsequent to September 30, 1935.

You are advised accordingly.

Respectfully,

J. R. McCARL,
*Comptroller General of the United States.*

# TITLE V.—ADMISSIONS AND DUES. (1926)

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## SECTION 500(a)1 OF THE REVENUE ACT OF 1926, AS AMENDED BY SECTION 411(a) OF THE REVENUE ACT OF 1928 AND BY SECTION 711(a) OF THE REVENUE ACT OF 1932.

REGULATIONS 43, ARTICLE 1: Basis, rate, and computation of tax. XV-12-8011 S. T. 831
(Also Section 500(b) and Article 24.)

Payments for admissions to theatrical performances sponsored by the Works Progress Administration are taxable, except where the payment is less than 41 cents.

Advice is requested whether payments for admissions to theatrical performances sponsored by the Works Progress Administration are subject to tax under section 500(a)1 of the Revenue Act of 1926, as amended by section 411(a) of the Revenue Act of 1928 and by section 711(a) of the Revenue Act of 1932.

Section 500(a)1, as amended, imposes a tax of 1 cent for each 10 cents or fraction thereof paid for admission to any place if the amount paid is 41 cents or more. The tax is payable by the person paying for admission and must be collected by the person to whom the admission charge is paid. Section 500(b) of the Revenue Act of 1926 provides for certain exemptions from the tax.

The Works Progress Administration was established by Executive Order on May 6, 1935, under the authority conferred by Public Resolution No. 11, Seventy-fourth Congress. A portion of the funds appropriated by the Emergency Relief Appropriation Act of 1935 has been made available to the Works Progress Administration for use in providing employment for professional persons, such as actors, artists, musicians, and writers. In order to accomplish such purpose, the Works Progress Administration is sponsoring theatrical performances to which admission charges will be made. The proceeds from the admission charges will be used for the transportation and subsistence expenses of the troupe, necessary materials and supplies, rental of theaters, and compensation of extra workers. The compensation of the actors, musicians, and other members of the troupe will be paid from Federal funds.

The Works Progress Administration does not come within any of the classes of organizations which are exempt under section 500(b) of the Revenue Act of 1926. No exemption is provided with respect to payments for admissions collected by an agency of the Federal Government as such.

It is held that amounts paid for admission to theatrical performances sponsored by the Works Progress Administration are subject to tax under section 500(a)1 of the Revenue Act of 1926, as amended, if the admission charge is 41 cents or more, and must be collected by representatives of that organization and paid over to the collector of internal revenue.

SECTION 502 OF THE REVENUE ACT OF 1926, AS AMENDED BY SECTION 414 OF THE REVENUE ACT OF 1928.

REGULATIONS 43, ARTICLE 43: Duty to collect, return, and pay tax—Admissions. (Also Section 607, Revenue Act of 1934.) XV-24-8125 G. C. M. 16543

Officers of a corporation may be held personally liable for taxes on admissions collected by the corporation but not paid over to the United States.

Advice is requested whether the officers of a corporation may be held personally liable for taxes on admissions collected by the corporation but not paid over to the United States.

The facts in the case in which the present issue arose are that a certain corporation sold taxable tickets of admission and collected the admission taxes thereon but failed to pay the taxes to the Government. The amount of the taxes collected was used for other purposes and funds are not now available to pay the assessment which has been made against the corporation.

The admissions tax is imposed by section 500 of the Revenue Act of 1926, as amended. Section 502(a) of the Act, as amended by section 414 of the Revenue Act of 1928, provides that every person receiving any payments for admissions shall collect the amount of the tax from the person making such payments, make returns thereof, and pay the tax so collected to the collector of internal revenue for the district in which the principal office or place of business is located.

Section 607 of the Revenue Act of 1934 provides as follows:

Whenever any person is required to collect or withhold any internal-revenue tax from any other person and to pay such tax over to the United States, the amount of tax so collected or withheld shall be held to be a special fund in trust for the United States. The amount of such fund shall be assessed, collected, and paid in the same manner and subject to the same provisions and limitations (including penalties) as are applicable with respect to the taxes from which such fund arose.

Under the provisions of section 1114(b) of the Revenue Act of 1926, any person who willfully fails to collect or truthfully account for and pay over such tax shall, in addition to the other penalties provided by law, be guilty of a felony and upon conviction shall be fined or imprisoned. Under section 1114(d) such person shall, in addition to the other penalties provided by law, be liable to a penalty of the amount of tax evaded, or not paid, collected, or accounted for and paid over, to be assessed and collected in the same manner as taxes are assessed and collected.

Section 1114(f) of the Revenue Act of 1926 provides:

* * * The term "person" as used in this section includes an officer or employee of a corporation or a member or employee of a partnership, who as such officer, employee, or member is under a duty to perform the act in respect of which the violation occurs.

It is well established that where an officer of a corporation, knowing it to be insolvent, participates in the use, for the benefit of the corporation, of trust funds, he is personally liable for such funds whether he agreed to be responsible or not. Where money in the hands of a corporation is earmarked as belonging to a third person, the corporate officers are liable for its misapplication whether or not the corporation is insolvent. In 14a, C. J., page 180, it is stated:

* * * The rule that directors, officers, or agents, of a corporation are liable for their torts to a person injured thereby is applicable where they are guilty of conversion. This is true, even though they act as officers in behalf of the corporation and although the corporation may also be liable, as where money or property of a third person is in the hands of the corporation and the officers in control of the fund knowingly and intentionally convert it by refusing to give up possession, or by applying it to the uses of the corporation. All who are concerned in the wrong are personally liable. A director who has knowledge that a business corporation was receiving deposits of money for safe-keeping and that the officers were misappropriating them is liable for the misappropriation unless he protested and took steps to prevent loss to the depositors. Also directors are liable to a third person whose money has been misappropriated by officers or employees of the corporation where their negligence enabled, and was the proximate cause of such misappropriation. * * *

In *United States* v. *Thomas* (15 Wall. (82 U. S.), 337), the United States Supreme Court said:

* * * Trustees are only bound to exercise the same care and solicitude with regard to the trust property which they would exercise with regard to their own. Equity will not exact more of them. They are not liable for a loss by theft without their fault. But this exemption ceases when they mix the trust-money with their own, whereby it loses its identity, and they become mere debtors. * * *

The primary liability for admissions and other taxes within the scope of section 607 of the Revenue Act of 1934 is on the corporate or other principal required to make collection. Such taxes, together with the *ad valorem* penalties ordinarily assessable, may be assessed under section 607. However, section 607 has no application to, and, therefore, does not render assessable penalties which are not ordinarily assessable.

Where the facts warrant such action, resort may be had to the officers or a corporation for the collection of admissions taxes. A responsible corporate officer who fails, whether willfully in a legal sense or not, to pay over taxes within the scope of section 607, or permits the use of such taxes for corporate purposes, is personally liable therefor. Where an officer of a corporation who is under a duty to pay over taxes within the scope of section 607 fails to do so, he incurs personal liability to a penalty equal to the tax. This penalty is assessable by virtue of section 1114(f) of the Revenue Act of 1926, supra, regardless of section 607.

HERMAN OLIPHANT,
*General Counsel for the Department of the Treasury.*

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## TITLE VIII.—STAMP TAXES. (1926)

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### SCHEDULE A-1, AS AMENDED BY SECTION 721(a) OF THE REVENUE ACT OF 1932.—BONDS, DEBENTURES, AND CERTIFICATES OF INDEBTEDNESS.

REGULATIONS 71, ARTICLE 8: Bonds renewed by agreement extending mortgage. XV-18-8068
Ct. D. 1112

STAMP TAX—REVENUE ACTS OF 1926 AND 1932—DECISION OF COURT.

1. BONDS OF INDEBTEDNESS—SUPPLEMENTAL AGREEMENT—POSTPONEMENT OF MATURITY—RENEWAL.

In 1927 the taxpayer issued bonds secured by a mortgage, under the terms of which modifications of the mortgage provisions were authorized. Pursuant to that authority, a supplemental indenture was executed in 1933, by which the maturity dates of all then outstanding bonds were extended for periods of five years; indorsements of the extensions of maturity dates were made upon the bonds, and additional interest coupons to cover the extended periods were issued. Certain additional provisions were made relating to the conduct of the business and the powers and duties of the trustee. The supplemental indenture, and acts done pursuant thereto, postponed the maturities of the bonds and was therefore a renewal within the meaning of the proviso clause of Title VIII, Schedule A-1, of the Revenue Act of 1926 and article 8 of Regulations 71, and was subject to the tax imposed by that title, as amended by the Revenue Act of 1932.

2. Certiorari Denied.

Petition for certiorari denied March 16, 1936.

United States Circuit Court of Appeals for the Fifth Circuit.

*George L. Sheldon, Collector of Internal Revenue, appellant,* v. *Mississippi Cottonseed Products Co., appellee.*

Appeal from the District Court of the United States for the Southern District of Mississippi.

Before Sibley, Hutcheson, and Walker, Circuit Judges.

[January 8, 1936.]

OPINION.

Walker, Circuit Judge: The appellee, a Delaware corporation, brought this action to recover the amount, $945, of documentary stamp taxes exacted of it in circumstances mentioned below, with interest thereon. Appellee's original declaration contained two counts, one of which was withdrawn by it. Appellant's demurrer to the remaining count was overruled, and, upon appellant declining to plead further, final judgment was rendered in favor of the appellee. Allegations of the count demurred to showed the following: In July, 1927, appellee issued its bonds, with interest coupons, in the total amount of $1,250,000, and executed its mortgage to secure those bonds, which, in different amounts, were payable serially in successive years, beginning July 1, 1929, and ending July 1, 1942, when $350,000 of the bonds were payable. The mortgage contained a provision which, among other things, empowered the holders of 90 per cent of the principal amount of bonds outstanding at any time, with the consent of appellee and the corporate trustee named in the mortgage, to assent to and authorize any modification of the provision of the mortgage, such modification to be set forth in a supplemental indenture between the appellee and the trustee in the mortgage. Pursuant to that provision, on or about January 1, 1933, when there had been no default of any kind or character in the payment of the then outstanding bonds amounting to $945,000, by an instrument called "a supplemental indenture," to which appellee, the trustee in said mortgage, and a named bank, depository of 90 per cent in principal amount of all said bonds then outstanding, were parties, the maturity dates of all then outstanding bonds were extended for periods of five years. That instrument contained recitals to the effect that, due to the chaotic economic conditions for which appellee was in no way responsible, provisions of both the bonds and the mortgage securing them had become impossible of performance in respects mentioned. The depository indorsed on each of the then outstanding bonds the following: "The maturity date of this bond is hereby extended five years. Dated as at July 1, 1933." At the time of the execution of said supplemental indenture appellee issued additional interest coupons to cover interest for the five years for which said bonds were extended, and such coupons were delivered to the holders of said bonds. The above mentioned supplemental indenture contained, in addition to what said mortgage contained, provisions whereby appellee agreed to do, or refrain from doing, stated things in the conduct of its business; and also provisions which conferred or imposed upon the corporate trustee named in said mortgage specified powers and duties. Upon the Commissioner of Internal Revenue ruling that the transaction evidenced by the above-mentioned instruments was subject to the stamp taxes prescribed by Schedule A-1 of Title VIII of the

Revenue Act of 1926 (44 Stat., 99–101, 26 U. S. C. A., section 901(1)), and amended by the Revenue Act of 1932 (47 Stat., 169, 26 U. S. C. A., section 901), and demanding of the appellee the payment of such tax in the sum of $945, appellee paid that sum under protest, and duly claimed the refund of the sum so paid, which claim for refund was denied.

The above cited provision of the Revenue Act of 1926 reads as follows:

"SEC. 800. On and after the expiration of 30 days after the enactment of this Act there shall be levied, collected, and paid, for and in respect of the several bonds, debentures, or certificates of stock and of indebtedness, and other documents, instruments, matters, and things mentioned and described in Schedule A of this title, * * * the several taxes specified in such schedule. * * *

"SCHEDULE A.—STAMP TAXES.

"1. Bonds of indebtedness: On all bonds, debentures, or certificates of indebtedness issued by any corporation, and all instruments, however termed, issued by any corporation with interest coupons or in registered form, known generally as corporate securities, on each $100 of face value or fraction thereof, 5 cents: *Provided*, That every renewal of the foregoing shall be taxed as a new issue: * * *"

So far as is material in this case, the amendment of the just set out provision made by the above cited provision of the Revenue Act of 1932 consisted in striking from subdivision 1 of said Schedule A the words "5 cents," and inserting in lieu thereof "10 cents."

The decision of this case turns upon the meaning of the word "renewal" in the above set out proviso, "That every renewal of the foregoing shall be taxed as a new issue." The word "renewal" has different meanings, varying with the subjects with reference to which it is used. One of the definitions of the word "renew" found in Webster's New International Dictionary is: "To grant or obtain extension of; to continue in force for a fresh period; as to renew a note or a bond." As commonly used with reference to notes and bonds the word "renewal" imports a postponement of the maturity of the obligation dealt with, an extension of the time in which that obligation may be discharged. (*Lowry National Bank* v. *Fickett*, 122 Ga., 489; *Wilson* v. *Rousseau*, 4 How., 646, 697; *Farmers' Loan & Trust Co.* v. *Central Park, N. & E. R. R. Co.*, 193 Fed., 963.) With reference to the word "renewal" the following was said in the opinion in the case of *Lowry National Bank* v. *Fickett*, supra:

"In law it has been defined to be an obligation on which time of payment is extended. English Law Dict. It has also been said that it is not a word of art and has no legal or technical signification; * * * it has also been held that there might be such a thing as a renewal where the party was different, provided the obligation was of the same nature as in a case where a widow gave her note in lieu of the note of her deceased husband for the same amount. (*Sponhaus* v. *Malloy*, 21 Ind. App., 287; 52 N. E., 245.) * * * Not only the definition of renewal, but also its application in the cases cited and similar cases, carries the idea that an obligation is renewed when the same obligation is carried forward by the new paper or undertaking, whatever it may be. There may be a change of parties. There may be an increase of security, but there is no renewal unless the obligation is the same. What makes the renewal is an extension of time in which to discharge the obligation."

It well may be inferred that, in enacting the above set out proviso, the lawmakers contemplated that that proviso would cover such a transaction as the one now in question. It can not reasonably be supposed that it was intended that an issue of new bonds with interest coupons and maturing at later dates in lieu of previously outstanding similar bonds evidencing the same obligation as to principal and rate of interest would be subject to the tax, but that a change in the previously outstanding bonds by an indorsement thereon postponing the dates of the maturity thereof would not give rise to liability for that tax. Nothing in the language of the statute indicates a purpose to make liability for the tax imposed dependent upon form, rather than upon substance. To say the least, it appears, that, consistently with well recognized usage, a postponement of the maturity of corporate coupon bonds evidencing indebtedness may be described as a renewal of such bonds.

The proviso in question is found in provisions of earlier statutes imposing stamp taxes on bonds and other instruments evidencing indebtedness. We understand that it first appeared in such a connection in Schedule A-1 of

Title VIII of the Revenue Act of 1917 (40 Stat., 300). It was reenacted without change four times, namely, in the Revenue Act of 1918, Title 46, Schedule A–1 (40 Stat., 1057); in the Revenue Act of 1921, Title XI, Schedule A–1 (42 Stat., 303); in the Revenue Act of 1924, Title VIII, Schedule A–1 (43 Stat., 333); and in the Revenue Act of 1926. It appears that that proviso has been construed by officials charged with the enforcement of it as meaning postponement of the maturity of bonds referred to, and covering such a transaction as the one now in question, and that that construction has been impliedly approved by Congress. The following is article 8 of Treasury Regulations 71, relating to stamp taxes under Title VIII of the Revenue Act of 1926, as amended by the Revenue Act of 1932:

"ART. 8. *Bonds renewed by agreement extending mortgage.*—An agreement extending a mortgage upon maturity where a bond is secured by the mortgage and such agreement operates to renew the bond, subjects the latter to stamp tax as a renewal."

The just set out regulation was first issued in the same language as article 4 of Treasury Regulations 55, relating to stamp taxes under the Revenue Act of 1918, and has been carried forward into regulations relating to stamp taxes under subsequent Revenue Acts, and is still in force. Even if the meaning of the proviso in question properly could be regarded as doubtful, great weight should be given to the construction of it by the Department charged with its execution, and the repeated reenactment by Congress, without change, of the proviso which previously had received long continued executive construction is an adoption by Congress of such construction. (*Komada* v. *United States*, 215 U. S., 392; *Massachusetts Mutual Life Insurance Co.* v. *United States*, 288 U. S., 269, 273; *Old Mission Portland Cement Co.* v. *Helvering*, 293 U. S., 289, 293 [Ct. D. 903, C. B. XIV–1, 332]; *Herring* v. *Commissioner*, 293 U. S., 323 [Ct. D. 904, C. B. XIV–1, 303].)

Counsel for appellee suggested in argument that the above set out regulation is rendered inapplicable to the facts of the instant case by the circumstance that the agreement to extend the maturity dates of bonds was made in January, 1933, and the earliest maturity of any bond dealt with by that agreement was in July, 1933. Nothing in that regulation indicates that the words, "an agreement extending a mortgage upon maturity" referred only to an agreement made at or after the date of the maturity of the mortgage. It is quite manifest that an agreement extending a mortgage upon maturity is covered by the language used, though that agreement was entered into before the mortgage matured.

In behalf of the appellee it was contended that the agreement whereby the maturity dates of outstanding bonds were extended was kept from being "a renewal," within the meaning of the above set out proviso, by the circumstance that the making of that agreement was an exercise of a power conferred when those bonds were issued, with the result that that agreement effected a mere rearrangement of the relations between the maker of those bonds and the holders of them. The provision of the mortgage authorizing the transaction entered into in 1933 to be consummated if consented to by the holders of 90 per cent in principal amount of the then outstanding bonds did not make that transaction different in its nature or effect from what it would have been if the mortgage had not contained the above mentioned provision and that transaction had been consented to by the holders of all then outstanding bonds, instead of by the holders of 90 per cent in principal amount of such bonds. A valid agreement whereby the maturity of bonds is postponed for a definite time is, within the meaning of the proviso in question as it long has been authoritatively construed, a renewal of such bonds, whether the making of such agreement was authorized when the bonds were issued, or at a subsequent time was proposed and assented to by the parties in interest. The agreement entered into in 1933 having effected a renewal of then outstanding bonds, and such renewal being the subject of the tax imposed, it is not material in this case what other changes in the relations of the parties in interest were brought about by that agreement.

Though the proviso in question, when it was first enacted, may have been open to a construction different from that adopted by the officials charged with its enforcement, that administrative construction must be followed because it has been approved by Congress. We conclude that, within the meaning of that proviso, what occurred was a renewal of the bonds the maturities of which were postponed, and that the above mentioned ruling was erroneous.

The decree is reversed.

## SCHEDULE A-3 OF TITLE VIII OF THE REVENUE ACT OF 1926, AS AMENDED BY SECTION 723 OF THE REVENUE ACT OF 1932.

REGULATIONS 71, ARTICLE 34: Sales or transfers subject to tax. XV-4-7923 G. C. M. 15745

Transfers to the continuing corporation of stock held in a fiduciary capacity by a corporation which is merged or consolidated with another corporation under the banking law of New York are subject to stamp tax.

An opinion is requested whether transfers of stock by reason of the merger or consolidation of the M Corporation and the N Corporation under the banking law of the State of New York are subject to the stamp tax imposed by Schedule A-3 of Title VIII of the Revenue Act of 1926, as amended by section 723 of the Revenue Act of 1932.

That Act imposes a stamp tax on all sales, or agreements to sell, or memoranda of sales or deliveries of, or transfers of legal title to any of the shares or certificates mentioned or described in subdivision 2 of the Act, or to rights to subscribe for or to receive such shares or certificates.

Section 494 of the banking law of New York provides in part as follows:

* * * *Effect of merger.*—Upon the merger of any corporation into another as provided in the article:

1. Its corporate existence shall be merged into that of such other corporations; and all and singular its rights, privileges and franchises, and its right, title and interest in and to all property of whatsoever kind, whether real, personal or mixed, and things in action, and every right, privilege, interest or asset of conceivable value or benefit then existing which would inure to it under an unmerged existence, shall be deemed fully and finally, and without any right of reversion, transferred to and vested in the corporation into which it shall have been merged, without further act or deed, and such last-mentioned corporation shall have and hold the same in its own right as fully as the same was possessed and held by the merged corporation from which it was, by operation of the provisions of this article, transferred.

2. Its rights, obligations and relations to any person, creditor, depositor, trustee or beneficiary of any trust, shall remain unimpaired, and the corporation into which it shall have been merged shall *by such merger* succeed to all such relations, obligations, trusts and liabilities, and shall execute and perform all such trusts, in the same manner as though it had itself assumed the relation or trust, or incurred the obligation or liability; and its liabilities and obligations to creditors existing for any cause whatsoever shall not be impaired by such merger; nor shall any obligation or liability of any stockholder or shareholder in any corporation which is a party to such merger be affected by any such merger, but such obligations and liabilities shall continue as fully and to the same extent as existed before such merger. [Italics supplied.]

Article 34 of Regulations 71 cites examples of transactions subject to the tax, among which are: (*b*) the transfer of stock to or by trustees; (*r*) upon a merger, the transfer of stock owned by a corporation which is merged into another corporation from the name of the first to the name of the second corporation, such a transfer being effected by the act of the parties and not wholly by operation of law; and (*t*) the transfer of legal title to stock irrespective of whether the transferee received any beneficial interest therein, except as provided in article 35(*k*).

Among the transactions not subject to tax, enumerated in article 35 of Regulations 71, are: (*h*) the transfer of stock from the name of a deceased or resigned trustee to the name of a substituted trustee appointed in accordance with the terms of the original trust agreement, which is a transfer resulting wholly by operation of law; and (*r*) transfers of shares or certificates of stock which result wholly by operation of law.

Pursuant to a merger agreement, the M Corporation merged with the N Corporation (the continuing corporation). Both corporations were organized and were doing business in the State of New York. At the time of the merger the M Corporation held stock in a fiduciary capacity. As a result of the merger the N Corporation holds such stock formerly held by the M Corporation and is acting in a fiduciary capacity with respect thereto. Some of the trust instruments under which the stock was held by the M Corporation were silent as to a successor trustee, some provided for a successor trustee, while in others the trustor reserved the right to appoint a successor trustee in the event the original trustee for any reason ceased to act. In the last class of cases the trustors appointed the N Corporation as successor trustee. The merger agreement provides that each corporation shall contribute all of its assets, rights, privileges, and franchises to the continuing corporation; that upon merger the assets, etc., of the N Corporation shall belong to the continuing corporation as the continuation of the corporate entity of N without deed or assignment or devolution of title; that the assets, etc., of the M Corporation shall be deemed transferred and vested in the continuing corporation by operation of law, without further act or deed; and that in all respects the effects of the merger shall be as prescribed in the banking law of the State of New York. That law provides specifically that the corporation into which another is merged "*shall by such merger*" (i. e., the acts of the parties) succeed to trusts, liabilities, etc.

In G. C. M. 8050 (C. B. IX–1, 396) it was held that transfers of stock of other corporations owned by merging or consolidating corporations were not effected wholly by operation of law and were subject to stamp tax. It was further held that it was immaterial whether the stock so held was owned absolutely or was held in trust at the time of the merger or consolidation, since some action by the interested parties was required. In the present case it is apparent that action by the interested parties was also required. The board of directors had to act, the stockholders had to approve, and the merger agreement had to be executed. All of these acts by the parties in interest were required in order to accomplish the merger. It is the opinion of this office that the transfer of stock held by the merging corporation either as owner or in a fiduciary capacity to the continuing corporation was a transfer not effected *wholly* by operation of law but was brought about, in part at least, by acts of the parties.

With respect to stock held by the banks under trust instruments providing for the appointment of a successor trustee, or under trust instruments in which the trustor reserved the right to appoint a successor trustee in the event the original trustee ceased to act, it is the opinion of this office that the rule is the same in such situations as where the trust instrument is silent regarding a successor trustee.

It is well settled that the law will not permit a trust to fail because of lack of a trustee. Where one corporation succeeds another as trustee by reason of a merger or consolidation, it makes no difference whether (*a*) the succession be ordered by a court of equity or occurs because of a provision of State law, or whether (*b*) the successor corporation is appointed pursuant to a provision of the trust instrument. In each of the situations indicated, the succession is the result of the merger or consolidation which was consummated by act of the parties. Therefore, in none of the situations is there a transfer *wholly* by operation of law within the intent of the regulations. This view is not in conflict with article 35(*h*) or the other provisions of the regulations cited, supra. Article 35(*h*) holds nontaxable a transfer of stock from a deceased or resigned trustee to the name of a substituted trustee in accordance with the terms of the original trust agreement. This does not contemplate appointment of the trustee pursuant to a corporate merger or consolidation and should not be applied to the instant situation. Neither is such view in conflict with S. T. 699 (C. B. XII-2, 360), dealing with corporate liquidation through a State superintendent of banks. Obviously, a transfer due to forced liquidation through a State officer does not result from an act of the parties, as in the case of a voluntary merger or consolidation.

It is, therefore, the opinion of this office that where, upon a merger or consolidation of corporations under the banking law of New York, a successor corporation takes the place of another corporation previously acting as trustee or in other fiduciary capacities, the transfer of any corporate stocks held in a fiduciary capacity from the first to the successor corporation is taxable whether or not the instrument under which the stock is held makes provision for the appointment of a successor fiduciary and irrespective of any provision of State law conferring the powers and privileges of the original corporate trustee upon the successor corporation.

Arthur H. Kent,
*Acting Assistant General Counsel for the Bureau of Internal Revenue.*

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Regulations 71, Article 34: Sales or transfers subject to tax. XV-10-7986 G. C. M. 16290

Where a broker, as agent of the purchaser, has stock transferred through him either to the name of the purchasing broker's nominee or to the name of the purchaser's nominee, liability for two stamp taxes is incurred.

An opinion is requested concerning the stamp tax liability involved in the transfer of stock from the selling broker or his principal through the purchasing broker to the nominee of the purchasing broker or to the nominee of the purchaser.

Schedule A-3, Title VIII of the Revenue Act of 1926, as amended by section 723(a) of the Revenue Act of 1932, imposes documentary stamp taxes:

* * * On all sales, or agreements to sell, or memoranda of sales or deliveries of, or transfers of legal title to any of the shares or certificates mentioned or described in subdivision 2, or to rights to subscribe for or to

receive such shares or certificates, * * * *Provided further*, That the tax shall not be imposed upon deliveries or transfers to a broker for sale, nor upon deliveries or transfers by a broker to a customer for whom and upon whose order he has purchased same, but such deliveries or transfers shall be accompanied by a certificate setting forth the facts: * * *.

By reference to Schedule A–3, Title VIII, Revenue Act of 1926, as amended, imposing the tax in question, it will be seen that its provisions are broad in their scope. The tax is imposed thereby on *all* sales or transfers of legal title to shares or certificates of stock, with certain exceptions provided for in the Act. The plain intent of the proviso quoted above is to exempt from the stamp tax all deliveries by a seller to a broker for the purpose of making a sale and all deliveries by a broker to a customer in completing a sale. In such cases where the broker has no ownership or interest in the stock, he acts merely as agent for his principal. His act is in reality the act of the principal and, where the exemption certificate required is furnished, only one stamp tax is due on the sale by one principal to another principal, even though the transaction is carried on through the broker agents.

Where, however, a nominee takes legal title to the stock, the line is broken and there occurs a transaction which is not within the terms of the above-quoted proviso. The transfer of certificates of stock to a nominee is neither a delivery nor a transfer to a broker for sale nor is it a transfer by him to complete a sale within the meaning of the proviso. The fact that the nominee may have no personal interest in the securities is of no consequence in passing upon the taxability of the transaction because, under the express terms of the law, the tax is due on transfers of legal title " whether entitling the holder in any manner to the benefit of such share, certificate, interest, or rights, or not * * *." The statute being concerned with transfers of legal title, whether or not they involve transfers of equitable interests, the tax attaches to any and all transfers whatever the purpose may be, unless the transaction is clearly exempt. It is a well established rule of construction that exemptions from taxation must always be strictly construed against the person claiming exemption. (*Bank of Commerce* v. *Tennessee*, 161 U. S., 134.)

Upon careful consideration of the question presented, it is the opinion of this office that where stock is transferred from the selling broker or his principal through the purchasing broker to the purchasing broker's nominee, liability for two stamp taxes is incurred, one on the transfer of the stock from the selling broker or his principal to the purchasing broker, and one on the transfer of the stock from the purchasing broker to his nominee.

It is also the opinion of this office that when stock is transferred from the selling broker or his principal through the purchasing broker to the purchaser's nominee, liability for two stamp taxes is incurred, one on the transfer of the stock from the selling broker or his principal to the purchasing broker and one on the purchaser's constructive transfer to his nominee of his right to receive the stock. This position is in accord with the decision of the United States Supreme Court in *Raybestos-Manhattan, Inc.*, v. *United States* (296 U. S., 60, Ct. D. 1039, C. B. XIV–2, 400).

It is understood that brokers in reliance upon a position previously taken by the Bureau have considered that the stamped memorandum of sale executed at the time of sale covers the transfer of the stock not only from the selling broker or his principal to the purchasing broker or his principal but also to the nominee of the purchasing broker, and have followed the practice of having stock transferred from the selling broker or his principal to the purchasing broker's nominee with the payment of only one stamp tax. In view of that position and practice and in order that the opportunity may be given to all concerned to become apprised of the position taken herein before the effective date, it is recommended that this opinion be made effective 10 days after the date of its publication in the Internal Revenue Bulletin.

ROBERT H. JACKSON,
*Assistant General Counsel for the Bureau of Internal Revenue.*

Approved.

CHAS. T. RUSSELL,
*Acting Commissioner of Internal Revenue.*

T. J. COOLIDGE,
*Acting Secretary of the Treasury.*

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REGULATIONS 71, ARTICLE 34: Sales or transfers subject to tax. XV-10-7987 S. T. 830

Transfer of stock from the name of the trustee for a life tenant to the name of the life tenant is subject to stamp tax.

Advice is requested whether the transfer of stock from the name of the trustee for a life tenant to the name of the life tenant pursuant to court order is subject to the stamp tax imposed by Schedule A-3 of Title VIII of the Revenue Act of 1926, as amended by section 723(a) of the Revenue Act of 1932.

The Act imposes a stamp tax on all sales or agreements to sell, or memoranda of sales or deliveries of, or transfers of legal title to corporate shares or certificates of stock, or to rights to subscribe for or to receive such shares or certificates.

Under the will of a resident of Connecticut, the estate of the decedent was left to his widow for life with remainder to the decedent's children. The X Bank was appointed as trustee for the widow under the will and certain stock which was a part of the estate was transferred to the X Bank as trustee. The X Bank subsequently resigned as trustee. Pursuant to an order entered by the probate court, the stock in question was transferred to the widow as life tenant under the will rather than as successor trustee. The will provided that the life tenant should not be required to give bond. It is contended that the transfer of the stock to the life tenant is not subject to stamp tax since under the circumstances the life tenant was a successor trustee.

While the transfer of the stock to the life tenant was approved by the probate court, such transfer was, nevertheless, occasioned by the voluntary acts of the parties to the transfer and, therefore, did not result wholly by operation of law. As a result of the transfer the existing trust was dissolved and the trust property was transferred to the beneficiary of the trust, who had only a life estate therein. Since the beneficiary did not have complete ownership of the property, she is required under the laws of Connecticut to give bond for the protection of the remaindermen, but is not required to account to the court with respect to the funds in her hands in the same manner as does a trustee in respect of trust funds.

In view of the foregoing, it is held that the life tenant is not a successor trustee within the meaning of the law and regulations relating to stamp taxes, and that the transfer of the stock in question to the life tenant under the circumstances stated is subject to the stamp tax imposed by Schedule A–3 of Title VIII of the Revenue Act of 1926, as amended.

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REGULATIONS 71, ARTICLE 34: Sales or transfers subject to tax. XV–25–8138
S. T. 838
(Also Schedule A–9 of Title VIII of the Revenue Act of 1926, as added by section 724(a) of the Revenue Act of 1932.)

The deposit of stocks and bonds by the M Insurance Co., a foreign corporation, with a bank or trust company in the United States, as trustee, as security for its obligations constitutes a "delivery" which is subject to stamp tax.

Advice is requested whether the deposit of certificates of stock and corporate bonds by the M Insurance Co., a foreign corporation, with a bank or trust company in the United States, as trustee, under the circumstances hereinafter stated, is subject to the stamp taxes imposed by Schedule A–3 of Title VIII of the Revenue Act of 1926, as amended by section 723(a) of the Revenue Act of 1932, and by Schedule A–9 of Title VIII of the Revenue Act of 1926, as added by section 724(a) of the Revenue Act of 1932.

Schedule A–3 of Title VIII of the Revenue Act of 1926, as amended, imposes a stamp tax—

* * * On all sales, or agreements to sell, or memoranda of sales or deliveries of, or transfers of legal title to any of the shares or certificates mentioned or described in subdivision 2, * * * whether made upon or shown by the books of the corporation or other organization, or by any assignment in blank, or by any delivery, * * * (whether entitling the holder in any manner to the benefit of such share, certificate, interest, or rights, or not), * * * *Provided further*, That it is not intended by this title to impose a tax upon an agreement evidencing a deposit of certificates as collateral security for money loaned thereon, which certificates are not actually sold, nor upon the delivery or transfer for such purpose of certificates so deposited nor upon the return of stock loaned: * * *.

Schedule A–9 of Title VIII of the Revenue Act of 1926, as added by section 724(a) of the Revenue Act of 1932, imposes a stamp tax upon sales, transfers, or deliveries of corporate bonds in almost the identical terms of Schedule A–3, as amended, quoted above.

Under the provisions of section 801 of the Revenue Act of 1926, as amended by section 441 of the Revenue Act of 1928, Government bonds and certain other classes of securities are exempt from stamp tax.

The M Insurance Co., a foreign corporation, carries on an insurance business in the United States. Under the insurance laws of certain States the company is required to deposit with a bank or trust company in the United States, as trustee, securities of sufficient value to cover any possible losses which may be suffered by the policyholders of the company through any failure of the company to meet its obligations. The deposit agreement provides that the securities deposited pursuant thereto shall be held in trust to secure and carry out the objects and purposes of the agreement. The company reserves the right to withdraw any security and deposit in lieu thereof another security of equal value. Upon the demand of any person holding a final judgment or decree against the company in respect of moneys due and payable under any policy issued by it on the life of any person, a resident of the United States, the trustee, after the lapse of three months from the date of any such unpaid judgment or decree, is required to sell a sufficient amount of the deposited securities, or, at the option of the trustee, retain any dividends or cash received as income from the securities, to satisfy the judgment or decree. Until such a demand has been made by a policyholder or claimant, the income from the deposited securities is payable to the company. The company may modify, alter, or revoke the deposit agreement, provided the rights of the policyholders are not affected or impaired, and under specified conditions may change the trustee.

The deposit of securities with the trustee, except those securities coming within the exempt classes specified in section 801 of the Revenue Act of 1926, as amended, constitutes a "delivery" of the securities within the meaning of the stamp tax provisions of the Revenue Act of 1926, as amended, it being assumed that the securities were delivered to the trustee in such form that they may be sold by the trustee, i. e., by assignment in blank. The fact that the trustee acquires no beneficial ownership in the securities is immaterial under the express terms of the statute. The securities are delivered to the depository in its capacity as trustee. The transfer of securities to or by trustees is subject to stamp tax. (Article 34(*b*), Regulations 71.) It is well established that there can be no trust without a legal estate vested in the trustee. (1 Perry on Trusts, 7th Ed., page 443.) Consequently, the delivery of the securities to the depository as trustee is subject to the transfer tax, irrespective of whether the securities are actually registered in the name of the trustee. The fact that deposit of stocks and bonds as collateral security for loans is exempted from the stamp tax provisions of the law carries the clear implication that deposits for other purposes are taxable.

In view of the foregoing, it is held that the deposit of certificates of stock and corporate bonds by the M Insurance Co., a foreign corporation, with a trustee in the United States under the circumstances stated, other than those instruments specifically exempt under section 801 of the Revenue Act of 1926, as amended, is subject to the stamp taxes on transfers of stocks and bonds imposed by Schedule A–3 and Schedule A–9 of Title VIII of the Revenue Act of 1926, as amended.

## SCHEDULE A-5 OF TITLE VIII OF THE REVENUE ACT OF 1926, AS AMENDED BY SECTION 442 OF THE REVENUE ACT OF 1928.—PASSAGE TICKETS.

REGULATIONS 71, ARTICLE 53: Passage tickets issued to certain foreign representatives. XV-9-7976 S. T. 829

Consular officers of Finland are exempt from the tax on passage tickets.

Advice is requested whether consular officers of Finland are exempt from the tax imposed on passage tickets by Schedule A-5 of Title VIII of the Revenue Act of 1926, as amended by section 442 of the Revenue Act of 1928.

In view of the provisions of Article XIX of the Treaty of Friendship, Commerce and Consular Rights of February 13, 1934, effective August 10, 1934, between the United States and Finland, consular officers of Finland, and the members of their families, are entitled to exemption from the tax on passage tickets purchased on or after August 10, 1934, the effective date of the treaty, subject to the conditions outlined in S. T. 681 (C. B. XII-1, 455).

The consular officers of Finland are added to the list of consular officers published in S. T. 681, supra, as supplemented by S. T. 720 (C. B. XIII-1, 437), who have been held to be exempt from the tax on passage tickets.

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## SCHEDULE A-8 OF TITLE VIII OF THE REVENUE ACT OF 1926, AS ADDED BY SECTION 725 OF THE REVENUE ACT OF 1932.—CONVEYANCES.

REGULATIONS 71, ARTICLE 84: What constitutes real property determinable by law of State where located. XV-16-8053 G. C. M. 16510

An oil and gas lease of indefinite duration in respect of land situated in Arkansas, or any assignment thereof, is subject to stamp tax as a conveyance of realty.

The question is presented whether an oil and/or gas lease covering land in Arkansas, or any assignment thereof, is subject to the stamp tax on conveyances imposed by Schedule A-8 of Title VIII of the Revenue Act of 1926, as added by section 725 of the Revenue Act of 1932.

The law imposes a stamp tax on any "* * * Deed, instrument, or writing * * * whereby any lands, tenements, or other realty sold shall be granted, assigned, transferred, or otherwise conveyed to, or vested in, the purchaser or purchasers * * *, when the consideration or value of the interest or property conveyed, exclusive of the value of any lien or encumbrance remaining thereon at the time of sale, exceeds $100 * * *."

For stamp tax purposes, the law of the State in which the property is situated determines what constitutes "lands, tenements, or other realty." (Article 84, Regulations 71.)

The lease in question, for a valuable consideration, "granted, conveyed, demised, leased and let" certain land situated in Arkansas for the purpose of mining and operating for oil and gas for a specified term " and as long thereafter as oil or gas, or either of them is produced from said land by the lessee."

In *Arrington* v. *United Royalty Co.* (1933) (65 S. W. (2d), 36), the Supreme Court of Arkansas held that an oil and gas lease for a definite term of years, and to continue thereafter as long as oil and/or gas are produced, is a grant and conveyance for an indeterminate period whereby a freehold estate in realty is created in the nature of a qualified fee. In the course of its opinion the court said:

> * * * It seems, also, that whether the royalty, when severed from the reversion, is to be deemed real or personal property, depends upon the duration of the lease. If the oil and gas lease is for a definite term of years expiring at a certain time, it is a chattel real, and the severed royalty would be personal property; but, where the lease may endure for an indeterminate period, it creates an estate in the nature of a qualified fee, and the royalty reserved would be an interest in realty.

While the interest in dispute in the foregoing case had to do with the reserved royalty of the lessor rather than with the working interest of the lessee under the lease, his heirs, or assigns, still the character of the royalty was deemed to be governed by the nature of the lease under which it was reserved. The holding of the court appears to be clear that an oil and gas lease in Arkansas for a definite term of years, and to continue thereafter as long as oil and/or gas are produced, is for an indefinite duration and, as such, grants and conveys an estate in land in the nature of a qualified fee. (Compare *Bodcaw Lumber Co.* v. *Goode* (Ark., 1923), 254 S. W., 345.)

In *State* v. *Arkansas Fuel Oil Co.* (Ark., 1929) (18 S. W. (2d), 906), the court held that an oil and gas lease for a definite term of years, and as long thereafter as oil and gas (or either of them) are produced from the land by the lessee, constitutes a severance of the oil and gas rights from the fee simple (or general property) in the land within the meaning of section 9856 of Crawford & Moses' Digest of the Laws of Arkansas, which provides among other things that where mineral and/or timber rights in land are held by another than the owner of the land, such rights shall be assessed separately from the general property in the land; that the sale of such rights for nonpayment of taxes shall not affect the title to the land itself; and that a sale of the land for nonpayment of taxes shall not affect the title to such rights. The holding of the court in that case, considered in the light of the State statute referred to, would seem to be tantamount to holding that an oil and gas lease in Arkansas of indefinite duration creates a qualified fee in the land, " an interest and easement in the land itself."

In view of the foregoing, it is the opinion of this office that an oil and/or gas lease of the type herein considered covering land in Arkansas, or any assignment thereof, is a conveyance of realty sold and is subject to stamp tax under Schedule A–8 of Title VIII of the Revenue Act of 1926, as added by section 725 of the Revenue Act of 1932.

HERMAN OLIPHANT,

*General Counsel for the Department of the Treasury.*

## SCHEDULE A-9 OF TITLE VIII OF THE REVENUE ACT OF 1926, AS ADDED BY SECTION 724(a) OF THE REVENUE ACT OF 1932.

REGULATIONS 71, ARTICLE 120: Basis of tax. XV-15-8039
S. T. 832

The transfer of corporate bonds from the name of a guardian for a minor to the name of the ward in the State of New York is not subject to stamp tax.

Advice is requested whether the transfer of corporate bonds from the name of a guardian for a minor to the name of the ward upon the latter becoming of age, both being residents of the State of New York, is subject to the stamp tax imposed by Schedule A-9 of Title VIII of the Revenue Act of 1926, as added by section 724(a) of the Revenue Act of 1932.

The Act imposes a stamp tax upon all sales or transfers of legal title to bonds, debentures, or certificates of indebtedness issued by a corporation. The taxability of the transfer of corporate bonds from the name of a guardian for a minor to the name of the ward upon the latter becoming of age depends upon whether, under the laws of the jurisdiction, legal title to the bonds remained in the ward or vested in the guardian at the time of his appointment. (See MS. 42, C. B. IV-1, 338.) If under the State law no transfer of legal title to the bonds occurs when there is a transfer of the bonds from the name of the guardian to the name of the ward, no stamp tax liability is incurred.

In the State of New York a guardian for a minor does not acquire legal title to his ward's estate. Consequently, no transfer of legal title is involved in the transfer of corporate bonds from the name of the guardian to the name of the ward in that State, and no stamp tax liability is incurred with respect to such transfers.

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# TITLE XI.—GENERAL ADMINISTRATIVE PROVISIONS. (1926)

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## SECTION 1121 OF THE REVENUE ACT OF 1926, MADE APPLICABLE BY SECTION 627 OF THE REVENUE ACT OF 1932.

REGULATIONS 46, ARTICLE 74: Sales for export. XV-17-8061
S. T. 833

Meaning of the words "in due course so exported" in section 1121 of the Revenue Act of 1926 as applied to "drive-away" sales of automobiles or trucks for export.

Advice is requested whether automobiles or trucks sold for export under the circumstances stated herein are "in due course so exported" within the meaning of section 1121 of the Revenue Act of 1926, made applicable by section 627 of the Revenue Act of 1932, to sales of articles taxable under Title IV of that Act.

Under the provisions of section 1121 of the Revenue Act of 1926, and article 74 of Regulations 46, as amended by Treasury Decision 4355 (C. B. XI-2, 551), sales for export of automobiles and other articles taxable under Title IV of the Revenue Act of 1932 are exempt from tax, provided the evidence required by articles 74 and 75 of Regulations 46, as amended by Treasury Decision 4355, supra, shows that the article was sold for export and that the article was in due course exported.

An automobile or truck sold for export is sometimes delivered to a purchaser at the factory and is driven by him to a port of the United States for embarkation to a foreign country, or to a point on the Canadian or Mexican border for entry into either of those countries. Occasionally, an automobile and a truck are sold and delivered to the purchaser at the factory and the automobile is loaded on the truck and driven to such port or country.

Automobiles and trucks sold, delivered, and driven under the foregoing circumstances are considered to have been " in due course so exported " within the meaning of section 1121 of the Revenue Act of 1926, provided the automobile or truck is not used for any purpose other than the hauling, towing, or driving thereof from the factory to the point of exportation; that the time intervening between delivery at the factory and arrival at the point of exportation is devoted to reaching such point; and that the evidence required by the regulations is furnished. The time or mileage involved in making the trip is not important so long as the automobile or truck is driven directly from the factory to the place of exportation without delay and is not used for any other purpose, as, for example, making a tour or visiting places of interest in the United States.

Where an automobile and truck are sold for export and delivery is made at the factory, the automobile is loaded on the truck, and the truck is driven to the point of exportation under the conditions specified herein, the truck is not considered to have been used in the United States for any purpose other than that incident to exportation.

Merchandise which may be transported in automobiles and trucks so sold and delivered, without destroying the exemption, is limited to the personal baggage of the passengers.

# AGRICULTURAL ADJUSTMENT ACT.

XV-2-7906
T. D. 4622

Compensating tax with respect to peanuts under the Agricultural Adjustment Act, as amended.—Refund of compensating tax paid on peanut oils.—Article 3 of Treasury Decision 4489 [C. B. XIII-2, 493] amended.

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

*To Collectors of Internal Revenue and Others Concerned:*

Section 15(a) of the Agricultural Adjustment Act, as amended, provides, in part:

* * * During the period in which any certificate under this section is effective, the provisions of subsection (e) of this section shall be suspended with respect to all imported articles of the kind described in such certificate; and notwithstanding the provisions of section 21, any compensating taxes, which have heretofore, during the period in which any certificate under this section has been effective, become due and payable upon imported articles of the kind described in such certificate, shall be refunded by the Secretary of the Treasury if the same have been paid, or, if the same have not been paid the amount thereof shall be abated. * * *

Pursuant to the above provisions, article 3 of Treasury Decision 4489 is hereby amended to read as follows:

ART. 3. *Compensating tax on imported articles.*—(*a*) A compensating tax became effective at the earliest moment of October 1, 1934, with respect to all articles processed or manufactured wholly or partly from any type or kind of peanuts, and imported into the United States, or any possession thereof to which the Act applies, from any foreign country, or from any possession of the United States to which the Act does not apply. The respective rates of tax applicable to such articles are given in article 4(*a*) of these regulations. Effective August 24, 1935, no compensating tax is imposed with respect to peanut oil imported on and after that date. For detailed regulations relative to the compensating tax, see Chapter IV of Regulations 81, as amended.

(*b*) *Refund of compensating tax paid with respect to peanut oils.*—Any person who imported peanut oil and paid the compensating tax with respect thereto, upon complying with the conditions hereinafter prescribed, is entitled to a refund of such tax.

The claim for refund shall be executed, under oath, on P. T. Form 24, in accordance with these regulations and in accordance with the instructions printed on the form, and filed with the collector of internal revenue for the district in which the tax was paid.

The grounds and facts alleged in support of the claim shall be completely set forth in detail and show (1) the amount of refund claimed, (2) the date on which the peanut oil was imported, the port of entry, the customs entry number, and the name of the vessel, (3) the date of payment of the tax, the amount thereof, and to which collector (revenue or customs) the tax was paid, and (4) the number of containers, gallon content of each container, and the total number in gallons of each importation. If the tax has been paid to a collector of customs, the collector of internal revenue with whom the claim is filed shall procure from the collector of customs a statement relative to payment and shall submit such statement with the claim to the Commissioner.

GUY T. HELVERING,
*Commissioner of Internal Revenue.*

Approved January 4, 1936.

T. J. COOLIDGE,
*Acting Secretary of the Treasury.*

REGULATIONS 81, CHAPTER IV.

XV–18–8069
T. D. 4638

**Compensating tax under Agricultural Adjustment Act, as amended.—Treasury Decision 4501, approved December 4, 1934 [C. B. XIII–2, 524], amending Chapter IV of Regulations 81, revoked.**

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

*To Collectors of Internal Revenue, Collectors of Customs, and Others Concerned:*

Treasury Decision 4501, approved December 4, 1934, which amended Chapter IV of Regulations 81, relating to the collection of compensating taxes under section 15(e) of the Agricultural Adjustment Act, as amended, is hereby revoked.

This Treasury decision is promulgated under authority of section 10(d) of the Agricultural Adjustment Act, as amended.

GUY T. HELVERING,
*Commissioner of Internal Revenue.*

Approved April 25, 1936.

STEPHEN B. GIBBONS,
*Acting Secretary of the Treasury.*

(Filed with the Division of the Federal Register April 28, 1936, 3.46 p. m.)

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XV–6–7943
Ct. D. 1070

PROCESSING AND FLOOR TAXES—AGRICULTURAL ADJUSTMENT ACT—DECISION OF SUPREME COURT.

CONSTITUTIONALITY.

The Agricultural Adjustment Act, 1933 (48 Stat., 31), which provides for reduction in acreage or in production for market of any basic agricultural commodity, for rental and benefit payments to producers in connection therewith, and for the levying of a tax upon processors and others engaged in the handling of any agricultural commodity in order to obtain revenue for the administration of the Act, does not come within Article I, section 8, of the Constitution, and violates the tenth amendment thereof. The Act invades the reserved rights of the States, being a statutory plan for the regulation and control of agricultural production, a matter beyond the powers delegated to the Federal Government; and the tax, the appropriation of the funds raised, and the direction for their disbursement, are but means to an unconstitutional end.

SUPREME COURT OF THE UNITED STATES.

*United States of America, petitioner, v. William M. Butler et al., Receivers of Hoosac Mills Corporation.*

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

[January 6, 1936.]

OPINION.

Mr. Justice ROBERTS delivered the opinion of the Court.

In this case we must determine whether certain provisions of the Agricultural Adjustment Act, 1933,[1] conflict with the Federal Constitution.

[1] May 12, 1933 (ch. 25, 48 Stat., 31).

Title I of the statute is captioned "Agricultural Adjustment." Section 1 recites that an economic emergency has arisen, due to disparity between the prices of agricultural and other commodities, with consequent destruction of farmers' purchasing power and breakdown in orderly exchange, which, in turn, have affected transactions in agricultural commodities with a national public interest and burdened and obstructed the normal currents of commerce, calling for the enactment of legislation.

Section 2 declares it to be the policy of Congress:

"To establish and maintain such balance between the production and consumption of agricultural commodities, and such marketing conditions therefor, as will reestablish prices to farmers at a level that will give agricultural commodities[2] a purchasing power with respect to articles that farmers buy, equivalent to the purchasing power of agricultural commodities in the base period."

The base period, in the case of cotton, and all other commodities except tobacco, is designated as that between August, 1909, and July, 1914.

The further policies announced are an approach to the desired equality by gradual correction of present inequalities "at as rapid a rate as is deemed feasible in view of the current consumptive demand in domestic and foreign markets," and the protection of consumers' interest by readjusting farm production at such level as will not increase the percentage of the consumers' retail expenditures for agricultural commodities or products derived therefrom, which is returned to the farmer, above the percentage returned to him in the base period.

Section 8 provides, amongst other things, that "In order to effectuate the declared policy," the Secretary of Agriculture shall have power

"(1) To provide for reduction in the acreage or reduction in the production for market, or both, of any basic agricultural commodity, through agreements with producers or by other voluntary methods, and to provide for rental or benefit payments in connection therewith or upon that part of the production of any basic agricultural commodity required for domestic consumption, in such amounts as the Secretary deems fair and reasonable, to be paid out of any moneys available for such payments. * * *

"(2) To enter into marketing agreements with processors, associations of producers, and others engaged in the handling, in the current of interstate or foreign commerce of any agricultural commodity or product thereof, after due notice and opportunity for hearing to interested parties. * * *

"(3) To issue licenses permitting processors, associations of producers, and others to engage in the handling, in the current of interstate or foreign commerce, of any agricultural commodity or product thereof, or any competing commodity or product thereof."

It will be observed that the Secretary is not required, but is permitted, if, in his uncontrolled judgment, the policy of the Act will so be promoted, to make agreements with individual farmers for a reduction of acreage or production upon such terms as he may think fair and reasonable.

Section 9(a) enacts:

"To obtain revenue for extraordinary expenses incurred by reason of the national economic emergency, there shall be levied processing taxes as hereinafter provided. When the Secretary of Agriculture determines that rental or benefit payments are to be made with respect to any basic agricultural commodity, he shall proclaim such determination, and a processing tax shall be in effect with respect to such commodity from the beginning of the marketing year therefor next following the date of such proclamation. The processing tax shall be levied, assessed, and collected upon the first domestic processing of the commodity, whether of domestic production or imported, and shall be paid by the processor. * * *"

The Secretary may from time to time, if he finds it necessary for the effectuation of the policy of the Act, readjust the amount of the exaction to meet the requirements of subsection (b). The tax is to terminate at the end of any marketing year if the rental or benefit payments are discontinued by the Secretary with the expiration of that year.

Section 9(b) fixes the tax "at such rate as equals the difference between the current average farm price for the commodity and the fair exchange value,"

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[2] Section 11 denominates wheat, cotton, field corn, hogs, rice, tobacco, and milk and its products, "basic agricultural commodities," to which the Act is to apply. Others have been added by later legislation.

with power in the Secretary, after investigation, notice, and hearing, to readjust the tax so as to prevent the accumulation of surplus stocks and depression of farm prices.

Section 9(c) directs that the fair exchange value of a commodity shall be such a price as will give that commodity the same purchasing power with respect to articles farmers buy as it had during the base period and that the fair exchange value and the current average farm price of a commodity shall be ascertained by the Secretary from available statistics in his department.

Section 12(a) appropriates $100,000,000 "to be available to the Secretary of Agriculture for administrative expenses under this title and for rental and benefit payments * * *"; and section 12(b) appropriates the proceeds derived from all taxes imposed under the Act "to be available to the Secretary of Agriculture for expansion of markets and removal of surplus agricultural products * * *: Administrative expenses, rental and benefit payments, and refunds on taxes."

Section 15(d) permits the Secretary, upon certain conditions, to impose compensating taxes on commodities in competition with those subject to the processing tax.

By section 16 a floor tax is imposed upon the sale or other disposition of any article processed wholly or in chief value from any commodity with respect to which a processing tax is to be levied in amount equivalent to that of the processing tax which would be payable with respect to the commodity from which the article is processed if the processing had occurred on the date when the processing tax becomes effective.

On July 14, 1933, the Secretary of Agriculture, with the approval of the President, proclaimed that he had determined rental and benefit payments should be made with respect to cotton; that the marketing year for that commodity was to begin August 1, 1933; and calculated and fixed the rates of processing and floor taxes on cotton in accordance with the terms of the Act.

The United States presented a claim to the respondents as receivers of the Hoosac Mills Corporation for processing and floor taxes on cotton levied under sections 9 and 16 of the Act. The receivers recommended that the claim be disallowed. The district court found the taxes valid and ordered them paid.[3] Upon appeal the circuit court of appeals reversed the order.[4] The judgment under review was entered prior to the adoption of the amending Act of August 24, 1935,[5] and we are therefore concerned only with the original Act.

First. At the outset the United States contends that the respondents have no standing to question the validity of the tax. The position is that the Act is merely a revenue measure levying an excise upon the activity of processing cotton—a proper subject for the imposition of such a tax—the proceeds of which go into the Federal Treasury and thus become available for appropriation for any purpose. It is said that what the respondents are endeavoring to do is to challenge the intended use of the money pursuant to congressional appropriation when, by confession, that money will have become the property of the Government and the taxpayer will no longer have any interest in it. *Massachusetts* v. *Mellon* (262 U. S., 447) is claimed to foreclose litigation by the respondents or other taxpayers, as such, looking to restraint of the expenditure of Government funds. That case might be an authority in the petitioners' favor if we were here concerned merely with a suit by a taxpayer to restrain the expenditure of the public moneys. It was there held that a taxpayer of the United States may not question expenditures from its Treasury on the ground that the alleged unlawful diversion will deplete the public funds and thus increase the burden of future taxation. Obviously the asserted interest of a taxpayer in the Federal Government's funds and the supposed increase of the future burden of taxation is minute and indeterminable. But here the respondents who are called upon to pay moneys as taxes, resist the exaction as a step in an unauthorized plan. This circumstance clearly distinguishes the case. The Government in substance and effect asks us to separate the Agricultural Adjustment Act into two statutes, the one levying an excise on processors of certain commodities, the other appropriating the public moneys independently of the first. Passing the novel suggestion that two statutes enacted as parts of a single scheme should be tested as if they were distinct and unrelated, we think the legislation now before us is not susceptible of such separation and treatment.

[3] *Franklin Process Co.* v. *Hoosac Mills Corporation* (8 F. Supp., 552).
[4] *Butler et al.* v. *United States* (78 F. (2d), 1).
[5] Public, No. 320, Seventy-fourth Congress, first session.

The tax can only be sustained by ignoring the avowed purpose and operation of the Act, and holding it a measure merely laying an excise upon processors to raise revenue for the support of government. Beyond cavil the sole object of the legislation is to restore the purchasing power of agricultural products to a parity with that prevailing in an earlier day; to take money from the processor and bestow it upon farmers[6] who will reduce their acreage for the accomplishment of the proposed end, and, meanwhile, to aid these farmers during the period required to bring the prices of their crops to the desired level.

The tax plays an indispensable part in the plan of regulation. As stated by the Agricultural Adjustment Administrator, it is "the heart of the law"; a means of "accomplishing one or both of two things intended to help farmers attain parity prices and purchasing power."[7] A tax automatically goes into effect for a commodity when the Secretary of Agriculture determines that rental or benefit payments are to be made for reduction of production of that commodity. The tax is to cease when rental or benefit payments cease. The rate is fixed with the purpose of bringing about crop reduction and price raising. It is to equal the difference between the "current average farm price" and "fair exchange value." It may be altered to such amount as will prevent accumulation of surplus stocks. If the Secretary finds the policy of the Act will not be promoted by the levy of the tax for a given commodity, he may exempt it. (Section 11.) The whole revenue from the levy is appropriated in aid of crop control; none of it is made available for general governmental use. The entire agricultural adjustment program embodied in Title I of the Act is to become inoperative when, in the judgment of the President, the national economic emergency ends; and as to any commodity he may terminate the provisions of the law, if he finds them no longer requisite to carrying out the declared policy with respect to such commodity. (Section 13.)

The statute not only avows an aim foreign to the procurement of revenue for the support of government, but by its operation shows the exaction laid upon processors to be the necessary means for the intended control of agricultural production.

In these aspects the tax, so-called, closely resembles that laid by the Act of August 3, 1882, entitled "An Act to regulate immigration," which came before this Court in the Head Money cases (112 U. S., 580). The statute directed that there should be levied, collected and paid a duty of 50 cents for each alien passenger who should come by vessel from a foreign port to one in the United States. Payment was to be made to the collector of the port by the master, owner, consignee or agent of the ship; the money was to be paid into the Treasury, was to be called the immigrant fund, and to be used by the Secretary of the Treasury to defray the expense of regulating immigration, for the care of immigrants and relieving those in distress, and for the expenses of effectuating the Act.

Various objections to the Act were presented. In answering them the Court said (page 595):

"But the true answer to all these objections is that the power exercised in this instance is not the taxing power. The burden imposed on the shipowner by this statute is the mere incident of the regulation of commerce—of that branch of foreign commerce which is involved in immigration. * * *

"It is true not much is said about protecting the shipowner. But he is the man who reaps the profit from the transaction, * * *. The sum demanded of him is not, therefore, strictly speaking, a tax or duty within the meaning of the Constitution. The money thus raised, though paid into the Treasury, is appropriated in advance to the uses of the statute, and does not go to the general support of the Government."

While there the exaction was sustained as an appropriate element in a plan within the power of Congress "to regulate commerce with foreign nations," no question was made of the standing of the shipowner to raise the question of the validity of the scheme and consequently of the exaction which was an incident of it.

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[6] United States Department of Agriculture, Achieving a Balanced Agriculture, page 38: "Farmers should not forget that all the processing tax money ends up in their own pockets. Even in those cases where they pay part of the tax, they get it all back. Every dollar collected in processing taxes goes to the farmer in benefit payments."

United States Department of Agriculture, The Processing Tax, page 1: "Proceeds of processing taxes are passed to farmers as benefit payments."

[7] United States Department of Agriculture, Agricultural Adjustment, page 9.

It is inaccurate and misleading to speak of the exaction from processors prescribed by the challenged Act as a tax, or to say that as a tax it is subject to no infirmity. A tax, in the general understanding of the term, and as used in the Constitution, signifies an exaction for the support of the Government. The word has never been thought to connote the expropriation of money from one group for the benefit of another. We may concede that the latter sort of imposition is constitutional when imposed to effectuate regulation of a matter in which both groups are interested and in respect of which there is a power of legislative regulation. But manifestly no justification for it can be found unless as an integral part of such regulation. The exaction can not be wrested out of its setting, denominated an excise for raising revenue and legalized by ignoring its purpose as a mere instrumentality for bringing about a desired end. To do this would be to shut our eyes to what all others than we can see and understand. (*Child Labor Tax case*, 259 U. S., 20, 37.)

We conclude that the Act is one regulating agricultural production; that the tax is a mere incident of such regulation and that the respondents have standing to challenge the legality of the exaction.

It does not follow that as the Act is not an exertion of the taxing power and the exaction not a true tax, the statute is void or the exaction uncollectible. For, to paraphrase what was said in the Head Money cases (supra), page 596, if this is an expedient regulation by Congress, of a subject within one of its granted powers, "and the end to be attained is one falling within that power, the Act is not void, because, within a loose and more extended sense than was used in the Constitution," the exaction is called a tax.

Second. The Government asserts that even if the respondents may question the propriety of the appropriation embodied in the statute their attack must fail because Article I, section 8 of the Constitution authorizes the contemplated expenditure of the funds raised by the tax. This contention presents the great and the controlling question in the case.[8] We approach its decision with a sense of our grave responsibility to render judgment in accordance with the principles established for the governance of all three branches of the Government.

There should be no misunderstanding as to the function of this Court in such a case. It is sometimes said that the Court assumes a power to overrule or control the action of the people's representatives. This is a misconception. The Constitution is the supreme law of the land ordained and established by the people. All legislation must conform to the principles it lays down. When an Act of Congress is appropriately challenged in the courts as not conforming to the constitutional mandate the judicial branch of the Government has only one duty—to lay the article of the Constitution which is invoked beside the statute which is challenged and to decide whether the latter squares with the former. All the Court does, or can do, is to announce its considered judgment upon the question. The only power it has, if such it may be called, is the power of judgment. This Court neither approves nor condemns any legislative policy. Its delicate and difficult office is to ascertain and declare whether the legislation is in accordance with, or in contravention of, the provisions of the Constitution; and, having done that, its duty ends.[9]

The question is not what power the Federal Government ought to have but what powers in fact have been given by the people. It hardly seems necessary to reiterate that ours is a dual form of government; that in every State there are two governments—the State and the United States. Each State has all governmental powers save such as the people, by their Constitution, have conferred upon the United States, denied to the States, or reserved to themselves. The Federal Union is a Government of delegated powers. It has only such as are expressly conferred upon it and such as are reasonably to be implied from those granted. In this respect we differ radically from nations

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[8] Other questions were presented and argued by counsel, but we do not consider or decide them. The respondents insist that the Act in numerous respects delegates legislative power to the Executive contrary to the principles announced in *Panama Refining Co.* v. *Ryan* (293 U. S., 388) and *Schechter Corporation* v. *United States* (295 U. S., 495); that this unlawful delegation is not cured by the amending Act of August 24, 1935; that the exaction is in violation of the due process clause of the fifth amendment since the legislation takes their property for a private use; that the floor tax is a direct tax and therefore void for lack of apportionment amongst the States, as required by Article I, section 9; and that the processing tax is wanting in uniformity and so violates Article I, section 8, clause 1, of the Constitution.

[9] Compare *Adkins* v. *Children's Hospital* (261 U. S., 525, 544): *Massachusetts* v. *Mellon* (262 U. S., 447, 488).

where all legislative power, without restriction or limitation, is vested in a parliament or other legislative body subject to no restrictions except the discretion of its members.

Article I, section 8, of the Constitution vests sundry powers in the Congress. But two of its clauses have any bearing upon the validity of the statute under review.

The third clause endows the Congress with power "to regulate commerce * * * among the several States." Despite a reference in its first section to a burden upon, and an obstruction of the normal currents of commerce, the Act under review does not purport to regulate transactions in interstate or foreign[10] commerce. Its stated purpose is the control of agricultural production, a purely local activity, in an effort to raise the prices paid the farmer. Indeed, the Government does not attempt to uphold the validity of the Act on the basis of the commerce clause, which, for the purpose of the present case, may be put aside as irrelevant.

The clause thought to authorize the legislation—the first—confers upon the Congress power "to lay and collect taxes, duties, imposts and excises, to pay the debts and provide for the common defense and general welfare of the United States; * * *." It is not contended that this provision grants power to regulate agricultural production upon the theory that such legislation would promote the general welfare. The Government concedes that the phrase "to provide for the general welfare" qualifies the power "to lay and collect taxes." The view that the clause grants power to provide for the general welfare, independently of the taxing power, has never been authoritatively accepted. Mr. Justice Story points out that if it were adopted "it is obvious that under color of the generality of the words, to 'provide for the common defense and general welfare,' the Government of the United States is, in reality, a Government of general and unlimited powers, notwithstanding the subsequent enumeration of specific powers."[11] The true construction undoubtedly is that the only thing granted is the power to tax for the purpose of providing funds for payment of the Nation's debts and making provision for the general welfare.

Nevertheless the Government asserts that warrant is found in this clause for the adoption of the Agricultural Adjustment Act. The argument is that Congress may appropriate and authorize the spending of moneys for the "general welfare"; that the phrase should be liberally construed to cover anything conducive to national welfare; that decision as to what will promote such welfare rests with Congress alone, and the courts may not review its determination; and finally that the appropriation under attack was in fact for the general welfare of the United States.

The Congress is expressly empowered to lay taxes to provide for the general welfare. Funds in the Treasury as a result of taxation may be expended only through appropriation. (Article I, section 9, clause 7.) They can never accomplish the objects for which they were collected unless the power to appropriate is as broad as the power to tax. The necessary implication from the terms of the grant is that the public funds may be appropriated "to provide for the general welfare of the United States." These words can not be meaningless, else they would not have been used. The conclusion must be that they were intended to limit and define the granted power to raise and to expend money. How shall they be construed to effectuate the intent of the instrument?

Since the foundation of the Nation sharp differences of opinion have persisted as to the true interpretation of the phrase. Madison asserted it amounted to no more than a reference to the other powers enumerated in the subsequent clauses of the same section; that, as the United States is a Government of limited and enumerated powers, the grant of power to tax and spend for the general national welfare must be confined to the enumerated legislative fields committed to the Congress. In this view the phrase is mere tautology, for taxation and appropriation are or may be necessary incidents of the exercise of any of the enumerated legislative powers. Hamilton, on the other hand, maintained the clause confers a power separate and distinct from those later enumerated, is not restricted in meaning by the grant of them, and Congress consequently has a substantive power to tax and to appropriate, limited only by

[10] The enactment of protective tariff laws has its basis in the power to regulate foreign commerce. See *Board of Trustees of the University of Illinois* v. *United States* (289 U. S., 48, 58).

[11] Story, Commentaries on the Constitution of the United States, fifth edition, Volume I, section 907.

the requirement that it shall be exercised to provide for the general welfare of the United States. Each contention has had the support of those whose views are entitled to weight. This Court has noticed the question, but has never found it necessary to decide which is the true construction. Mr. Justice Story, in his Commentaries, espouses the Hamiltonian position.[12] We shall not review the writings of public men and commentators or discuss the legislative practice. Study of all these leads us to conclude that the reading advocated by Mr. Justice Story is the correct one. While, therefore, the power to tax is not unlimited, its confines are set in the clause which confers it, and not in those of section 8 which bestow and define the legislative powers of the Congress. It results that the power of Congress to authorize expenditure of public moneys for public purposes is not limited by the direct grants of legislative power found in the Constitution.

But the adoption of the broader construction leaves the power to spend subject to limitations.

As Story says:

"The Constitution was, from its very origin, contemplated to be the frame of a national government, of special and enumerated powers, and not of general and unlimited powers."[13]

Again he says:

"A power to lay taxes for the common defense and general welfare of the United States is not in common sense a general power. It is limited to those objects. It can not constitutionally transcend them."[14]

That the qualifying phrase must be given effect all advocates of broad construction admit. Hamilton, in his well-known Report on Manufactures, states that the purpose must be "general, and not local."[15] Monroe, an advocate of Hamilton's doctrine, wrote: "Have Congress a right to raise and appropriate the money to any and to every purpose according to their will and pleasure? They certainly have not."[16] Story says that if the tax be not proposed for the common defense or general welfare, but for other objects wholly extraneous, it would be wholly indefensible upon constitutional principles.[17] And he makes it clear that the powers of taxation and appropriation extend only to matters of national, as distinguished from local welfare.

As elsewhere throughout the Constitution the section in question lays down principles which control the use of the power, and does not attempt meticulous or detailed directions. Every presumption is to be indulged in favor of faithful compliance by Congress with the mandates of the fundamental law. Courts are reluctant to adjudge any statute in contravention of them. But, under our frame of government, no other place is provided where the citizen may be heard to urge that the law fails to conform to the limits set upon the use of a granted power. When such a contention comes here we naturally require a showing that by no reasonable possibility can the challenged legislation fall within the wide range of discretion permitted to the Congress. How great is the extent of that range, when the subject is the promotion of the general welfare of the United States, we need hardly remark. But, despite the breadth of the legislative discretion, our duty to hear and to render judgment remains. If the statute plainly violates the stated principle of the Constitution we must so declare.

We are not now required to ascertain the scope of the phrase "general welfare of the United States" or to determine whether an appropriation in aid of agriculture falls within it. Wholly apart from that question, another principle embedded in our Constitution prohibits the enforcement of the Agricultural Adjustment Act. The Act invades the reserved rights of the States. It is a statutory plan to regulate and control agricultural production, a matter beyond the powers delegated to the Federal Government. The tax, the appropriation of the funds raised, and the direction for their disbursement, are but parts of the plan. They are but means to an unconstitutional end.

From the accepted doctrine that the United States is a Government of delegated powers, it follows that those not expressly granted, or reasonably to be implied from such as are conferred, are reserved to the States or to the people.

[12] *Loc. cit.*, Chapter XIV, *passim*.
[13] *Loc. cit.*, section 909.
[14] *Loc. cit.*, section 922.
[15] Works, Volume III, page 250.
[16] Richardson, Messages and Papers of the Presidents, Volume II, page 167.
[17] *Loc. cit.*, page 673.

To forestall any suggestion to the contrary, the tenth amendment was adopted.[18] The same proposition, otherwise stated, is that powers not granted are prohibited. None to regulate agricultural production is given, and therefore legislation by Congress for that purpose is forbidden.

It is an established principle that the attainment of a prohibited end may not be accomplished under the pretext of the exertion of powers which are granted.

"Should Congress, in the execution of its powers, adopt measures which are prohibited by the Constitution; or should Congress, under the pretext of executing its powers, pass laws for the accomplishment of objects not intrusted to the Government; it would become the painful duty of this tribunal, should a case requiring such a decision come before it, to say that such an Act was not the law of the land." (*McCulloch* v. *Maryland*, 4 Wheat., 316, 423.)

"Congress can not, under the pretext of executing delegated power, pass laws for the accomplishment of objects not intrusted to the Federal Government. And we accept as established doctrine that any provision of an Act of Congress ostensibly enacted under power granted by the Constitution, not naturally and reasonably adapted to the effective exercise of such power but solely to the achievement of something plainly within power reserved to the States, is invalid and can not be enforced." (*Linder* v. *United States*, 268 U. S., 5, 17.)

These principles are as applicable to the power to lay taxes as to any other Federal power. Said the Court, in *McCulloch* v. *Maryland* (supra, 421):

"Let the end be legitimate, let it be within the scope of the Constitution, and all means which are appropriate, which are plainly adapted to that end, which are not prohibited, but consistent with the letter and spirit of the Constitution, are constitutional."

The power of taxation, which is expressly granted, may, of course, be adopted as a means to carry into operation another power also expressly granted. But resort to the taxing power to effectuate an end which is not legitimate, not within the scope of the Constitution, is obviously inadmissible.

"Congress is not empowered to tax for those purposes which are within the exclusive province of the States." (*Gibbons* v. *Ogden*, 9 Wheat., 1, 199.)

"There are, indeed, certain virtual limitations, arising from the principles of the Constitution itself. It would undoubtedly be an abuse of the [taxing] power if so exercised as to impair the separate existence and independent self-government of the States, or if exercised for ends inconsistent with the limited grants of power in the Constitution." (*Veazie Bank* v. *Fenno*, 8 Wall., 533, 541.)

In the *Child Labor Tax case* (259 U. S., 20) and in *Hill* v. *Wallace* (259 U. S., 44), this Court had before it statutes which purported to be taxing measures. But their purpose was found to be to regulate the conduct of manufacturing and trading, not in interstate commerce, but in the States—matters not within any power conferred upon Congress by the Constitution—and the levy of the tax a means to force compliance. The Court held this was not a constitutional use, but an unconstitutional abuse of the power to tax. In *Linder* v. *United States*, supra, we held that the power to tax could not justify the regulation of the practice of a profession, under the pretext of raising revenue. In *United States* v. *Constantine* (decided December 11, 1935) [Ct. D. 1053, C. B. XIV-2, 403] we declared that Congress could not, in the guise of a tax, impose sanctions for violation of State law respecting the local sale of liquor. These decisions demonstrate that Congress could not, under the pretext of raising revenue, lay a tax on processors who refuse to pay a certain price for cotton and exempt those who agree so to do, with the purpose of benefiting producers.

Third. If the taxing power may not be used as the instrument to enforce a regulation of matters of State concern with respect to which the Congress has no authority to interfere, may it, as in the present case, be employed to raise the money necessary to purchase a compliance which the Congress is powerless to command? The Government asserts that whatever might be said against the validity of the plan, if compulsory, it is constitutionally sound because the

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[18] The tenth amendment declares: "The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people."

end is accomplished by voluntary cooperation. There are two sufficient answers to the contention. The regulation is not in fact voluntary. The farmer, of course, may refuse to comply, but the price of such refusal is the loss of benefits. The amount offered is intended to be sufficient to exert pressure on him to agree to the proposed regulation.[10] The power to confer or withhold unlimited benefits is the power to coerce or destroy. If the cotton grower elects not to accept the benefits, he will receive less for his crop; those who receive payments will be able to undersell him. The result may well be financial ruin. The coercive purpose and intent of the statute is not obscured by the fact that it has not been perfectly successful. It is pointed out that, because there still remained a minority whom the rental and benefit payments were insufficient to induce to surrender their independence of action, the Congress has gone further and, in the Bankhead Cotton Act, used the taxing power in a more directly minatory fashion to compel submission. This progression only serves more fully to expose the coercive purpose of the so-called tax imposed by the present Act. It is clear that the Department of Agriculture has properly described the plan as one to keep a noncooperating minority in line. This is coercion by economic pressure. The asserted power of choice is illusory.

In *Frost Trucking Co.* v. *R. R. Commission* (271 U. S., 583), a State act was considered which provided for supervision and regulation of transportation for hire by automobile on the public highways. Certificates of convenience and necessity were to be obtained by persons desiring to use the highways for this purpose. The regulatory commission required that a private contract carrier should secure such a certificate as a condition of its operation. The effect of the commission's action was to transmute the private carrier into a public carrier. In other words, the privilege of using the highways as a private carrier for compensation was conditioned upon his dedicating his property to the quasi public use of public transportation. While holding that the private carrier was not obliged to submit himself to the condition the commission denied him the privilege of using the highways if he did not do so. The argument was, as here, that the carrier had a free choice. This Court said, in holding the act as construed unconstitutional:

"If so, constitutional guaranties, so carefully safeguarded against direct assault, are open to destruction by the indirect but no less effective process of requiring a surrender, which, though, in form voluntary, in fact lacks none of the elements of compulsion. Having regard to form alone, the act here is an offer to the private carrier of a privilege, which the State may grant or deny, upon a condition, which the carrier is free to accept or reject. In reality, the carrier is given no choice, except a choice between the rock and the whirlpool—an option to forego a privilege which may be vital to his livelihood or submit to a requirement which may constitute an intolerable burden." (Page 593.)

But if the plan were one for purely voluntary cooperation it would stand no better so far as Federal power is concerned. At best it is a scheme for purchasing with Federal funds submission to Federal regulation of a subject reserved to the States.

It is said that Congress has the undoubted right to appropriate money to executive officers for expenditure under contracts between the Government and individuals; that much of the total expenditures is so made. But appropriations and expenditures under contracts for proper governmental purposes can not justify contracts which are not within Federal power. And contracts for the reduction of acreage and the control of production are outside the range of that power. An appropriation to be expended by the United States under contracts calling for violation of a State law clearly would offend the Constitution. Is a statute less objectionable which authorizes expenditure of Federal moneys to induce action in a field in which the United States has no power to intermeddle? The Congress can not invade State jurisdiction to compel individual action; no more can it purchase such action.

[10] United States Department of Agriculture, Agricultural Adjustment, page 9: "Experience of cooperative associations and other groups has shown that without such Government support, the efforts of the farmers to band together to control the amount of their product sent to market are nearly always brought to nothing. Almost always, under such circumstances, there has been a noncooperating minority, which, refusing to go along with the rest, has stayed on the outside and tried to benefit from the sacrifices the majority has made. * * * It is to keep this noncooperating minority in line, or at least prevent it from doing harm to the majority, that the power of the Government has been marshaled behind the adjustment programs."

We are referred to numerous types of Federal appropriation which have been made in the past, and it is asserted no question has been raised as to their validity. We need not stop to examine or consider them. As was said in *Massachusetts* v. *Mellon*, supra (page 487):

"* * * as an examination of the Acts of Congress will disclose, a large number of statutes appropriating or involving the expenditure of moneys for non-Federal purposes have been enacted and carried into effect."

As the opinion points out, such expenditures have not been challenged because no remedy was open for testing their constitutionality in the courts.

We are not here concerned with a conditional appropriation of money, nor with a provision that if certain conditions are not complied with the appropriation shall no longer be available. By the Agricultural Adjustment Act the amount of the tax is appropriated to be expended only in payment under contracts whereby the parties bind themselves to regulation by the Federal Government. There is an obvious difference between a statute stating the conditions upon which moneys shall be expended and one effective only upon assumption of a contractual obligation to submit to a regulation which otherwise could not be enforced. Many examples pointing the distinction might be cited. We are referred to appropriations in aid of education, and it is said that no one has doubted the power of Congress to stipulate the sort of education for which money shall be expended. But an appropriation to an educational institution which by its terms is to become available only if the beneficiary enters into a contract to teach doctrines subversive of the Constitution is clearly bad. An affirmance of the authority of Congress so to condition the expenditure of an appropriation would tend to nullify all constitutional limitations upon legislative power.

But it is said that there is a wide difference in another respect, between compulsory regulation of the local affairs of a State's citizens and the mere making of a contract relating to their conduct; that, if any State objects, it may declare the contract void and thus prevent those under the State's jurisdiction from complying with its terms. The argument is plainly fallacious. The United States can make the contract only if the Federal power to tax and to appropriate reaches the subject matter of the contract. If this does reach the subject matter, its exertion can not be displaced by State action. To say otherwise is to deny the supremacy of the laws of the United States: to make them subordinate to those of a State. This would reverse the cardinal principle embodied in the Constitution and substitute one which declares that Congress may only effectively legislate as to matters within Federal competence when the States do not dissent.

Congress has no power to enforce its commands on the farmer to the ends sought by the Agricultural Adjustment Act. It must follow that it may not indirectly accomplish those ends by taxing and spending to purchase compliance. The Constitution and the entire plan of our Government negative any such use of the power to tax and to spend as the Act undertakes to authorize. It does not help to declare that local conditions throughout the Nation have created a situation of national concern; for this is but to say that whenever there is a widespread similarity of local conditions, Congress may ignore constitutional limitations upon its own powers and usurp those reserved to the States. If, in lieu of compulsory regulation of subjects within the States' reserved jurisdiction, which is prohibited, the Congress could invoke the taxing and spending power as a means to accomplish the same end, clause 1 of section 8 of Article I would become the instrument for total subversion of the governmental powers reserved to the individual States.

If the Act before us is a proper exercise of the Federal taxing power, evidently the regulation of all industry throughout the United States may be accomplished by similar exercises of the same power. It would be possible to exact money from one branch of an industry and pay it to another branch in every field of activity which lies within the province of the States. The mere threat of such a procedure might well induce the surrender of rights and the compliance with Federal regulation as the price of continuance in business. A few instances will illustrate the thought.

Let us suppose Congress should determine that the farmer, the miner or some other producer of raw materials is receiving too much for his products, with consequent depression of the processing industry and idleness of its employees. Though, by confession, there is no power vested in Congress to compel by statute a lowering of the prices of the raw material the same result might be accomplished, if the questioned Act be valid, by taxing the producer upon his output and appropriating the proceeds to the processors, either with or without conditions imposed as the consideration for payment of the subsidy.

We have held in *Schechter Poultry Corporation* v. *United States* (295 U. S., 495) that Congress has no power to regulate wages and hours of labor in a local business. If the petitioner is right this very end may be accomplished by appropriating money to be paid to employers from the Federal Treasury under contracts whereby they agree to comply with certain standards fixed by Federal law or by contract.

Should Congress ascertain that sugar refiners are not receiving a fair profit, and that this is detrimental to the entire industry, and in turn has its repercussions in trade and commerce generally, it might, in analogy to the present law, impose an excise of 2 cents a pound on every sale of the commodity and pass the funds collected to such refiners, and such only, as will agree to maintain a certain price.

Assume that too many shoes are being manufactured throughout the Nation; that the market is saturated, the price depressed, the factories running half-time, the employees suffering. Upon the principle of the statute in question Congress might authorize the Secretary of Commerce to enter into contracts with shoe manufacturers providing that each shall reduce his output and that the United States will pay him a fixed sum proportioned to such reduction, the money to make the payments to be raised by a tax on all retail shoe dealers or their customers.

Suppose that there are too many garment workers in the large cities; that this results in dislocation of the economic balance. Upon the principle contended for an excise might be laid on the manufacture of all garments manufactured and the proceeds paid to those manufacturers who agree to remove their plants to cities having not more than a hundred thousand population. Thus, through the asserted power of taxation, the Federal Government, against the will of individual States, might completely redistribute the industrial population.

A possible result of sustaining the claimed Federal power would be that every business group which thought itself underprivileged might demand that a tax be laid on its vendors or vendees the proceeds to be appropriated to the redress of its deficiency of income.

These illustrations are given, not to suggest that any of the purposes mentioned are unworthy, but to demonstrate the scope of the principle for which the Government contends; to test the principle by its application; to point out that, by the exercise of the asserted power, Congress would, in effect, under the pretext of exercising the taxing power, in reality accomplish prohibited ends. It can not be said that they envisage improbable legislation. The supposed cases are no more improbable than would the present Act have been deemed a few years ago.

Until recently no suggestion of the existence of any such power in the Federal Government has been advanced. The expressions of the framers of the Constitution, the decisions of this Court interpreting that instrument and the writings of great commentators will be searched in vain for any suggestion that there exists in the clause under discussion or elsewhere in the Constitution, the authority whereby every provision and every fair implication from that instrument may be subverted, the independence of the individual States obliterated, and the United States converted into a central Government exercising uncontrolled police power in every State of the Union, superseding all local control or regulation of the affairs or concerns of the States.

Hamilton himself, the leading advocate of broad interpretation of the power to tax and to appropriate for the general welfare, never suggested that any power granted by the Constitution could be used for the destruction of local self-government in the States. Story countenances no such doctrine. It seems never to have occurred to them, or to those who have agreed with them, that the general welfare of the United States (which has aptly been termed "an indestructible Union, composed of indestructible States") might be served by obliterating the constituent members of the Union. But to this fatal conclusion the doctrine contended for would inevitably lead. And its sole premise is that, though the makers of the Constitution, in erecting the Federal Government, intended sedulously to limit and define its powers, so as to reserve to the States and the people sovereign power, to be wielded by the States and their citizens and not to be invaded by the United States, they nevertheless by a single clause gave power to the Congress to tear down the barriers, to invade the States' jurisdiction, and to become a parliament of the whole people, subject to no restrictions save such as are self-imposed. The argument when seen in its true character and in the light of its inevitable results must be rejected.

Since, as we have pointed out, there was no power in the Congress to impose the contested exaction, it could not lawfully ratify or confirm what an executive officer had done in that regard. Consequently the Act of 1935 does not affect the rights of the parties.

The judgment is affirmed.

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*United States of America, petitioner,* v. *William M. Butler et al., Receivers of Hoosac Mills Corporation.*

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

[January 6, 1936.]

DISSENTING OPINION.

Mr. Justice STONE: I think the judgment should be reversed.

The present stress of widely held and strongly expressed differences of opinion of the wisdom of the Agricultural Adjustment Act makes it important, in the interest of clear thinking and sound result, to emphasize at the outset certain propositions which should have controlling influence in determining the validity of the Act. They are:

1. The power of courts to declare a statute unconstitutional is subject to two guiding principles of decision which ought never to be absent from judicial consciousness. One is that courts are concerned only with the power to enact statutes, not with their wisdom. The other is that while unconstitutional exercise of power by the executive and legislative branches of the Government is subject to judicial restraint, the only check upon our own exercise of power is our own sense of self-restraint. For the removal of unwise laws from the statute books appeal lies not to the courts but to the ballot and to the processes of democratic government.

2. The constitutional power of Congress to levy an excise tax upon the processing of agricultural products is not questioned. The present levy is held invalid, not for any want of power in Congress to lay such a tax to defray public expenditures, including those for the general welfare, but because the use to which its proceeds are put is disapproved.

3. As the present depressed state of agriculture is Nation-wide in its extent and effects, there is no basis for saying that the expenditure of public money in aid of farmers is not within the specifically granted power of Congress to levy taxes to "provide for the * * * general welfare." The opinion of the Court does not declare otherwise.

4. No question of a variable tax fixed from time to time by fiat of the Secretary of Agriculture, or of unauthorized delegation of legislative power, is now presented. The schedule of rates imposed by the Secretary in accordance with the original command of Congress has since been specifically adopted and confirmed by Act of Congress, which has declared that it shall be the lawful tax. (Act of August 24, 1935, — Stat., —.) That is the tax which the Government now seeks to collect. Any defects there may have been in the manner of laying the tax by the Secretary have now been removed by the exercise of the power of Congress to pass a curative statute validating an intended, though defective tax. (*United States* v. *Heintzen & Co.*, 206 U. S., 370; *Graham & Foster* v. *Goodcell*, 282 U. S., 409 [Ct. D. 287, C. B. X–1, 191]; cf. *Milliken* v. *United States*, 283 U. S., 15 [Ct. D. 320, C. B. X–1, 472].) The Agricultural Adjustment Act as thus amended declares that none of its provisions shall fail because others are pronounced invalid.

It is with these preliminary and hardly controverted matters in mind that we should direct our attention to the pivot on which the decision of the Court is made to turn. It is that a levy unquestionably within the taxing power of Congress may be treated as invalid because it is a step in a plan to regulate agricultural production and is thus a forbidden infringement of State power. The levy is not any the less an exercise of taxing power because it is intended to defray an expenditure for the general welfare rather than for some other support of government. Nor is the levy and collection of the tax pointed to as effecting the regulation. While all Federal taxes inevitably have some influence on the internal economy of the States, it is not contended that the levy of a processing tax upon manufacturers using agricultural products as raw material has any perceptible regulatory effect upon either their production or manufacture. The tax is unlike the penalties which were held invalid in the *Child Labor Tax case* (259 U. S., 20), in *Hill* v. *Wallace* (259 U. S., 44), in *Linder* v. *United States* (268 U. S., 5, 17), and in *United States* v. *Constantine*, decided December 11, 1935 [Ct. D. 1053, C. B. XIV-2, 403], because they were themselves the instruments of regulation by virtue of their coercive effect on matters left to the control of the States. Here regulation, if any there be, is accomplished not by the tax but by the method by which its proceeds are expended, and would equally be accomplished by any like use of public funds, regardless of their source.

The method may be simply stated. Out of the available fund payments are made to such farmers as are willing to curtail their productive acreage, who in fact do so and who in advance have filed their written undertaking to do so with the Secretary of Agriculture. In saying that this method of spending public moneys is an invasion of the reserved powers of the States, the Court does not assert that the expenditure of public funds to promote the general welfare is not a substantive power specifically delegated to the National Government, as Hamilton and Story pronounced it to be. It does not deny that the expenditure of funds for the benefit of farmers and in aid of a program of curtailment of production of agricultural products, and thus of a supposedly better ordered national economy, is within the specifically granted power. But it is declared that State power is nevertheless infringed by the expenditure of the proceeds of the tax to compensate farmers for the curtailment of their cotton acreage. Although the farmer is placed under no legal compulsion to reduce acreage, it is said that the mere offer of compensation for so doing is a species of economic coercion which operates with the same legal force and effect as though the curtailment were made mandatory by Act of Congress. In any event it is insisted that even though not coercive the expenditure of public funds to induce the recipients to curtail production is itself an infringement of State power, since the Federal Government can not invade the domain of the States by the "purchase" of performance of acts which it has no power to compel.

Of the assertion that the payments to farmers are coercive, it is enough to say that no such contention is pressed by the taxpayer, and no such consequences were to be anticipated or appear to have resulted from the administration of the Act. The suggestion of coercion finds no support in the record or in any data showing the actual operation of the Act. Threat of loss, not hope of gain, is the essence of economic coercion. Members of a long depressed industry have undoubtedly been tempted to curtail acreage by the hope of resulting better prices and by the proferred opportunity to obtain needed ready money. But there is nothing to indicate that those who accepted benefits were impelled by fear of lower prices if they did not accept, or that at any stage in the operation of the plan a farmer could say whether, apart from the certainty of cash payments at specified times, the advantage would lie with curtailment of production plus compensation, rather than with the same or increased acreage plus the expected rise in prices which actually occurred. Although the Agricultural Adjustment Act was put into operation in June, 1933, the official reports of the Department of Agriculture show that 6,343,000 acres of productive cotton land, 14 per cent of the total, did not participate in the plan in 1934, and 2,790,000 acres, 6 per cent of the total, did not participate in 1935. Of the total number of farms growing cotton, estimated at 1,500,000, 33 per cent in 1934 and 13 per cent in 1935 did not participate.

It is significant that in the congressional hearings on the bill that became the Bankhead Act (48 Stat., 598), as amended by Act of June 20, 1934 (48 Stat., 1184), which imposes a tax of 50 per cent on all cotton produced in excess of limits prescribed by the Secretary of Agriculture, there was abundant testimony that the restriction of cotton production attempted by the Agricultural Adjustment Act could not be secured without the coercive provisions of the Bankhead Act. (See hearing before Committee on Agriculture, United States Senate, on S. 1974, Seventy-third Congress, second session; hearing before Committee on Agriculture, United States House of Representatives, on H. R. 8402. Seventy-third Congress, second session.) The Senate and House committees so reported (Senate Report No. 283, Seventy-third Congress, second session, page 3; House Report No. 867, Seventy-third Congress, second session, page 3.) The report of the Department of Agriculture on the administration of the Agricultural Adjustment Act (February 15, 1934, to December 31, 1934), page 50, points out that the Bankhead Act was passed in response to a strong sentiment in favor of mandatory production control "that would prevent noncooperating farmers from increasing their own plantings in order to capitalize upon the price advances that had resulted from the reductions made by contract signers." [1] The presumption of constitutionality of a statute is not to be overturned by an assertion of its coercive effect which rests on nothing more substantial than groundless speculation.

It is upon the contention that State power is infringed by purchased regulation of agricultural production that chief reliance is placed. It is insisted that, while the Constitution gives to Congress, in specific and unambiguous terms, the power to tax and spend, the power is subject to limitations which do not find their origin in any express provision of the Constitution and to which other expressly delegated powers are not subject.

The Constitution requires that public funds shall be spent for a defined purpose, the promotion of the general welfare. Their expenditure usually involves payment on terms which will insure use by the selected recipients within the limits of the constitutional purpose. Expenditures would fail of their purpose and thus lose their constitutional sanction if the terms of payment were not such that by their influence on the action of the recipients the permitted end would be attained. The power of Congress to spend is inseparable from persuasion to action over which Congress has no legislative control. Congress may not command that the science of agriculture be taught in State universities. But if it would aid the teaching of that science by grants to State institutions, it is appropriate, if not necessary, that the grant be on the condition, incorporated in the Morrill Act (12 Stat., 503; 26 Stat., 417), that it be used for the intended purpose. Similarly it would seem to be compliance with the Constitution, not violation of it, for the Government to take and the university to give a contract that the grant would be so used. It makes no difference that there is a promise to do an act which the condition is calculated to induce. Condition and promise are alike valid since both are in furtherance of the national purpose for which the money is appropriated.

These effects upon individual action, which are but incidents of the authorized expenditure of Government money, are pronounced to be themselves a limitation upon the granted power, and so the time-honored principle of constitutional interpretation that the granted power includes all those which are incident to it is reversed. "Let the end be legitimate," said the great Chief Justice, "let it be within the scope of the Constitution, and all means which are appropriate, which are plainly adapted to that end, which are not prohibited, but consist with the letter and spirit of the Constitution, are constitutional." (*McCulloch* v. *Maryland*, 4 Wheat., 316, 421.) This cardinal guide to constitutional exposition must now be rephrased so far as the spending power of the Federal Government is concerned. Let the expenditure be to promote the general welfare, still, if it is needful in order to insure its use for the intended purpose to influence any action which Congress can not command because within the sphere of State government, the expenditure is unconstitutional. And taxes otherwise lawfully levied are likewise unconstitutional if they are appropriated to the expenditure whose incident is condemned.

Congress through the Interstate Commerce Commission has set aside intrastate railroad rates. It has made and destroyed intrastate industries by raising or lowering tariffs. These results are said to be permissible because they are incidents of the commerce power and the power to levy duties on imports. (See *Minnesota Rate cases*, 230 U. S., 352; *Shreveport Rate cases*, 234 U. S., 342; *Board of Trustees of the University of Illinois* v. *United States*, 289 U. S., 48.) The only conclusion to be drawn is that results become lawful when they are incidents of those powers but unlawful when incident to the similarly granted power to tax and spend.

Such a limitation is contradictory and destructive of the power to appropriate for the public welfare, and is incapable of practical application. The spending power of Congress is in addition to the legislative power and not subordinate to it. This independent grant of the power of the purse, and its very nature, involving in its exercise the duty to insure expenditure within the granted power, presuppose freedom of selection among divers ends and aims, and the

[1] Whether coercion was the sole or the dominant purpose of the Bankhead Act, or whether the Act was designed also for revenue or other legitimate ends, there is no occasion to consider now.

capacity to impose such conditions as will render the choice effective. It is a contradiction in terms to say that there is power to spend for the national welfare, while rejecting any power to impose conditions reasonably adapted to the attainment of the end which alone would justify the expenditure.

The limitation now sanctioned must lead to absurd consequences. The Government may give seeds to farmers, but may not condition the gift upon their being planted in places where they are most needed or even planted at all. The Government may give money to the unemployed, but may not ask that those who get it shall give labor in return, or even use it to support their families. It may give money to sufferers from earthquake, fire, tornado, pestilence or flood, but may not impose conditions—health precautions designed to prevent the spread of disease, or induce the movement of population to safer or more sanitary areas. All that, because it is purchased regulation infringing State powers, must be left for the States, who are unable or unwilling to supply the necessary relief. The Government may spend its money for vocational rehabilitation (48 Stat., 389), but it may not, with the consent of all concerned, supervise the process which it undertakes to aid. It may spend its money for the suppression of the boll weevil, but may not compensate the farmers for suspending the growth of cotton in the infected areas. It may aid State reforestation and forest fire prevention agencies (43 Stat., 653), but may not be permitted to supervise their conduct. It may support rural schools (39 Stat., 929; 45 Stat., 1151; 48 Stat., 792), but may not condition its grant by the requirement that certain standards be maintained. It may appropriate moneys to be expended by the Reconstruction Finance Corporation "to aid in financing agriculture, commerce and industry," and to facilitate "the exportation of agricultural and other products." Do all its activities collapse because, in order to effect the permissible purpose, in myriad ways the money is paid out upon terms and conditions which influence action of the recipients within the States, which Congress can not command? The answer would seem plain. If the expenditure is for a national public purpose, that purpose will not be thwarted because payment is on condition which will advance that purpose. The action which Congress induces by payments of money to promote the general welfare, but which it does not command or coerce, is but an incident to a specifically granted power, but a permissible means to a legitimate end. If appropriation in aid of a program of curtailment of agricultural production is constitutional, and it is not denied that it is, payment to farmers on condition that they reduce their crop acreage is constitutional. It is not any the less so because the farmer at his own option promises to fulfill the condition.

That the governmental power of the purse is a great one is not now for the first time announced. Every student of the history of government and economics is aware of its magnitude and of its existence in every civilized government. Both were well understood by the framers of the Constitution when they sanctioned the grant of the spending power to the Federal Government, and both were recognized by Hamilton and Story, whose views of the spending power as standing on a parity with the other powers specifically granted, have hitherto been generally accepted.

The suggestion that it must now be curtailed by judicial fiat because it may be abused by unwise use hardly rises to the dignity of argument. So may judicial power be abused. "The power to tax is the power to destroy," but we do not, for that reason, doubt its existence, or hold that its efficacy is to be restricted by its incidental or collateral effects upon the States. (See *Veazie Bank* v. *Fenno*, 8 Wall., 533; *McCray* v. *United States*, 195 U. S., 27; compare *Magnano Co.* v. *Hamilton*, 292 U. S., 40.) The power to tax and spend is not without constitutional restraints. One restriction is that the purpose must be truly national. Another is that it may not be used to coerce action left to State control. Another is the conscience and patriotism of Congress and the Executive. "It must be remembered that legislators are the ultimate guardians of the liberties and welfare of the people in quite as great a degree as the courts." (Justice Holmes, in *Missouri, Kansas & Texas R. R. Co.* v. *May*, 194 U. S., 267, 270.)

A tortured construction of the Constitution is not to be justified by recourse to extreme examples of reckless congressional spending which might occur if courts could not prevent expenditures which, even if they could be thought to effect any national purpose, would be possible only by action of a Legislature lost to all sense of public responsibility. Such suppositions are addressed to the mind accustomed to believe that it is the business of courts to sit in judgment on the wisdom of legislative action. Courts are not the only agency of government that must be assumed to have capacity to govern. Congress and the courts both unhappily may falter or be mistaken in the performance of their constitutional duty. But interpretation of our great charter of government which proceeds on any assumption that the responsibility for the preservation of our institutions is the exclusive concern of any one of the three branches of government, or that it alone can save them from destruction is far more likely, in the long run, "to obliterate the constituent members" of "an indestructible union of indestructible States" than the frank recognition that language, even of a Constitution, may mean what it says: that the power to tax and spend includes the power to relieve a Nation-wide economic maladjustment by conditional gifts of money.

Mr. Justice BRANDEIS and Mr. Justice CARDOZO join in this opinion.

## SECTION 9.—PROCESSING TAX.

REGULATIONS 81, ARTICLE 4: Nature of the tax. XV-7-7956
Ct. D. 1080

PROCESSING TAX—AGRICULTURAL ADJUSTMENT ACT—DECISION OF SUPREME COURT.

1. AMENDMENT OF ACT—CONSTITUTIONALITY.

The changes made by the Act of August 24, 1935, amending the Agricultural Adjustment Act, 1933, do not cure the infirmities of the original Act. The exaction still lacks the quality of a true tax, and remains a means for effectuating the regulation of agricultural production, a matter not within the powers of Congress.

2. COLLECTION BY DISTRAINT—INJUNCTION.

Upon the issue of the right of the petitioner to an injunction to restrain collection of processing taxes on rice imposed by the Agricultural Adjustment Act, as amended, it was held, in view of the decision in *United States* v. *Butler et al.* (Ct. D. 1070, page 421, this Bulletin), decided January 6, 1936, that the petitioner can not be required to pay any outstanding tax; that if the collector should now attempt to collect the tax by distraint he would be a trespasser; and that a decree should be entered enjoining collection. In so holding the Court did not pass upon the adequacy of the relief afforded by section 21(d) of the Agricultural Adjustment Act, as amended.

SUPREME COURT OF THE UNITED STATES.

No. 577. *Rickert Rice Mills, Inc., petitioner,* v. *Rufus W. Fontenot, Individually and as Acting United States Collector of Internal Revenue for the District of Louisiana.*

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

[January 13, 1936.]

OPINION.

Mr. Justice ROBERTS delivered the opinion of the Court.

This is one of eight companion cases.[1] They were consolidated for hearing by the district court. It will be sufficient briefly to state the facts in No. 577:

The petitioner, a processor of rice, filed its bill in the District Court for Eastern Louisiana, to restrain the respondent from assessing or collecting taxes levied for the month of September, 1935, and subsequent months, pursuant to the Agricultural Adjustment Act, 1933,[2] as amended by the Act of August 24,

[1] The others are: 578, *Dore* v. *Fontenot;* 579, *United Rice Milling Products Co., Inc.,* v. *Fontenot;* 580, *Baton Rouge Rice Mill, Inc.,* v. *Fontenot;* 581, *Simon* v. *Fontenot;* 585, *Levy Rice Milling Co., Inc.,* v. *Fontenot;* 586, *Farmers Rice Milling Co., Inc.,* v. *Fontenot;* and 587, *Noble-Trotter Rice Milling Co., Inc.,* v. *Fontenot.*

[2] Ch. 25, 48 Stat., 31.

1935.[6] The bill charges the exaction is unconstitutional and alleges the respondent threatens collection by distraint, which will cause irreparable injury, as the petitioner has no adequate remedy at law to recover what may be collected. A preliminary injunction was sought. The respondent filed a motion to dismiss, citing Revised Statutes 3224 and section 21(a) of the amended Agricultural Adjustment Act as prohibiting restraint of collection, and also asserting that the petitioner had a plain, adequate, and complete remedy at law. The court refused an interlocutory injunction and entered a decree dismissing the bill. Appeal was perfected to the circuit court of appeals. The district judge refused to grant an injunction pending the appeal. Application to the circuit court of appeals for such an injunction was denied upon the view that the petitioner had an adequate remedy at law and the statute deprived the court of jurisdiction to restrain collection.

In praying a writ of certiorari the petitioner asserted that by reason of the provisions of section 21(d) it would be impossible to recover taxes collected, even though the Act were unconstitutional, since the section forbids recovery except upon a showing of facts not susceptible of proof. This Court granted the writ and restrained collection of the tax upon condition that the petitioner should pay the amount of the accruing taxes to a depositary, to the joint credit of petitioner and respondent, such funds to be withdrawn only upon the further order of the Court. The cause was advanced for hearing and has been fully argued on the questions of the constitutionality of the exaction and the inadequacy of the remedy for recovery of taxes paid.

The changes made by the amendatory Act of August 24, 1935, do not cure the infirmities of the original Act which were the basis of decision in *United States* v. *Butler* (January 6, 1936 [Ct. D. 1070, page 421, this Bulletin]). The exaction still lacks the quality of a true tax. It remains a means for effectuating the regulation of agricultural production, a matter not within the powers of Congress.

We have no occasion to discuss or decide whether section 21(d) affords an adequate remedy at law. As yet the petitioner has not paid the taxes to the respondent, and, in view of the decision in the Butler case, hereafter can not be required so to do. If the respondent should now attempt to collect the tax by distraint he would be a trespasser. The decree of the district court will be vacated, an appropriate order entered directing the repayment to the petitioner of the funds impounded *pendente lite*, and the cause remanded to the district court for the entry of a decree enjoining collection of the assailed exaction. A similar disposition will be made of the companion cases.

So ordered.

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[6] Public, No. 320, Seventy-fourth Congress, first session.

# BITUMINOUS COAL CONSERVATION ACT, 1935 (PUBLIC, NO. 402, SEVENTY-FOURTH CONGRESS).

XV-23-8117
Ct. D. 1123

EXCISE TAX—BITUMINOUS COAL CONSERVATION ACT—DECISION OF SUPREME COURT.

1. INJUNCTIONS AGAINST ENFORCEMENT OF ACT—STOCKHOLDERS' SUITS—JURISDICTION OF COURT OF EQUITY.

Suits brought by coal companies against officials of the Federal Government, to enjoin the enforcement of the Bituminous Coal Conservation Act of 1935, and suits by stockholders against such companies and their officers, to enforce compliance with their demands, are maintainable in a court of equity, and are not premature where brought to prevent an injury which is certainly impending.

2. CONSTITUTIONALITY.

The Bituminous Coal Conservation Act of 1935, the declared purposes of which are to stabilize the bituminous coal-mining industry and promote its interstate commerce, to provide for cooperative marketing of such coal, to levy an excise tax thereon, to declare the production, distribution, and use of such coal to be affected with a national public interest, to conserve the national coal resources, to provide for the general welfare, and for other purposes, is unconstitutional. The so-called excise tax is not a tax but a penalty; the general purposes which the Act recites are beyond the power of Congress; the labor provisions of the Act do not come within the power of Congress as a regulation of interstate commerce; the delegation of power to fix hours of labor is arbitrary and violates the due process clause of the fifth amendment; and the price-fixing provisions are inseparable from the unconstitutional labor-regulating provisions.

SUPREME COURT OF THE UNITED STATES.

636. *James Walter Carter, petitioner,* v. *Carter Coal Co., George L. Carter, as Vice President and a Director of said Company, et al.*

651. *Guy T. Helvering et al., petitioners,* v. *James Walter Carter et al.*

On writs of certiorari to the United States Court of Appeals for the District of Columbia.

649. *R. C. Tway Coal Co., Kentucky Cardinal Coal Corporation, Harlan-Wallins Coal Corporation, et al., petitioners,* v. *Selden R. Glenn, Individually and as Collector of Internal Revenue for the District of Kentucky.*

650. *R. C. Tway Coal Co., R. C. Tway, President and Directors of R. C. Tway Coal Co., et al., petitioners,* v. *C. H. Clark.*

On writs of certiorari to the United States Circuit Court of Appeals for the Sixth Circuit.

[May 18, 1936.]

OPINION.

Mr. Justice SUTHERLAND delivered the opinion of the Court.

The purposes of the "Bituminous Coal Conservation Act of 1935," involved in these suits, as declared by the title, are to stabilize the bituminous coal-mining industry and promote its interstate commerce; to provide for cooperative marketing of bituminous coal; to levy a tax on such coal and provide for a drawback under certain conditions; to declare the production, distribution, and use of such coal to be affected with a national public interest; to conserve the national resources of such coal; to provide for the general welfare, and for other purposes. (Ch. 824, 49 Stat., 991.) The constitutional validity of the act is challenged in each of the suits.

Nos. 636 and 651 are cross-writs of certiorari in a stockholder's suit, brought in the Supreme Court of the District of Columbia by Carter against the Carter Coal Co. and some of its officers, Guy T. Helvering (Commissioner of Internal Revenue of the United States), and certain other officers of the United States, to enjoin the coal company and its officers named from filing an acceptance of the code provided for in said Act, from paying any tax imposed upon the coal company under the authority of the Act, and from complying with its provisions or the provisions of the code. The bill sought to enjoin the Commissioner of Internal Revenue and the other Federal officials named from proceeding under the Act in particulars specified, the details of which it is unnecessary to state.

No. 649 is a suit brought in a Federal district court in Kentucky by petitioners against respondent collector of internal revenue for the district of Kentucky, to enjoin him from collecting or attempting to collect the taxes sought to be imposed upon them by the Act, on the ground of its unconstitutionality.

No. 650 is a stockholder's suit brought in the same court against the coal company and some of its officers, to secure a mandatory injunction against their refusal to accept and operate under the provisions of the bituminous coal code prepared in pursuance of the Act.

By the terms of the Act, every producer of bituminous coal within the United States is brought within its provisions.

Section 1 is a detailed assertion of circumstances thought to justify the Act. It declares that the mining and distribution of bituminous coal throughout the United States by the producer are affected with a national public interest; and that the service of such coal in relation to industrial activities, transportation facilities, health and comfort of the people, conservation by controlled production and economical mining and marketing, maintenance of just and rational relations between the public, owners, producers and employees, the right of the public to constant and adequate supplies of coal at reasonable prices, and the general welfare of the Nation, require that the bituminous coal industry should be regulated as the Act provides.

Section 1, among other things, further declares that the production and distribution by producers of such coal bear upon and directly affect interstate commerce, and render regulation of production and distribution imperative for the protection of such commerce; that certain features connected with the production, distribution, and marketing have led to waste of the national coal resources, disorganization of interstate commerce in such coal, and burdening and obstructing interstate commerce therein; that practices prevailing in the production of such coal directly affect interstate commerce and require regulation for the protection of that commerce; and that the right of mine workers to organize and collectively bargain for wages, hours of labor, and conditions of employment should be guaranteed in order to prevent constant wage cutting and disparate labor costs detrimental to fair interstate competition, and in order to avoid obstructions to interstate commerce that recur in industrial disputes over labor relations at the mines. These declarations constitute not enactments of law, but legislative averments by way of inducement to the enactment which follows.

The substantive legislation begins with section 2, which establishes in the Department of the Interior a National Bituminous Coal Commission, to be appointed and constituted as the section then specifically provides. Upon this commission is conferred the power to hear evidence and find facts upon which its orders and actions may be predicated.

Section 3 provides:

"There is hereby imposed upon the sale or other disposal of all bituminous coal produced within the United States an excise tax of 15 per centum on the sale price at the mine, or in the case of captive coal the fair market value of such coal at the mine, such tax, subject to the later provisions of this section, to be payable to the United States by the producers of such coal, and to be payable monthly for each calendar month, on or before the first business day of the second succeeding month, and under such regulations, and in such manner, as shall be prescribed by the Commissioner of Internal Revenue: *Provided*, That in the case of captive coal produced as aforesaid, the Commissioner of Internal Revenue shall fix a price therefor at the current market price for the comparable kind, quality, and size of coals in the locality where the same is produced: *Provided further*, That any such coal producer who has filed with the National Bituminous Coal Commission his acceptance of the code provided for in section 4 of this Act, and who acts in compliance with the provisions of such code, shall be entitled to a drawback in the form of a credit upon the amount of such tax payable hereunder, equivalent to 90 per centum of the amount of such tax, to be allowed and deducted therefrom at the time settlement therefor is required, in such manner as shall be prescribed by the Commissioner of Internal Revenue. Such right or benefit of drawback shall apply to all coal sold or disposed of from and after the day of the producer's filing with the commission his acceptance of said code in such form of agreement as the commission may prescribe. No producer shall by reason of his acceptance of the code provided for in section 4 or of the drawback of taxes provided in section 3 of this Act be held to be precluded or estopped from contesting the constitutionality of any provision of said code, or its validity as applicable to such producer."

Section 4 provides that the commission shall formulate the elaborate provisions contained therein into a working agreement to be known as the Bituminous Coal Code. These provisions require the organization of 23 coal districts, each with a district board the membership of which is to be determined in a manner pointed out by the Act. Minimum prices for coal are to be established by each of these boards, which is authorized to make such classification of coals and price variation as to mines and consuming market areas as it may deem proper. "In order to sustain the stabilization of wages, working conditions, and maximum hours of labor, said prices shall be established so as to yield a return per net ton for each district in a minimum price area, as such districts are identified and such area is defined in the subjoined table designated 'Minimum-price area table,' equal as nearly as may be to the weighted average of the total costs, per net ton, determined as hereinafter provided, of the tonnage of such minimum price area. The computation of the total costs shall include the cost of labor, supplies, power, taxes, insurance, workmen's compensation, royalties, depreciation, and depletion (as determined by the Bureau of Internal Revenue in the computation of the Federal income tax) and all other direct expenses of production, coal operators' association dues, district board assessments for board operating expenses only levied under the code, and reasonable costs of selling and the cost of administration." The district board must determine and adjust the total cost of the ascertainable tonnage produced in the district so as to give effect to any changes in wage rates, hours of employment, or other factors substantially affecting costs, which may have been established since January 1, 1934.

Without repeating the long and involved provisions with regard to the fixing of minimum prices, it is enough to say that the Act confers the power to fix the minimum price of coal at each and every coal mine in the United States, with such price variations as the board may deem necessary and proper. There is also a provision authorizing the commission, when deemed necessary in the public interest, to establish maximum prices in order to protect the consumer against unreasonably high prices.

All sales and contracts for the sale of coal are subject to the code prices provided for and in effect when such sales and contracts are made. Various unfair methods of competition are defined and forbidden.

The labor provisions of the code, found in Part III of the same section, require that in order to effectuate the purposes of the Act the district boards and code members shall accept specified conditions contained in the code, among which are the following:

Employees to be given the right to organize and bargain collectively, through representatives of their own choosing, free from interference, restraint, or coercion of employers or their agents in respect of their concerted activities.

Such employees to have the right of peaceable assemblage for the discussion of the principles of collective bargaining and to select their own checkweighman to inspect the weighing or measuring of coal.

A Labor Board is created, consisting of three members, to be appointed by the President and assigned to the Department of Labor. Upon this board is conferred authority to adjudicate disputes arising under the provisions just stated, and to determine whether or not an organization of employees had been promoted, or is controlled or dominated by an employer in its organization, management, policy, or election of representatives. The board "may order a code member to meet the representatives of its employees for the purpose of collective bargaining."

Subdivision (g) of Part III provides:

"Whenever the maximum daily and weekly hours of labor are agreed upon in any contract or contracts negotiated between the producers of more than two-thirds of the annual national tonnage production for the preceding calendar year and the representatives of more than one-half of the mine workers employed, such maximum hours of labor shall be accepted by all the code members. The wage agreement or agreements negotiated by collective bargaining in any district or group of two or more districts, between representatives of producers of more than two-thirds of the annual tonnage production of such district or each of such districts in a contracting group during the preceding calendar year, and representatives of the majority of the mine workers therein, shall be filed with the Labor Board and shall be accepted as the minimum wages for the various classifications of labor by the code members operating in such district or group of districts."

The bill of complaint in Nos. 636 and 651 was filed in the Supreme Court of the District of Columbia on August 31, 1935, the day after the Coal Conservation Act came into effect. That court among other things, found that the suit was brought in good faith; that if Carter Coal Co. should join the code it would be compelled to cancel existing contracts and pay its proportionate share of administering the code; that the production of bituminous coal is a local activity carried on within State borders; that coal is the Nation's greatest and primary source of energy, vital to the public welfare, of the utmost importance to the industrial and economic life of the Nation and the health and comfort of its inhabitants; and that its distribution in interstate commerce should be regular, continuous, and free of interruptions, obstructions, burdens, and restraints.

Other findings are to the effect that such coal is generally sold f. o. b. mine, and the predominant portion of it shipped outside the State in which it is produced; that the distribution and marketing is predominantly interstate in character, and that the intrastate distribution and sale are so connected that interstate regulation can not be accomplished effectively unless transactions of intrastate distribution and sale be regulated.

The court further found the existence of a condition of unrestrained and destructive competition in the system of distribution and marketing such coal, and of destructive price-cutting, burdening and restraining interstate commerce and dislocating and diverting its normal flow.

The court concluded as a matter of law that the bringing of the suit was not premature; that the plaintiff was without legal remedy, and rightly invoked relief in equity; that the labor provisions of the Act and code were unconstitutional for reasons stated, but the price-fixing provisions were valid and constitutional; that the labor provisions are separable; and, since the provisions with respect to price-fixing and unfair competition are valid, the taxing provisions of the Act could stand. Therefore, except for granting a permanent injunction against collection of the "taxes" accrued during the suit (*Ex parte Young*, 209 U. S., 123, 147–148), the court denied the relief sought, and dismissed the bill.

Appeals were taken to the United States Court of Appeals for the District of Columbia by the parties; but pending hearing and submission in that court, petitions for writs of certiorari were presented asking us to review the decree of the Supreme Court of the District without awaiting such hearing and submission. Because of the importance of the question and the advantage of a speedy final determination thereof, the writs were granted. (— U. S., —.)

The remaining two suits (Nos. 649 and 650), involving the same questions, were brought in the Federal District Court for the Western District of Kentucky. That court held the Act valid and constitutional in its entirety and entered a decree accordingly. (12 F. Supp., 570.) Appeals were taken to the Circuit Court of Appeals for the Sixth Circuit; but, as in the Carter case and for the same reasons, this Court granted writs of certiorari in advance of hearing and submission. (— U. S., —.)

The questions involved will be considered under the following heads:

1. The right of stockholders to maintain suits of this character.
2. Whether the suits were prematurely brought.
3. Whether the exaction of 15 *per centum* on the sale price of coal at the mine is a tax or a penalty.

4. The purposes of the Act as set forth in section 1, and the authority vested in Congress by the Constitution to effectuate them.

5. Whether the labor provisions of the Act can be upheld as an exercise of the power to regulate interstate commerce.

6. Whether subdivision (g) of Part III of the code, is an unlawful delegation of power.

7. The constitutionality of the price-fixing provisions, and the question of severability—that is to say, whether, if either the group of labor provisions or the group of price-fixing provisions be found constitutionally invalid, the other can stand as separable.

First. In the Carter case (Nos. 636 and 651) the stockholder who brought the suit had formally demanded of the board of directors that the company should not join the code, should refuse to pay the tax fixed by the Act, and should bring appropriate judicial proceedings to prevent an unconstitutional and improper diversion of the assets of the company and to have determined the liability of the company under the Act. The board considered the demand, determined that, while it believed the Act to be unconstitutional and economically unsound and that it would adversely affect the business of the company if accepted, nevertheless it should accept the code provided for by the Act because the penalty in the form of a 15 per cent tax on its gross sales would be seriously injurious and might result in bankruptcy. This action of the board was approved by a majority of the shareholders at a special meeting called for the purpose of considering it.

In the Tway company cases, the company itself brought suit to enjoin the enforcement of the Act (No. 649); and a stockholder brought suit to compel the company to accept the code and operate under its provisions (No. 650).

Without repeating the long averments of the several bills, we are of opinion that the suits were properly brought and were maintainable in a court of equity. The right of stockholders to bring such suits under the circumstances disclosed is settled by the recent decision of this Court in *Ashwander et al.* v. *Tennessee Valley Authority* (— U. S., —) (February 17, 1936), and requires no further discussion.

Second. That the suits were not prematurely brought also is clear. Section 2 of the Act is mandatory in its requirement that the commission be appointed by the President. The provisions of section 4 that the code be formulated and promulgated are equally mandatory. The so-called tax of 15 per cent is definitely imposed, and its exaction certain to ensue.

In *Pennsylvania* v. *West Virginia* (262 U. S., 553, 592–595) suits were brought by Pennsylvania and Ohio against West Virginia to enjoin the defendant State from enforcing an act of her legislature upon the ground that it would injuriously affect or cut off the supply of natural gas produced in her territory and carried by pipe lines into the territory of the plaintiff States and there sold and used. These suits were brought a few days after the West Virginia act became effective. No order had yet been made under it by the public service commission, nor had it been tested in actual practice. But it appeared that the act was certain to operate as the complainant States apprehended it would. This Court held that the suit was not premature. "One does not have to await the consummation of threatened injury to obtain preventive relief. If the injury is certainly impending that is enough."

*Pierce* v. *Society of Sisters* (268 U. S., 510, 535–536) involved the constitutional validity of the Oregon compulsory education act, which required every parent or other person having control of a child between the ages of 8 and 16 years to send him to the public school of the district where he resides. Suit was brought to enjoin the operation of the act by corporations owning and conducting private schools, on the ground that their business and property was threatened with destruction through the unconstitutional compulsion exercised by the act upon parents and guardians. The suits were held to be not premature, although the effective date of the act had not yet arrived. We said—"The injury to appellees was present and very real, not a mere possibility in the remote future. If no relief had been possible prior to the effective date of the act, the injury would have become irreparable. Prevention of impending injury by unlawful action is a well recognized function of courts of equity."

(See, also, *Terrace* v. *Thompson*, 263 U. S., 197, 215–216; *Swift & Co.* v. *United States*, 276 U. S., 311, 326; *Euclid* v. *Ambler Co.*, 272 U. S., 365, 386; *City Bank Co.* v. *Schnader*, 291 U. S., 24, 34.)

Third. The so-called excise tax of 15 *per centum* on the sale price of coal at the mine, or, in the case of captive coal the fair market value, with its drawback allowance of 13½ per cent, is clearly not a tax but a penalty. The exaction applies to all bituminous coal produced, whether it be sold, transported or consumed in interstate commerce, or transactions in respect of it be confined wholly to the limits of the State. It also applies to "captive coal"—that is to say, coal produced for the sole use of the producer.

It is very clear that the "excise tax" is not imposed for revenue but exacted as a penalty to compel compliance with the regulatory provisions of the Act. The whole purpose of the exaction is to coerce what is called an agreement—which, of course, it is not, for it lacks the essential element of consent. One who does a thing in order to avoid a monetary penalty does not agree; he yields to compulsion precisely the same as though he did so to avoid a term in jail.

The exaction here is a penalty and not a tax within the test laid down by this Court in numerous cases. (*Child Labor Tax case*, 259 U. S., 20, 37–39; *United States* v. *La Franca*, 282 U. S., 568, 572; *United States* v. *Constantine*, 296 U. S., 287, 293 et seq.; *United States* v. *Butler*, 297 U. S., 1, 70.) While the lawmaker is entirely free to ignore the ordinary meanings of words and make definitions of his own (*Karnuth* v. *United States*, 279 U. S., 231, 242; *Tyler* v. *United States*, 281 U. S., 497, 502 [Ct. D. 190, C. B. IX–1, 383]), that device may not be employed so as to change the nature of the acts or things to which the words are applied. But it is not necessary to pursue the matter further. That the "tax" is in fact a penalty is not seriously in dispute. The position of the Government, as we understand it, is that the validity of the exaction does not rest upon the taxing power but upon the power of Congress to regulate interstate commerce; and that if the Act in respect of the labor and price-fixing provisions be not upheld, the "tax" must fall with them. With that position we agree and confine our consideration accordingly.

Fourth. Certain recitals contained in the Act plainly suggest that its makers were of opinion that its constitutionality could be sustained under some general Federal power, thought to exist, apart from the specific grants of the Constitution. The fallacy of that view will be apparent when we recall fundamental principles which, although hitherto often expressed in varying forms of words, will bear repetition whenever their accuracy seems to be challenged. The recitals to which we refer are contained in section 1 (which is simply a preamble to the Act), and, among others, are to the effect that the distribution of bituminous coal is of national interest, affecting the health and comfort of the people and the general welfare of the Nation; that this circumstance, together with the necessity of maintaining just and rational relations between the public, owners, producers, and employees, and the right of the public to constant and adequate supplies at reasonable prices, require regulation of the industry as the Act provides. These affirmations—and the further ones that the production and distribution of such coal "directly affect interstate commerce," because of which and of the waste of the national coal resources and other circumstances, the regulation is necessary for the protection of such commerce—do not constitute an exertion of the *will* of Congress which is legislation, but a recital of considerations which in the *opinion* of that body existed and justified the expression of its will in the present Act. Nevertheless, this preamble may not be disregarded. On the contrary it is important, because it makes clear, except for the pure assumption that the conditions described "directly" affect interstate commerce, that the powers which Congress undertook to exercise are not specific but of the most general character—namely, to protect the general public interest and the health and comfort of the people, to conserve privately-owned coal, maintain just relations between producers and employees and others, and promote the general welfare, by controlling nation-wide production and distribution of coal. These, it may be conceded, are objects of great worth; but are they ends, the attainment of which has been committed by the Constitution to the Federal Government? This is a vital question; for nothing is more certain than that beneficient aims, however great or well directed, can never serve in lieu of constitutional power.

The ruling and firmly established principle is that the powers which the General Government may exercise are only those specifically enumerated in the Constitution, and such implied powers as are necessary and proper to carry into effect the enumerated powers. Whether the end sought to be attained by an Act of Congress is legitimate is wholly a matter of constitutional power and not at all of legislative discretion. Legislative congressional discretion begins with the choice of means and ends with the adoption of methods and details to carry the delegated powers into effect. The distinction between these two things—power and discretion—is not only very plain but very important. For while the powers are rigidly limited to the enumerations of the Constitution, the means which may be employed to carry the powers into effect are not restricted, save that they must be appropriate, plainly adapted to the end, and not prohibited by, but consistent with, the letter and spirit of the Constitution. (*McCulloch* v. *Maryland*, 4 Wheat., 316, 421.) Thus, it may be said that to a constitutional end many ways are open; but to an end not within the terms of the Constitution, all ways are closed.

The proposition, often advanced and as often discredited, that the power of the Federal Government inherently extends to purposes affecting the Nation as a whole with which the States severally can not deal or can not adequately deal, and the related notion that Congress, entirely apart from those powers delegated by the Constitution, may enact laws to promote the general welfare, have never been accepted but always definitely rejected by this Court. Mr. Justice Story, as early as 1816, laid down the cardinal rule, which has ever since been followed—that the General Government "can claim no powers which are not granted to it by the Constitution, and the powers actually granted, must be such as are expressly given, or given by necessary implication." (*Martin* v. *Hunter's Lessee*, 1 Wheat., 304, 326.) In the Framers Convention, the proposal to confer a general power akin to that just discussed was included in Mr. Randolph's resolutions, the sixth of which, among other things, declared that the National Legislature ought to enjoy the legislative rights vested in Congress by the Confederation, and "moreover to legislate in all cases to which the separate States are incompetent, or in which the harmony of the United States may be interrupted by the exercise of individual legislation." The convention, however, declined to confer upon Congress power in such general terms; instead of which it carefully limited the powers which it thought wise to entrust to Congress by specifying them, thereby denying all others not granted expressly or by necessary implication. It made no grant of authority to Congress to legislate substantively for the general welfare (*United States* v. *Butler*, supra, page 64); and no such authority exists, save as the general welfare may be promoted by the exercise of the powers which are granted. (Compare *Jacobsen v. Massachusetts*, 197 U. S., 11, 22.)

There are many subjects in respect of which the several States have not legislated in harmony with one another, and in which their varying laws and the failure of some of them to act at all have resulted in injurious confusion and embarrassment. (See *Addyston Pipe & Steel Co.* v. *United States*, 175 U. S., 211, 232–233.) The State laws with respect to marriage and divorce present a case in point; and the great necessity of national legislation on that subject has been from time to time vigorously urged. Other pertinent examples are laws with respect to negotiable instruments, desertion and nonsupport, certain phases of State taxation, and others which we do not pause to mention. In many of these fields of legislation, the necessity of bringing the applicable rules of law into general harmonious relation has been so great that a Commission on Uniform State Laws, composed of commissioners from every State in the Union, has for many years been industriously and successfully working to that end by preparing and securing the passage by the several States of uniform laws. If there be an easier and constitutional way to these desirable results through congressional action, it thus far has escaped discovery.

Replying directly to the suggestion advanced by counsel in *Kansas* v. *Colorado* (206 U. S., 46, 89–90), to the effect that necessary powers national in their scope must be found vested in Congress, though not expressly granted or essentially implied, this Court said:

"But the proposition that there are legislative powers affecting the Nation as a whole which belong to, although not expressed in the grant of powers, is in direct conflict with the doctrine that this is a government of enumerated powers. That this is such a government clearly appears from the Constitution, independently of the amendments, for otherwise there would be an instrument granting certain specified things made operative to grant other and distinct things. This natural construction of the original body of the Constitution is made absolutely certain by the tenth amendment. This amendment, which was seemingly adopted with prescience of just such contention as the present, disclosed the widespread fear that the National Government might, under the pressure of a supposed general welfare, attempt to exercise powers which had not been granted. With equal determination the framers intended that no such assumption should ever find justification in the organic act, and that if in the future further powers seemed necessary they should be granted by the people in the manner they had provided for amending that act."

The general rule with regard to the respective powers of the National and the State Governments under the Constitution, is not in doubt. The States were before the Constitution; and, consequently, their legislative powers antedated the Constitution. Those who framed and those who adopted that instrument meant to carve from the general mass of legislative powers, then possessed by the States, only such portions as it was thought wise to confer upon the Federal Government; and in order that there should be no uncertainty in respect of what was taken and what was left, the national powers of legislation were not aggregated but enumerated—with the result that what was not embraced by the enumeration remained vested in the States without change or impairment. Thus, "when it was found necessary to establish a National Government for national purposes," this Court said in *Munn* v. *Illinois* (94 U. S., 113, 124), "a part of the powers of the States and of the people of the States was granted to the United States and the people of the United States. This grant operated as a further limitation upon the powers of the States, so that now the governments of the States possess all the powers of the Parliament of England, except such as have been delegated to the United States or reserved by the people." While the States are not sovereign in the true sense of that term, but only *quasi*-sovereign, yet in respect of all powers reserved to them they are supreme—"as independent of the General Government as that Government within its sphere is independent of the States." (*The Collector* v. *Day*, 11 Wall., 113, 124.) And since every addition to the National legislative power to some extent detracts from or invades the power of the States, it is of vital moment that, in order to preserve the fixed balance intended by the Constitution, the powers of the General Government be not so extended as to embrace any not within the express terms of the several grants or the implications necessarily to be drawn therefrom. It is no longer open to question that the General Government, unlike the States (*Hammer* v. *Dagenhart*, 247 U. S., 251, 275), possesses no *inherent* power in respect of the internal affairs of the States; and emphatically not with regard to legislation. The question in respect of the inherent power of that Government as to the external affairs of the Nation and in the field of international law is a wholly different matter which it is not necessary now to consider. (See, however, *Jones* v. *United States*, 137 U. S., 202, 212; *Nishimura Ekiu* v. *United States*, 142 U. S., 651, 659; *Fong Yue Ting* v. *United States*, 149 U. S., 698, 705 et seq.; *Burnet* v. *Brooks*, 288 U. S., 378, 396 [Ct. D. 648, C. B. XII–1, 362]).

The determination of the Framers Convention and the ratifying conventions to preserve complete and unimpaired State self-government in all matters not committed to the General Government is one of the plainest facts which emerges from the history of their deliberations. And adherence to that determination is incumbent equally upon the Federal Government and the States. State powers can neither be appropriated on the one hand nor abdicated on the other. As this Court said in *Texas* v. *White* (7 Wall., 700, 725)—"the preservation of the States, and the maintenance of their governments, are as much within the design and care of the Constitution as the preservation of the Union and the maintenance of the National Government. The Constitution, in all its provisions, looks to an indestructible Union, composed of indestructible States." Every journey to a forbidden end begins with the first step; and the danger of such a step by the Federal Government in the direction of taking over the powers of the States is that the end of the journey may find the States so despoiled of their powers, or—what may amount to the same thing—so relieved of the responsibilities which possession of the powers necessarily enjoins, as to reduce them to little more than geographical subdivisions of the national domain. It is safe to say that if, when the Constitution was under consideration, it had been thought that any such danger lurked behind its plain words, it would never have been ratified.

And the Constitution itself is in every real sense a law—the lawmakers being the people themselves, in whom under our system all political power and sovereignty primarily resides, and through whom such power and sovereignty primarily speaks. It is by that law, and not otherwise, that the legislative, executive, and judicial agencies which it created exercise such political authority as they have been permitted to possess. The Constitution speaks for itself in terms so plain that to misunderstand their import is not rationally possible. "We the People of the United States," it says, "do ordain and establish this Constitution * * *." Ordain and establish! These are definite words of enactment, and without more would stamp what follows with the dignity and character of law. The framers of the Constitution, however, were not content to let the matter rest here, but provided explicity—"This Constitution, and the laws of the United States which shall be made in pursuance thereof; * * * shall be the supreme law of the land; * * *." The supremacy of the Constitution as law is thus declared without qualification. That supremacy is absolute; the supremacy of a statute enacted by Congress is not absolute but conditioned upon its being made in pursuance of the Constitution. And a judicial tribunal, clothed by that instrument with complete judicial power, and, therefore, by the very nature of the power, required to ascertain and apply the law to the facts in every case or proceeding properly brought for adjudication, must apply the supreme law and reject the inferior statute whenever the two conflict. In the discharge of that duty, the opinion of the lawmakers that a statute passed by them is valid must be given great weight (*Adkins* v. *Children's Hospital*, 261 U. S., 525, 544); but their opinion, or the court's opinion, that the statute will prove greatly or generally beneficial is wholly irrelevant to the inquiry. (*Schechter* v. *United States*, 295 U. S., 495, 549–550.)

We have set forth, perhaps at unnecessary length, the foregoing principles, because it seemed necessary to do so in order to demonstrate that the general purposes which the Act recites, and which, therefore, unless the recitals be disregarded, Congress undertook to achieve, are beyond the power of Congress except so far, and only so far, as they may be realized by an exercise of some specific power granted by the Constitution. Proceeding by a process of elimination, which it is not necessary to follow in detail, we shall find no grant of power which authorizes Congress to legislate in respect of these general purposes unless it be found in the commerce clause—and this we now consider.

Fifth. Since the validity of the Act depends upon whether it is a regulation of interstate commerce, the nature and extent of the power conferred upon Congress by the commerce clause becomes the determinative question in this branch of the case. The commerce clause vests in Congress the power—"To regulate commerce with foreign nations, and among the several States, and with the Indian Tribes." The function to be exercised is that of regulation. The thing to be regulated is the commerce described. In exercising the authority conferred by this clause of the Constitution, Congress is powerless to regulate anything which is not commerce, as it is powerless to do anything about commerce which is not regulation. We first inquire, then—What is commerce? The term, as this Court many times has said, is one of extensive import. No all-embracing definition has ever been formulated. The question is to be approached both affirmatively and negatively—that is to say, from the points of view as to what it includes and what it excludes.

In *Gibbons* v. *Ogden* (9 Wheat., 1, 189–190), Chief Justice Marshall said:

"Commerce, undoubtedly, is traffic, but it is something more: it is intercourse. It describes the commercial intercourse between nations, and parts of nations, in all its branches, and is regulated by prescribing rules for carrying on that intercourse. * * *"

As used in the Constitution, the word "commerce" is the equivalent of the phrase "intercourse for the purposes of trade," and includes transportation, purchase, sale, and exchange of commodities between the citizens of the different States. And the power to regulate commerce embraces the instruments by which commerce is carried on. (*Welton* v. *State of Missouri*, 91 U. S., 275, 280; *Addyston Pipe & Steel Co.* v. *United States*, 175 U. S., 211, 241; *Hopkins* v. *United States*, 171 U. S., 578, 597.) In *Adair* v. *United States* (208 U. S., 161, 177) the phrase "Commerce among the several States" was defined as comprehending "traffic, intercourse, trade, navigation, communication, the transit of persons and the transmission of messages by telegraph—indeed, every species of commercial intercourse among the several States." In *Veazie et al.* v. *Moor* (14 How., 568, 573–574), this Court, after saying that the phrase could never be applied to transactions wholly internal, significantly added: "Nor can it be properly concluded, that, because the products of domestic enterprise in agriculture or manufactures, or in the arts, may ultimately become the subjects of foreign commerce, that the control of the means or the encouragements by which enterprise is fostered and protected, is legitimately within the import of the phrase *foreign commerce*, or fairly implied in any investiture of the power to regulate such commerce. A pretension as far-reaching as this, would extend to contracts between citizen and citizen of the same State, would control the pursuits of the planter, the grazier, the manufacturer, the mechanic, the immense operations of the collieries and mines and furnaces of the country; for there is not one of these avocations, the results of which may not become the subjects of foreign commerce, and be borne either by turnpikes, canals, or railroads, from point to point within the several States, towards an ultimate destination, like the one above mentioned. * * * "

The distinction between manufacture and commerce was discussed in *Kidd v. Pearson* (128 U. S., 1, 20, 21, 22); and it was said:

"No distinction is more popular to the common mind, or more clearly expressed in economic and political literature, than that between manufacture and commerce. Manufacture is transformation—the fashioning of raw materials into a change of form for use. The functions of commerce are different. * * * If it be held that the term includes the regulation of all such manufactures as are intended to be the subject of commercial transactions in the future, it is impossible to deny that it would also include all productive industries that contemplate the same thing. The result would be that Congress would be invested, to the exclusion of the States, with the power to regulate, not only manufactures, but also agriculture, horticulture, stock raising, domestic fisheries, mining—in short, every branch of human industry. For is there one of them that does not contemplate, more or less clearly, an interstate or foreign market? Does not the wheat grower of the Northwest and the cotton planter of the South, plant, cultivate, and harvest his crop with an eye on the prices at Liverpool, New York, and Chicago? The power being vested in Congress and denied to the States, it would follow as an inevitable result that the duty would devolve on Congress to regulate all of these delicate, multiform, and vital interests—interests which in their nature are and must be local in all the details of their successful management."

And then, as though foreseeing the present controversy, the opinion proceeds:

"Any movement toward the establishment of rules of production in this vast country, with its many different climates and opportunities, could only be at the sacrifice of the peculiar advantages of a large part of the localities in it, if not of every one of them. On the other hand, any movement toward the local, detailed and incongruous legislation required by such interpretation would be about the widest possible departure from the declared object of the clause in question. Nor this alone. Even in the exercise of the power contended for, Congress would be confined to the regulation, not of certain branches of industry, however numerous, but to those instances in each and every branch where the producer contemplated an interstate market. * * * A situation more paralyzing to the State governments, and more provocative of conflicts between the General Government and the States, and less likely to have been what the framers of the Constitution intended, it would be difficult to imagine."

Chief Justice Fuller, speaking for this Court in *United States* v. *E. C. Knight Co.* (156 U. S., 1, 12, 13), said:

"Doubtless the power to control the manufacture of a given thing involves in a certain sense the control of its disposition, but this is a secondary and not the primary sense; and although the exercise of that power may result in bringing the operation of commerce into play, it does not control it, and affects it only incidentally and indirectly. Commerce succeeds to manufacture, and is not a part of it. * * *

"It is vital that the independence of the commercial power and of the police power, and the delimitation between them, however sometimes perplexing, should always be recognized and observed, for while the one furnishes the strongest bond of union, the other is essential to the preservation of the autonomy of the States as required by our dual form of government; and acknowledged evils, however grave and urgent they may appear to be, had better be borne, than the risk be run, in the effort to suppress them, of more serious consequences by resort to expedients of even doubtful constitutionality.

"* * * The regulation of commerce applies to the subjects of commerce and not to matters of internal police. Contracts to buy, sell, or exchange goods to be transported among the several States, the transportation and its instrumentalities, and articles bought, sold, or exchanged for the purposes of such transit among the States, or put in the way of transit, may be regulated, but this is because they form part of interstate trade or commerce.

The fact that an article is manufactured for export to another State does not of itself make it an article of interstate commerce, and the intent of the manufacturer does not determine the time when the article or product passes from the control of the State and belongs to commerce. * * * "

That commodities produced or manufactured within a State are intended to be sold or transported outside the State does not render their production or manufacture subject to Federal regulation under the commerce clause. As this Court said in *Coe* v. *Errol* (116 U. S., 517, 526), "Though intended for exportation, they may never be exported; the owner has a perfect right to change his mind; and until actually put in motion, for some place out of the State, or committed to the custody of a carrier for transportation to such place, why may they not be regarded as still remaining a part of the general mass of property in the State?" It is true that this was said in respect of a challenged power of the State to impose a tax; but the query is equally pertinent where the question, as here, is with regard to the power of regulation. The case was relied upon in *Kidd* v. *Pearson*, supra, page 26. "The application of the principles above announced," it was there said, "to the case under consideration leads to a conclusion against the contention of the plaintiff in error. The police power of a State is as broad and plenary as its taxing power; and property within the State is subject to the operations of the former so long as it is within the regulating restrictions of the latter."

In *Heisler* v. *Thomas Colliery Co.* (260 U. S., 245, 259–260), we held that the possibility, or even certainty of exportation of a product or article from a State did not determine it to be in interstate commerce before the commencement of its movement from the State. To hold otherwise "would nationalize all industries, it would nationalize and withdraw from State jurisdiction and deliver to Federal commercial control the fruits of California and the South, the wheat of the West and its meats, the cotton of the South, the shoes of Massachusetts and the woolen industries of other States, at the very inception of their production or growth, that is, the fruits unpicked, the cotton and wheat ungathered, hides and flesh of cattle yet 'on the hoof,' wool yet unshorn, and coal yet unmined, because they are in varying percentages destined for and surely to be exported to States other than those of their production."

In *Oliver Iron Co.* v. *Lord* (262 U. S., 172, 178), we said on the authority of numerous cited cases: "Mining is not interstate commerce, but, like manufacturing, is a local business subject to local regulation and taxation. * * * Its character in this regard is intrinsic, is not affected by the intended use or disposal of the product, is not controlled by contractual engagements, and persists even though the business be conducted in close connection with interstate commerce."

The same rule applies to the production of oil. "Such production is essentially a mining operation and therefore is not a part of interstate commerce even though the product obtained is intended to be and in fact is immediately shipped in such commerce." (*Champlin Rfg. Co.* v. *Commission*, 286 U. S., 210, 235.) One who produces or manufactures a commodity, subsequently sold and shipped by him in interstate commerce, whether such sale and shipment were originally intended or not, has engaged in two distinct and separate activities. So far as he produces or manufactures a commodity, his business is purely local. So far as he sells and ships, or contracts to sell and ship, the commodity to customers in another State, he engages in interstate commerce. In respect of the former, he is subject only to regulation by the State; in respect of the latter, to regulation only by the Federal Government. (*Utah Power & L. Co.* v. *Pfost*, 286 U. S., 165, 182.) Production is not commerce; but a step in preparation for commerce. (*Chassaniol* v. *Greenwood*, 291 U. S., 584, 587.)

We have seen that the word "commerce" is the equivalent of the phrase "intercourse for the purposes of trade." Plainly, the incidents leading up to and culminating in the mining of coal do not constitute such intercourse. The employment of men, the fixing of their wages, hours of labor and working conditions, the bargaining in respect of these things—whether carried on separately or collectively—each and all constitute intercourse for the purposes of production, not of trade. The latter is a thing apart from the relation of employer and employee, which in all producing occupations is purely local in character. Extraction of coal from the mine is the aim and the completed result of local activities. Commerce in the coal mined is not brought into being by force of these activities, but by negotiations, agreements, and circumstances entirely apart from production. Mining brings the subject matter of commerce into existence. Commerce disposes of it.

A consideration of the foregoing, and of many cases which might be added to those already cited, renders inescapable the conclusion that the effect of the labor provisions of the Act, including those in respect of minimum wages, wage agreements, collective bargaining, and the Labor Board and its powers, primarily falls upon production and not upon commerce; and confirms the further resulting conclusion that production is a purely local activity. It follows that none of these essential antecedents of production constitutes a transaction in or forms any part of interstate commerce. (*Schechter Corporation* v. *United States*, supra, 542 et seq.) Everything which moves in interstate commerce has had a local origin. Without local production somewhere, interstate commerce, as now carried on, would practically disappear. Nevertheless, the local character of mining, of manufacturing and of crop growing is a fact, and remains a fact, whatever may be done with the products.

Certain decisions of this Court, superficially considered, seem to lend support to the defense of the Act now under review. But upon examination, they will be seen to be inapposite. Thus, *Coronado Co.* v. *U. M. Workers* (268 U. S., 295, 310), and kindred cases, involved conspiracies to restrain interstate commerce in violation of the anti-trust laws. The acts of the persons involved were local in character; but the intent was to restrain interstate commerce, and the means employed were calculated to carry that intent into effect. Interstate commerce was the direct object of attack; and the restraint of such commerce was the necessary consequence of the acts and the immediate end in view. (*Bedford Co.* v. *Stone Cutters Assn.*, 274 U. S., 37, 46.) The applicable law was concerned not with the character of the acts or of the means employed, which might be in and of themselves purely local, but with the intent and direct operation of those acts and means upon interstate commerce. "The mere reduction in the supply of an article," this Court said in the *Coronado Co.* case, supra, page 310, "to be shipped in interstate commerce by the illegal or tortious prevention of its manufacture or production is ordinarily an indirect and remote obstruction to that commerce. But when the intent of those unlawfully preventing the manufacture or production is shown to be to restrain or control the supply entering and moving in interstate commerce, or the price of it in interstate markets, their action is a direct violation of the Anti-Trust Act."

Another group of cases, of which *Swift & Co.* v. *United States* (196 U. S., 375) is an example, rest upon the circumstance that the acts in question constituted direct interferences with the "flow" of commerce among the States. In the Swift case, live stock was consigned and delivered to stock-yards—not as a place of final destination, but, as the Court said in *Stafford* v. *Wallace* (258 U. S., 495, 516), "a throat through which the current flows." The sales which ensued merely changed the private interest in the subject of the current without interfering with its continuity. (*Industrial Ass'n* v. *United States*, 268 U. S., 64, 79.) It was nowhere suggested in these cases that the interstate commerce power extended to the growth or production of the things which, after production, entered the flow. If the Court had held that the raising of the cattle, which were involved in the Swift case, including the wages paid to and working conditions of the herders and others employed in the business, could be regulated by Congress, that decision and decisions holding similarly would be in point; for it is that situation, and not the one with which the Court actually dealt, which here concerns us.

The distinction suggested is illustrated by the decision in *Arkadelphia Co.* v. *St. Louis S. W. Ry. Co.* (249 U. S., 134, 150–152). That case dealt with orders of a State commission fixing railroad rates. One of the questions considered was whether certain shipments of rough material from the forest to mills in the same State for manufacture, followed by the forwarding of the finished product to points outside the State, was a continuous movement in interstate commerce. It appeared that when the rough material reached the mills it was manufactured into various articles which were stacked or placed in kilns to dry, the processes occupying several months. Markets for the manufactured articles were almost entirely in other States or in foreign countries. About 95 per cent of the finished articles was made for outbound shipment. When the rough material was shipped to the mills, it was expected by the mills that this percentage of the finished articles would be so sold and shipped outside the State. And all of them knew and intended that this 95 per cent of the finished product would be so sold and shipped. This

Court held that the State order did not interfere with interstate commerce, and that the Swift case was not in point; as it is not in point here.

The restricted field covered by the Swift and kindred cases is illustrated by the Schechter case, supra, page 543. There the commodity in question, although shipped from another State, had come to rest in the State of its destination, and, as the Court pointed out, was no longer in a current or flow of interstate commerce. The Swift doctrine was rejected as inapposite. In the Schechter case the flow had ceased. Here it had not begun. The difference is not one of substance. The applicable principle is the same.

But section 1 (the preamble) of the Act now under review declares that all production and distribution of bituminous coal "bear upon and directly affect its interstate commerce"; and that regulation thereof is imperative for the protection of such commerce. The contention of the Government is that the labor provisions of the Act may be sustained in that view.

That the production of every commodity intended for interstate sale and transportation has some effect upon interstate commerce may be, if it has not already been, freely granted; and we are brought to the final and decisive inquiry, whether here that effect is direct, as the "preamble" recites, or indirect. The distinction is not formal, but substantial in the highest degree, as we pointed out in the Schechter case, supra, page 546, et seq. "If the commerce clause were construed," we there said, "to reach all enterprises and transactions which could be said to have an indirect effect upon interstate commerce, the Federal authority would embrace practically all the activities of the people and the authority of the State over its domestic concerns would exist only by sufferance of the Federal Government. Indeed, on such a theory, even the development of the State's commercial facilities would be subject to Federal control." It was also pointed out, page 548, that "the distinction between direct and indirect effects of intrastate transactions upon interstate commerce must be recognized as a fundamental one, essential to the maintenance of our constitutional system."

Whether the effect of a given activity or condition is direct or indirect is not always easy to determine. The word "direct" implies that the activity or condition invoked or blamed shall operate proximately—not mediately, remotely, or collaterally—to produce the effect. It connotes the absence of an efficient intervening agency or condition. And the extent of the effect bears no logical relation to its character. The distinction between a direct and an indirect effect turns, not upon the magnitude of either the cause or the effect, but entirely upon the manner in which the effect has been brought about. If the production by one man of a single ton of coal intended for interstate sale and shipment, and actually so sold and shipped, affects interstate commerce indirectly, the effect does not become direct by multiplying the tonnage, or increasing the number of men employed, or adding to the expense or complexities of the business, or by all combined. It is quite true that rules of law are sometimes qualified by considerations of degree, as the Government argues. But the matter of degree has no bearing upon the question here, since that question is not—What is the *extent* of the local activity or condition, or the *extent* of the effect produced upon interstate commerce? but—What is the *relation* between the activity or condition and the effect?

Much stress is put upon the evils which come from the struggle between employers and employees over the matter of wages, working conditions, the right of collective bargaining, etc., and the resulting strikes, curtailment and irregularity of production and effect on prices; and it is insisted that interstate commerce is *greatly* affected thereby. But, in addition to what has just been said, the conclusive answer is that the evils are all local evils over which the Federal Government has no legislative control. The relation of employer and employee is a local relation. At common law, it is one of the domestic relations. The wages are paid for the doing of local work. Working conditions are obviously local conditions. The employees are not engaged in or about commerce, but exclusively in producing a commodity. And the controversies and evils, which it is the object of the Act to regulate and minimize, are local controversies and evils affecting local work undertaken to accomplish that local result. Such effect as they may have upon commerce, however extensive it may be, is secondary and indirect. An increase in the greatness of the effect adds to its importance. It does not alter its character.

The Government's contentions in defense of the labor provisions are really disposed of adversely by our decision in the Schechter case, supra. The only perceptible difference between that case and this is that in the Schechter case, the Federal power was asserted with respect to commodities which had come to rest after their interstate transportation; while here, the case deals with commodities at rest before interstate commerce has begun. That difference is without significance. The Federal regulatory power ceases when interstate commercial intercourse ends; and, correlatively, the power does not attach until interstate commercial intercourse begins. There is no basis in law or reason for applying different rules to the two situations. No such distinction can be found in anything said in the Schechter case. On the contrary, the situations were recognized as akin. The opinion, at page 546, after calling attention to the fact that if the commerce clause could be construed to reach transactions having an indirect effect upon interstate commerce the Federal authority would embrace practically all the activities of the people, and the authority of the State over its domestic concerns would exist only by sufferance of the Federal Government, we said: "Indeed, on such a theory, even the development of the State's commercial facilities would be subject to Federal control." And again, after pointing out that hours and wages have no direct relation to interstate commerce and that if the Federal Government had power to determine the wages and hours of employees in the internal commerce of a State because of their relation to cost and prices and their indirect effect upon interstate commerce, we said, page 549: "All the processes of production and distribution that enter into cost could likewise be controlled. If the cost of doing an intrastate business is in itself the permitted object of Federal control, the extent of the regulation of cost would be a question of discretion and not of power." A reading of the entire opinion makes clear, what we now declare, that the want of power on the part of the Federal Government is the same whether the wages, hours of service, and working conditions, and the bargaining about them, are related to production before interstate commerce has begun, or to sale and distribution after it has ended.

Sixth. That the Act, whatever it may be in form, in fact is compulsory clearly appears. We have already discussed section 3, which imposes the excise tax as a penalty to compel "acceptance" of the code. Section 14 provides that the United States shall purchase no bituminous coal produced at any mine where the producer has not complied with the provisions of the code; and that each contract made by the United States shall contain a provision that the contractor will buy no bituminous coal to use on, or in the carrying out of, such contract unless the producer be a member of the code, as certified by the Coal Commission. In the light of these provisions we come to a consideration of subdivision (g) of Part III of section 4, dealing with "Labor relations."

That subdivision delegates the power to fix maximum hours of labor to a part of the producers and the miners—namely, "the producers of more than two-thirds of the annual national tonnage production for the preceding calendar year" and "more than one-half of the mine workers employed"; and to producers of more than two-thirds of the district annual tonnage during the preceding calendar year and a majority of the miners, there is delegated the power to fix minimum wages for the district or group of districts. The effect, in respect of wages and hours, is to subject the dissentient minority, either of producers or miners or both, to the will of the stated majority, since, by refusing to submit, the minority at once incurs the hazard of enforcement of the drastic compulsory provisions of the Act to which we have referred. To "accept," in these circumstances, is not to exercise a choice, but to surrender to force.

The power conferred upon the majority is, in effect, the power to regulate the affairs of an unwilling minority. This is legislative delegation in its most obnoxious form; for it is not even delegation to an official or an official body, presumptively disinterested, but to private persons whose interests may be and often are adverse to the interests of others in the same business. The record shows that the conditions of competition differ among the various localities. In some, coal dealers compete among themselves. In other localities, they also compete with the mechanical production of electrical energy and of natural gas. Some coal producers favor the code; others oppose it; and the record clearly indicates that this diversity of view arises from their conflicting and even antagonistic interests. The difference between producing coal and regulating its production is, of course, fundamental. The former is a private activity; the latter is necessarily a governmental function, since, in the very nature of things, one person may not be entrusted with the power to regulate the business of another, and especially of a competitor. And a statute which attempts to confer such power undertakes an intolerable and unconstitutional interference with personal liberty and private property. The delegation is so clearly arbitrary, and so clearly a denial of rights safeguarded by the due process clause of the fifth amendment, that it is unnecessary to do more than refer to decisions of this Court which foreclose the question. (*Schechter Corporation* v. *United States*, 295 U. S., at page 537; *Eubank* v. *Richmond*, 226 U. S., 137, 143; *Seattle Trust Co.* v. *Roberge*, 278 U. S., 116, 121–122.)

Seventh. Finally, we are brought to the price-fixing provisions of the code. The necessity of considering the question of their constitutionality will depend upon whether they are separable from the labor provisions so that they can stand independently. Section 15 of the Act provides:

"If any provision of this Act, or the application thereof to any person or circumstances, is held invalid, the remainder of the Act and the application of such provisions to other persons or circumstances shall not be affected thereby."

In the absence of such a provision, the presumption is that the legislature intends an act to be effective as an entirety—that is to say, the rule is against the mutilation of a statute; and if any provision be unconstitutional, the presumption is that the remaining provisions fall with it. The effect of the statute is to reverse this presumption in favor of inseparability, and create the opposite one of separability. Under the nonstatutory rule, the burden is upon the supporter of the legislation to show the separability of the provisions involved. Under the statutory rule, the burden is shifted to the assailant to show their inseparability. But under either rule, the determination, in the end, is reached by applying the same test—namely, What was the intent of the lawmakers?

Under the statutory rule, the presumption must be overcome by considerations which establish "the clear probability that the invalid part being eliminated the legislature would not have been satisfied with what remains" (*Williams* v. *Standard Oil Co.*, 278 U. S., 235, 241 et seq.); or, as stated in *Utah Power & L. Co.* v. *Pfost* (286 U. S., 165, 184–185), "the clear probability that the legislature would not have been satisfied with the statute unless it had included the invalid part." Whether the provisions of a statute are so interwoven that one being held invalid the others must fall, presents a question of statutory construction and of legislative intent, to the determination of which the statutory provision becomes an aid. "But it is an aid merely; not an inexorable command." (*Dorchy* v. *Kansas*, 264 U. S., 286, 290.) The presumption in favor of separability does not authorize the court to give the statute "an effect altogether different from that sought by the measure viewed as a whole." (*Retirement Board* v. *Alton R. Co.*, 295 U. S., 330, 362.)

The statutory aid to construction in no way alters the rule that in order to hold one part of a statute unconstitutional and uphold another part as separable, they must not be mutually dependent upon one another. Perhaps a fair approach to a solution of the problem is to suppose that while the bill was pending in Congress a motion to strike out the labor provisions had prevailed, and to inquire whether, in that event, the statute should be so construed as to justify the conclusion that Congress, notwithstanding, probably would not have passed the price-fixing provisions of the code.

Section 3 of the Act, which provides that no producer shall, by accepting the code or the drawback of taxes, be estopped from contesting the constitutionality of any provision of the code is thought to aid the separability clause. But the effect of that provision is simply to permit the producer to challenge any provision of the code despite his acceptance of the code or the drawback. It seems not to have anything to do with the question of separability.

With the foregoing principles in mind, let us examine the Act itself. The title of the Act and the preamble demonstrate, as we have already seen, that Congress desired to accomplish certain general purposes therein recited. To that end it created a commission, with mandatory directions to formulate into a working agreement the provisions set forth in section 4 of the Act. That being done, the result is a code. Producers accepting and operating under the code are to be known as code members; and section 4 specifically requires that, in order to carry out the policy of the Act, "the code shall contain the following conditions, provisions, and obligations * * *," which are then set forth. No power is vested in the commission, in formulating the code, to omit any of these conditions, provisions, or obligations. The mandate to include them embraces all of them. Following the requirement just quoted, and, significantly, *in the same section* (*International Textbook Co.* v. *Pigg*, 217 U. S., 91, 112–113) under appropriate headings, the price-fixing and labor-regulating provisions are set out in great detail. These provisions, plainly, meant to operate together and not separately, constitute the means designed to bring about the stabilization of bituminous-coal production, and thereby to regulate or affect interstate commerce in such coal. The first clause of the title is: "To stabilize the bituminous coal-mining industry and promote its interstate commerce."

Thus, the primary contemplation of the Act is stabilization of the industry through the regulation of labor *and* the regulation of prices; for, since both were adopted, we must conclude that both were thought essential. The regulations of labor on the one hand and prices on the other furnish mutual aid and support; and their associated force—not one or the other but both combined—was deemed by Congress to be necessary to achieve the end sought. The statutory mandate for a code upheld by two legs at once suggests the improbability that Congress would have assented to a code supported by only one.

This seems plain enough; for Congress must have been conscious of the fact that elimination of the labor provisions from the Act would seriously impair, if not destroy, the force and usefulness of the price provisions. The interdependence of wages and prices is manifest. Approximately two-thirds of the cost of producing a ton of coal is represented by wages. Fair prices necessarily depend upon the cost of production; and since wages constitute so large a proportion of the cost, prices can not be fixed with any proper relation to cost without taking into consideration this major element. If one of them becomes uncertain, uncertainty with respect to the other necessarily ensues.

So much is recognized by the code itself. The introductory clause of Part III declares that the conditions respecting labor relations are "To effectuate the purposes of this Act." And subdivision (a) of Part II, quoted in the forepart of this opinion, reads in part: "In order to sustain the stabilization of wages, working conditions, and maximum hours of labor, said prices shall be established so as to yield a return per net ton for each district in a minimum price area, * * * equal as nearly as may be to the weighted average of the total costs, per net ton * * *." Thus wages, hours of labor, and working conditions are to be so adjusted as to effectuate the purposes of the Act; and prices are to be so regulated as to *stabilize* wages, working conditions, and hours of labor which have been or are to be fixed under the labor provisions. The two are so woven together as to render the probability plain enough that uniform prices, in the opinion of Congress, could not be fairly fixed or effectively regulated, without also regulating these elements of labor which enter so largely into the cost of production.

These two sets of requirements are not like a collection of bricks, some of which may be taken away without disturbing the others, but rather are like the interwoven threads constituting the warp and woof of a fabric, one set of which can not be removed without fatal consequences to the whole. Paraphrasing the words of this Court in *Butts* v. *Merchants Transp'n Co.* (230 U. S., 126, 133), we inquire—What authority has this Court, by construction, to convert the manifest purpose of Congress to regulate production by the mutual operation and interaction of fixed wages and fixed prices into a purpose to regulate the subject by the operation of the latter alone? Are we at liberty to say from the fact that Congress has adopted an entire integrated system that it probably would have enacted a doubtfully effective fraction of the system? The words of the concurring opinion in the *Schechter case* (295 U. S., at pages 554–555) are pertinent in reply. "To take from this code the provisions as to wages and the hours of labor is to destroy it altogether. * * * Wages and the hours of labor are essential features of the plan, its very bone and sinew. There is no opportunity in such circumstances for the severance of the infected parts in the hope of saving the remainder." The conclusion is unavoidable that the price-fixing provisions of the code are so related to and dependent upon the labor provisions as conditions, considerations or compensations, as to make it clearly probable that the latter being held bad, the former would not have been passed. The fall of the latter, therefore, carries down with it the former. (*International Textbook Co.* v. *Pigg*, supra, 113; *Warren* v. *Mayor and Aldermen of Charlestown*, 2 Gray [Mass.], 84, 98–99.)

The price-fixing provisions of the code are thus disposed of without coming to the question of their constitutionality; but neither this disposition of the matter, nor anything we have said, is to be taken as indicating that the Court is of opinion that these provisions, if separately enacted, could be sustained.

If there be in the Act provisions, other than those we have considered, that may stand independently, the question of their validity is left for future determination when, if ever, that question shall be presented for consideration.

The decrees in Nos. 636, 649, and 650 must be reversed and the causes remanded for further consideration in conformity with this opinion. The decree in No. 651 will be affirmed.

It is so ordered.

SEPARATE OPINION OF MR. CHIEF JUSTICE HUGHES.

I agree that the stockholders were entitled to bring their suits; that, in view of the question whether any part of the Act could be sustained, the suits were not premature; that the so-called tax is not a real tax, but a penalty; that the constitutional power of the Federal Government to impose this penalty must rest upon the commerce clause, as the Government concedes; that production—in this case mining—which precedes commerce, is not itself commerce; and that the power to regulate commerce among the several States is not a power to regulate industry within the State.

The power to regulate interstate commerce embraces the power to protect that commerce from injury, whatever may be the source of the dangers which threaten it, and to adopt any appropriate means to that end. (*Second Employers' Liability cases*, 223 U. S., 1, 51.) Congress thus has adequate authority to maintain the orderly conduct of interstate commerce and to provide for the peaceful settlement of disputes which threaten it. (*Texas & N. O. R. Co.* v. *Railway Clerks*, 281 U. S., 548, 570.) But Congress may not use this protective authority as a pretext for the exertion of power to regulate activities and relations within the States which affect interstate commerce only indirectly. Otherwise, in view of the multitude of indirect effects, Congress in its discretion could assume control of virtually all the activities of the people to the subversion of the fundamental principle of the Constitution. If the people desire to give Congress the power to regulate industries within the State, and the relations of employers and employees in those industries, they are at liberty to declare their will in the appropriate manner, but it is not for the Court to amend the Constitution by judicial decision.

I also agree that subdivision (g) of Part III of the prescribed code is invalid upon three counts: (1) It attempts a broad delegation of legislative power to fix hours and wages without standards or limitation. The Government invokes the analogy of legislation which becomes effective on the happening of a specified event, and says that in this case the event is the agreement of a certain proportion of producers and employees, whereupon the other producers and employees become subject to legal obligations accordingly. I think that the argument is unsound and is pressed to the point where the principle would be entirely destroyed. It would remove all restrictions upon the delegation of legislative power, as the making of laws could thus be referred to any designated officials or private persons whose orders or agreements would be treated as "events," with the result that they would be invested with the force of law having penal sanctions. (2) The provision permits a group of producers and employees, according to their own views of expediency, to make rules as to hours and wages for other producers and employees who were not parties to the agreement. Such a provision, apart from the mere question of the delegation of legislative power, is not in accord with the requirement of due process of law which under the fifth amendment dominates the regulations which Congress may impose. (3) The provision goes beyond any proper measure of protection of interstate commerce and attempts a broad regulation of industry within the State.

But that is not the whole case. The Act also provides for the regulation of the prices of bituminous coal sold in interstate commerce and prohibits unfair methods of competition in interstate commerce. Undoubtedly transactions in carrying on interstate commerce are subject to the Federal power to regulate that commerce and the control of charges and the protection of fair competition in that commerce are familiar illustrations of the exercise of the power, as the Interstate Commerce Act, the Packers and Stockyards Act, and the Anti-Trust Acts abundantly show. The court has repeatedly stated that the power to regulate interstate commerce among the several States is supreme and plenary. (*Minnesota Rate cases*, 230 U. S., 352, 398.) It is "complete in itself, and may be exercised to its utmost extent, and acknowledges no limitations, other than are prescribed in the Constitution." (*Gibbons*

v. *Ogden*, 9 Wheat., 1, 196.) We are not at liberty to deny to the Congress, with respect to interstate commerce, a power commensurate with that enjoyed by the States in the regulation of their internal commerce. (See *Nebbia* v. *New York*, 291 U. S., 502.)

Whether the policy of fixing prices of commodities sold in interstate commerce is a sound policy is not for our consideration. The question of that policy, and of its particular applications, is for Congress. The exercise of the power of regulation is subject to the constitutional restriction of the due process clause, and if in fixing rates, prices or conditions of competition, that requirement is transgressed, the judicial power may be invoked to the end that the constitutional limitation may be maintained. (*Interstate Commerce Commission* v. *Union Pacific R. R. Co.*, 222 U. S., 541, 547; *St. Joseph Stock Yards Co.* v. *United States*, decided April 27, 1936.)

In the legislation before us, Congress has set up elaborate machinery for the fixing of prices of bituminous coal sold in interstate commerce. That provision is attacked *in limine*. Prices have not yet been fixed. If fixed, they may not be contested. If contested, the Act provides for review of the administrative ruling. If in fixing prices, due process is violated by arbitrary, capricious or confiscatory action, judicial remedy is available. If an attempt is made to fix prices for sales in intrastate commerce, that attempt will also be subject to attack by appropriate action. In that relation it should be noted that in the Carter cases, the court below found that substantially all the coal mined by the Carter Coal Co. is sold f. o. b. mines and is transported into States other than those in which it is produced for the purpose of filling orders obtained from purchasers in such States. Such transactions are in interstate commerce. (*Savage* v. *Jones*, 225 U. S., 501, 520.) The court below also found that "the interstate distribution and sale and the intrastate distribution and sale" of the coal are so "intimately and inextricably connected" that "the regulation of interstate transactions of distribution and sale can not be accomplished effectively without discrimination against interstate commerce unless transactions of intrastate distribution and sale be regulated." Substantially the same situation is disclosed in the Kentucky cases. In that relation, the Government invokes the analogy of transportation rates. (*The Shreveport case*, 234 U. S., 342; *Wisconsin Railroad Commission* v. *Chicago, Burlington & Quincy R. R. Co.*, 257 U. S., 563.) The question will be the subject of consideration when it arises in any particular application of the Act.

Upon what ground, then, can it be said that this plan for the regulation of transactions in interstate commerce in coal is beyond the constitutional power of Congress? The Court reaches that conclusion in the view that the invalidity of the labor provisions requires us to condemn the Act in its entirety. I am unable to concur in that opinion. I think that the express provisions of the Act preclude such a finding of inseparability.

This is admittedly a question of statutory construction; and hence we must search for the intent of Congress. And in seeking that intent we should not fail to give full weight to what Congress itself has said upon the very point. The Act provides (section 15):

"If any provision of this Act, or the application thereof to any person or circumstances, is held invalid, the remainder of the Act and the application of such provisions to other persons or circumstances shall not be affected thereby."

That is a flat declaration against treating the provisions of the Act as inseparable. It is a declaration which Congress was competent to make. It is a declaration which reverses the presumption of indivisibility and creates an opposite presumption. (*Utah Power & Light Co.* v. *Pfost*, 286 U. S., 165, 184.)

The above quoted provision does not stand alone. Congress was at pains to make a declaration of similar import with respect to the provisions of the code (section 3):

"No producer shall by reason of his acceptance of the code provided for in section 4 or of the drawback of taxes provided in section 3 of this Act be held to be precluded or estopped from contesting the constitutionality of any provision of said code, or its validity as applicable to such producer."

This provision evidently contemplates, when read with the one first quoted, that a stipulation of the code may be found to be unconstitutional and yet that its invalidity shall not be regarded as affecting the obligations attaching to the remainder.

I do not think that the question of separability should be determined by trying to imagine what Congress would have done if certain provisions found to be invalid were excised. That, if taken broadly, would lead us into a realm of pure speculation. Who can tell amid the host of divisive influences playing upon the legislative body what its reaction would have been to a particular excision required by a finding of invalidity? The question does not call for speculation of that sort but rather for an inquiry whether the provisions are inseparable by virtue of inherent character. That is, when Congress states that the provisions of the Act are not inseparable and that the invalidity of any provision shall not affect others, we should not hold that the provisions are inseparable unless their nature, by reason of an inextricable tie, demands that conclusion.

All that is said in the preamble of the Act, in the directions to the commission which the Act creates, and in the stipulations of the code, is subject to the explicit direction of Congress that the provisions of the statute shall not be treated as forming an indivisible unit. The fact that the various requirements furnish to each other mutual aid and support does not establish indivisibility. The purpose of Congress, plainly expressed, was that if a part of that aid were lost, the whole should not be lost. Congress desired that the Act and code should be operative so far as they met the constitutional test. Thus we are brought, as I have said, to the question whether, despite this purpose of Congress, we must treat the marketing provisions and the labor provisions as inextricably tied together because of their nature. I find no such tie. The labor provisions are themselves separated and placed in a separate part (Part III) of the code. It seems quite clear that the validity of the entire Act can not depend upon the provisions as to hours and wages in paragraph (g) of Part III. For what was contemplated by that paragraph is manifestly independent of the other machinery of the Act, as it can not become effective unless the specified proportion of producers and employees reach an agreement as to particular wages and hours. And the provision for collective bargaining in paragraphs (a) and (b) of Part III is apparently made separable from the code itself by section 9 of the Act, providing, in substance, that the employees of all producers shall have the right of collective bargaining even when producers do not accept or maintain the code.

The marketing provisions (Part II) of the code naturally form a separate category. The interdependence of wages and prices is no clearer in the coal business than in transportation. But the broad regulation of rates in order to stabilize transportation conditions has not carried with it the necessity of fixing wages. Again, the requirement, in paragraph (a) of Part II that district boards shall establish prices so as to yield a prescribed "return per net ton" for each district in a minimum price area, in order "to sustain the stabilization of wages, working conditions and maximum hours of labor," does not link the marketing provisions to the labor provisions by an unbreakable bond. Congress evidently desired stabilization through both the provisions relating to marketing and those relating to labor, but the setting up of the two sorts of requirements did not make the one dependent upon the validity of the other. It is apparent that they are not so interwoven that they can not have separate operation and effect. The marketing provisions in relation to interstate commerce can be carried out as provided in Part II without regard to the labor provisions contained in Part III. That fact, in the light of the congressional declaration of separability, should be considered of controlling importance.

In this view, the Act, and the code for which it provides, may be sustained in relation to the provisions for marketing in interstate commerce, and the decisions of the courts below, so far as they accomplish that result, should be affirmed.

MR. JUSTICE CARDOZO (DISSENTING IN NOS. 636, 649, AND 650, AND IN NO. 651 CONCURRING IN THE RESULT).

My conclusions compendiously stated are these:

(a) Part II of the statute sets up a valid system of price-fixing as applied to transactions in interstate commerce and to those in intrastate commerce where interstate commerce is directly or intimately affected. The prevailing opinion holds nothing to the contrary.

(b) Part II, with its system of price-fixing, is separable from Part III, which contains the provisions as to labor considered and condemned in the opinion of the Court.

(c) Part II being valid, the complainants are under a duty to come in under the code, and are subject to a penalty if they persist in a refusal.

(d) The suits are premature in so far as they seek a judicial declaration as to the validity or invalidity of the regulations in respect of labor embodied in Part III. No opinion is expressed either directly or by implication as to those aspects of the case. It will be time enough to consider them when there is the threat or even the possibility of imminent enforcement. If that time shall arrive, protection will be given by clear provisions of the statute (section 3) against any adverse inference flowing from delay or acquiescence.

(e) The suits are not premature to the extent that they are intended to avert a present wrong, though the wrong upon analysis will be found to be unreal.

The complainants are asking for a decree to restrain the enforcement of the statute in all or any of its provisions on the ground that it is a void enactment, and void in all its parts. If some of its parts are valid and are separable from others that are or may be void, and if the parts upheld and separated are sufficient to sustain a regulatory penalty, the injunction may not issue and hence the suits must fail. There is no need when that conclusion has been reached to stir a step beyond. Of the provisions not considered, some may never take effect, at least in the absence of future happenings which are still uncertain and contingent. Some may operate in one way as to one group and in another way as to others according to particular conditions as yet unknown and unknowable. A decision in advance as to the operation and validity of separable provisions in varying contingencies is premature and hence unwise. "The court will not 'anticipate a question of constitutional law in advance of the necessity of deciding it.' (*Steamship Co.* v. *Emigration Commissioners*, 113 U. S., 33, 39; *Abrams* v. *Van Schaick*, 293 U. S., 188; *Wilshire Oil Co.* v. *United States*, 295 U. S., 100.) 'It is not the habit of the court to decide questions of a constitutional nature unless absolutely necessary to a decision of the case.' (*Burton* v. *United States*, 196 U. S., 283, 295.)" (Per Brandeis, J., in *Ashwander* v. *Tennessee Valley Authority*, — U. S., —, February 17, 1936.) The moment we perceive that there are valid and separable portions, broad enough to lay the basis for a regulatory penalty, inquiry should halt. The complainants must conform to whatever is upheld, and as to parts excluded from the decision, especially if the parts are not presently effective, must make their protest in the future when the occasion or the need arises.

First: I am satisfied that the Act is within the power of the Central Government in so far as it provides for minimum and maximum prices upon sales of bituminous coal in the transactions of interstate commerce and in those of intrastate commerce where interstate commerce is directly or intimately affected. Whether it is valid also in other provisions that have been considered and condemned in the opinion of the court, I do not find it necessary to determine at this time. Silence must not be taken as importing acquiescence. Much would have to be written if the subject, even as thus restricted were to be explored through all its implications, historical and economic as well as strictly legal. The fact that the prevailing opinion leaves the price provisions open for consideration in the future makes it appropriate to forego a fullness of elaboration that might otherwise be necessary. As a system of price fixing the Act is challenged upon three grounds: (1) because the governance of prices is not within the commerce clause; (2) because it is a denial of due process forbidden by the fifth amendment; and (3) because the standards for administrative action are indefinite, with the result that there has been an unlawful delegation of legislative power.

(1) With reference to the first objection, the obvious and sufficient answer is, so far as the Act is directed to interstate transactions, that sales made in such conditions constitute interstate commerce, and do not merely "affect" it. (*Dahnke-Walker Milling Co.* v. *Bondurant*, 257 U. S., 282, 290; *Flanagan* v. *Federal Coal Co.*, 267 U. S., 222, 225; *Lemke* v. *Farmers Grain Co.*, 258 U. S., 50, 60; *Public Utilities Commission* v. *Attleboro Steam & Electric Co.*, 273 U. S., 83, 90; *Federal Trade Commission* v. *Pacific States Paper Trade Association*, 273 U. S., 52, 64.) To regulate the price for such transactions is to regulate commerce itself, and not alone its antecedent conditions or its ultimate consequences. The very act of sale is limited and governed. Prices in interstate transactions may not be regulated by the States. (*Baldwin* v. *Seelig*, 294 U. S., 511.) They must therefore be subject to the power of the Nation unless they are to be withdrawn altogether from governmental supervision. (Cf. *The Head Money cases*, 112 U. S., 580, 593; Story, Commentaries on the

Constitution, section 1082.) If such a vacuum were permitted, many a public evil incidental to interstate transactions would be left without a remedy. This does not mean, of course, that prices may be fixed for arbitrary reasons or in an arbitrary way. The commerce power of the Nation is subject to the requirement of due process like the police power of the States. (*Hamilton* v. *Kentucky Distilleries Co.*, 251 U. S., 146, 156; cf. *Brooks* v. *United States*, 267 U. S., 432, 436, 437; *Nebbia* v. *New York*, 291 U. S., 502, 524.) Heed must be given to similar considerations of social benefit or detriment in marking the division between reason and oppression. The evidence is overwhelming that Congress did not ignore those considerations in the adoption of this Act. What is to be said in that regard may conveniently be postponed to the part of the opinion dealing with the fifth amendment.

Regulation of prices being an exercise of the commerce power in respect of interstate transactions, the question remains whether it comes within that power as applied to intrastate sales where interstate prices are directly or intimately affected. Mining and agriculture and manufacture are not interstate commerce considered by themselves, yet their relation to that commerce may be such that for the protection of the one there is need to regulate the other. (*Schechter Poultry Corporation* v. *United States*, 295 U. S., 495, 544, 545, 546.) Sometimes it is said that the relation must be "direct" to bring that power into play. In many circumstances such a description will be sufficiently precise to meet the needs of the occasion. But a great principle of constitutional law is not susceptible of comprehensive statement in an adjective. The underlying thought is merely this, that "the law is not indifferent to considerations of degree." (*Schechter Poultry Corporation* v. *United States*, supra, concurring opinion, page 554.) It can not be indifferent to them without an expansion of the commerce clause that would absorb or imperil the reserved powers of the States. At times, as in the case cited, the waves of causation will have radiated so far that their undulatory motion, if discernible at all, will be too faint or obscure, too broken by cross-currents, to be heeded by the law. In such circumstances the holding is not directed at prices or wages considered in the abstract, but at prices or wages in particular conditions. The relation may be tenuous or the opposite according to the facts. Always the setting of the facts is to be viewed if one would know the closeness of the tie. Perhaps, if one group of adjectives is to be chosen in preference to another, "intimate" and "remote" will be found to be as good as any. At all events, "direct" and "indirect," even if accepted as sufficient, must not be read too narrowly. (Cf. Stone, J., in *Di Santo* v. *Pennsylvania*, 273 U. S., 34, 44.) A survey of the cases shows that the words have been interpreted with suppleness of adaptation and flexibility of meaning. The power is as broad as the need that evokes it.

One of the most common and typical instances of a relation characterized as direct has been that between interstate and intrastate rates for carriers by rail where the local rates are so low as to divert business unreasonably from interstate competitors. In such circumstances Congress has the power to protect the business of its carriers against disintegrating encroachments. (*The Shreveport case*, 234 U. S., 342, 351, 352; *Wisconsin Railroad Commission* v. *Chicago, Burlington & Quincy R. Co.*, 257 U. S., 563, 588; *United States* v. *Louisiana*, 290 U. S., 70, 75; *Florida* v. *United States*, 292 U. S., 1.) To be sure, the relation even then may be characterized as indirect if one is nice or overliteral in the choice of words. Strictly speaking, the intrastate rates have a primary effect upon the intrastate traffic and not upon any other, though the repercussions of the competitive system may lead to secondary consequences affecting interstate traffic also. (*Atlantic Coast Line R. Co.* v. *Florida*, 295 U. S., 301, 306.) What the cases really mean is that the casual relation in such circumstances is so close and intimate and obvious as to permit it to be called direct without subjecting the word to an unfair or excessive strain. There is a like immediacy here. Within rulings the most orthodox, the prices for intrastate sales of coal have so inescapable a relation to those for interstate sales that a system of regulation for transactions of the one class is necessary to give adequate protection to the system of regulation adopted for the other. The argument is strongly pressed by intervening counsel that this may not be true in all communities or in exceptional conditions. If so, the operators unlawfully affected may show that the Act to that extent is invalid as to them. Such partial invalidity is plainly an insufficient basis for a declaration that the Act is invalid as a whole. (*Dahnke-Walker Co.* v. *Bondurant*, supra, 289; *DuPont* v. *Commissioner*, 289 U. S., 685, 688.)

What has been said in this regard is said with added certitude when complainants' business is considered in the light of the statistics exhibited in the several records. In No. 636, the Carter case, the complainant has admitted that "substantially all" (over 97½ per cent) of the sales of the Carter company are made in interstate commerce. In No. 649 the percentages of intrastate sales are, for one of the complaining companies, 25 per cent, for another 1 per cent, and for most of the others 2 per cent or 4. The Carter company has its mines in West Virginia; the mines of the other companies are located in Kentucky. In each of those States, moreover, coal from other regions is purchased in large quantities, and is thus brought into competition with the coal locally produced. Plainly, it is impossible to say either from the statute itself or from any figures laid before us that interstate sales will not be prejudicially affected in West Virginia and Kentucky if intrastate prices are maintained on a lower level. If it be assumed for present purposes that there are other States or regions where the effect may be different, the complainants are not the champions of any rights except their own. (*Hatch* v. *Reardon*, 204 U. S., 152, 160, 161; *Premier-Pabst Sales Co.* v. *Grosscup* (May 18, 1936), — U. S., —.)

(2) The commerce clause being accepted as a sufficient source of power, the next inquiry must be whether the power has been exercised consistently with the fifth amendment. In the pursuit of that inquiry, *Nebbia* v. *New York* (291 U. S., 502) lays down the applicable principle. There a statute of New York prescribing a minimum price for milk was upheld against the objection that price fixing was forbidden by the fourteenth amendment.[1] We found it a sufficient reason to uphold the challenged system that "the conditions or practices in an industry make unrestricted competition an inadequate safeguard of the consumer's interests, produce waste harmful to the public, threaten ultimately to cut off the supply of a commodity needed by the public, or portend the destruction of the industry itself." (291 U. S., at page 538.)

All this may be said, and with equal, if not greater force, of the conditions and practices in the bituminous coal industry, not only at the enactment of this statute in August, 1935, but for many years before. Overproduction was at a point where free competition had been degraded into anarchy. Prices had been cut so low that profit had become impossible for all except a lucky handful. Wages came down along with prices and with profits. There were strikes, at times nation-wide in extent, at other times spreading over broad areas and many mines, with the accompaniment of violence and bloodshed and misery and bitter feeling. The sordid tale is unfolded in many a document and treatise. During the 23 years between 1913 and 1935, there were 19 investigations or hearings by Congress or by specially created commissions with reference to conditions in the coal mines.[2] The hope of betterment was faint unless the industry could be subjected to the compulsion of a code. In the weeks immediately preceding the passage of this Act the country was threatened once more with a strike of ominous proportions. The plight of the industry was not merely a menace to owners and to mine workers: it was and had long been a menace to the public, deeply concerned in a steady and uniform supply of a fuel so vital to the national economy.

Congress was not condemned to inaction in the face of price wars and wage wars so pregnant with disaster. Commerce had been choked and burdened; its normal flow had been diverted from one State to another; there had been bankruptcy and waste and ruin alike for capital and for labor. The liberty protected by the fifth amendment does not include the right to persist in this anarchic riot. "When industry is greviously hurt, when producing concerns fail, when unemployment mounts and communities dependent upon profitable production are prostrated, the wells of commerce go dry." (*Appalachian Coals, Inc.*, v. *United States*, 288 U. S., 344, 372.) The free competition so often figured as a social goods imports order and moderation and a decent regard for the

[1] *Hamilton* v. *Kentucky Distilleries Co.* (251 U. S., 146, 156): "The war power of the United States, like its other powers and like the police power of the States, is subject to applicable constitutional limitations (*Ex parte Milligan*, 4 Wall., 2, 121–127; *Monongahela Navigation Co.* v. *United States*, 148 U. S., 312, 336; *United States* v. *Joint Traffic Assn.*, 171 U. S., 505, 571; *McCray* v. *United States*, 195 U. S., 27, 61; *United States* v. *Cress*, 243 U. S., 316, 326); but the fifth amendment imposes in this respect no greater limitation upon the National power than does the fourteenth amendment upon State power. (*In re Kemmler*, 136 U. S., 436, 448; *Carroll* v. *Greenwich Insurance Co.*, 199 U. S., 401, 410.)" (Cf. *Brooks* v. *United States*, 267 U. S., 432, 436, 437; *Nebbia* v. *New York*, 291 U. S., 502, 524.)

[2] The dates and titles are given in the brief for the Government in No. 636, at pages 15–18

welfare of the group. (Cf. *The Sugar Institute, Inc.*, v. *United States*, — U. S., —, March 30, 1936.) There is testimony in these records, testimony even by the assailants of the statute, that only through a system of regulated prices can the industry be stabilized and set upon the road of orderly and peaceful progress.[3] If further facts are looked for, they are narrated in the findings as well as in congressional reports and a mass of public records.[4] After making every allowance for difference of opinion as to the most efficient cure, the student of the subject is confronted with the indisputable truth that there were ills to be corrected, and ills that had a direct relation to the maintenance of commerce among the States without friction or diversion. An evil existing, and also the power to correct it, the lawmakers were at liberty to use their own discretion in the selection of the means.[5]

(3) Finally, and in answer to the third objection to the statute in its price-fixing provisions, there has been no excessive delegation of legislative power. The prices to be fixed by the district boards and the commission must conform to the following standards: they must be just and equitable; they must take account of the weighted average cost of production for each minimum price area; they must not be unduly prejudicial or preferential as between districts or as between producers within a district; and they must reflect as nearly as possible the relative market value of the various kinds, qualities and sizes of coal, at points of delivery in each common consuming market area; to the end of affording the producers in the several districts substantially the same opportunity to dispose of their coals on a competitive basis as has heretofore existed. The minimum for any district shall yield a return, per net ton, not less than the weighted average of the total costs per net ton of the tonnage of the minimum price area; the maximum for any mine, if a maximum is fixed, shall yield a return not less than cost plus a reasonable profit. Reasonable prices can as easily be ascertained for coal as for the carriage of passengers or property under the Interstate Commerce Act, or for the services of brokers in the stockyards (*Tagg Bros. & Moorhead* v. *United States*, 280 U. S., 420), or for the use of dwellings under the emergency rent laws (*Block* v. *Hirsh*, 256 U. S., 135, 157; *Marcus Brown Co.* v. *Feldman*, 256 U. S., 170; *Levy Leasing Co.* v. *Siegel*, 258 U. S., 242), adopted at a time of excessive scarcity, when the laws of supply and demand no longer gave a measure for the ascertainment of the reasonable. The standards established by this Act are quite as definite as others that have had the approval of this Court. (*New York Central Securities Corporation* v. *United States*, 287 U. S., 12, 24; *Federal Radio Commission* v. *Nelson Bros. Bond & Mortgage Co.*, 289 U. S., 266, 286; *Tagg Bros. & Moorhead* v. *United States*, supra; *Mahler* v. *Eby*, 264 U. S., 32.) Certainly a bench of judges, not experts in the coal business, can not say with assurance that members of a commission will be unable, when advised and informed by others experienced in the industry, to make the standards workable, or to overcome through the development of an administrative technique many obstacles and difficulties that might be baffling or confusing to inexperience or ignorance.

The price provisions of the Act are contained in a chapter known as Part II. The final subdivisions of that part enumerate certain forms of conduct which are denounced as "unfair methods of competition." For the most part the prohibitions are ancillary to the fixing of a minimum price. The power to fix a price carries with it the subsidiary power to forbid and prevent evasion. (Cf. *United States* v. *Ferger*, 250 U. S., 199.) The few prohibitions that may be viewed as separate are directed to situations that may never be realized in practice. None of the complainants threatens or expresses the desire to

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[3] See also the Report of the Fifteenth Annual Meeting of the National Coal Association, October 26–27, 1934, and the statement of the resolutions adopted at the sixteenth annual meeting as reported at hearings preliminary to the passage of this Act. Hearings before a Subcommittee of the Committee on Ways and Means, House of Representatives, Seventy-fourth Congress, first session, on H. R. 8479, pp. 20, 152.

[4] There is significance in the many bills proposed to the Congress after painstaking reports during successive national administrations with a view to the regulation of the coal industry by congressional action. S. 2557, October 4, 1921, Sixty-seventh Congress, first session; S. 3147, February 13, 1922, Sixty-seventh Congress, second session; H. R. 9222, February 11, 1926, Sixty-ninth Congress, first session; H. R. 11898, May 4, 1926 (S. 4177), Sixty-ninth Congress, first session; S. 2935, January 7, 1932 (H. R. 7536), Seventy-second Congress, first session; also same session H. R. 12916 and 9924.

[5] "Price control, like any other form of discrimination, is unconstitutional only if arbitrary, discriminatory or demonstrably irrelevant to the policy the legislature is free to adopt, and hence an unnecessary and unwarranted interference with individual liberty." (*Nebbia* v. *New York*, supra, at page 538.)

do these forbidden acts. As to those phases of the statute the suits are premature.

Second: The next inquiry must be whether Part I of the statute which creates the administrative agencies, and Part II, which has to do in the main with the price-fixing machinery, as well as preliminary sections levying a tax or penalty, are separable from Part III, which deals with labor relations in the industry, with the result that what is earlier would stand if what is later were to fall.

The statute prescribes the rule by which construction shall be governed. "If any provision of this Act, or the application thereof to any person or circumstances, is held invalid, the remainder of the Act and the application of such provisions to other persons or circumstances shall not be affected thereby." (Section 15.) The rule is not read as an inexorable mandate. (*Dorchy* v. *Kansas*, 264 U. S., 286, 290; *Utah Power & Light Co.* v. *Pfost*, 286 U. S., 165, 184; *Railroad Retirement Board* v. *Alton R. Co.*, 295 U. S., 330, 362.) It creates a "presumption of divisibility," which is not applied mechanically or in a manner to frustrate the intention of the lawmakers. Even so, the burden is on the litigant who would escape its operation. Here the probabilities of intention are far from overcoming the force of the presumption. They fortify and confirm it. A confirmatory token is the formal division of the statute into "parts" separately numbered. Part III which deals with labor is physically separate from everything that goes before it. But more convincing than the evidences of form and structure, the division into chapters and sections and paragraphs, each with its proper subject matter, are the evidences of plan and function. Part II, which deals with prices, is to take effect at once, or as soon as the administrative agencies have finished their administrative work. Part III in some of its most significant provisions, the section or subdivision in respect of wages and the hours of labor, may never take effect at all. This is clear beyond the need for argument from the mere reading of the statute. The maximum hours of labor may be fixed by agreement between the producers of more than two-thirds of the annual national tonnage production for the preceding calendar year and the representatives of more than one-half the mine workers. Wages may be fixed by agreement or agreements negotiated by collective bargaining in any district or group of two or more districts between representatives of producers of more than two-thirds of the annual tonnage production of such districts or each of such districts in a contracting group during the preceding calendar year, and representatives of the majority of the mine workers therein. It is possible that none of these agreements as to hours and wages will ever be made. If made, they may not be completed for months or even years. In the meantime, however, the provisions of Part II will be continuously operative, and will determine prices in the industry. Plainly, then, there was no intention on the part of the framers of the statute that prices should not be fixed if the provisions for wages or hours of labor were found to be invalid.

Undoubtedly the rules as to labor relations are important provisions of the statute. Undoubtedly the lawmakers were anxious that provisions so important should have the force of law. But they announced with all the directness possible for words that they would keep what they could have if they could not have the whole. Stabilizing prices would go a long way toward stabilizing labor relations by giving the producers capacity to pay a living wage.[6] To hold otherwise is to ignore the whole history of mining. All in vain have official committees inquired and reported in thousands of printed pages if this lesson has been lost. In the face of that history the Court is now holding

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[6] At a hearing before a Subcommittee of the Committee on Ways and Means, House of Representatives, Seventy-fourth Congress, first session, on H. R. 8479, counsel for the United Mine Workers of America, who had cooperated in the drafting of the Act, said (p. 35):

"We have, as can be well understood, a provision of this code dealing with labor relations at the mine. We think that is justified; we think it is impossible to conceive of any regulation of this industry that does not provide for regulation of labor relations at the mines. I realize that while it may be contested, yet I feel that it is going to be sustained.

"Also, there is a provision in this Act that if this Act, or any part of it, is declared to be invalid as affecting any person or persons, the rest of it will be valid, and if the other provisions of this Act still stand and the labor provisions are struck down, we still want the Act, because it stabilizes the industry and enables us to negotiate with them on a basis which will at least be different from what we have been confronted with since April, and that is a disinclination to even negotiate a labor wage scale because they claim they are losing money.

"If the labor provisions go down, we still want the industry stabilized so that our union may negotiate with them on the basis of a living American wage standard."

that Congress would have been unwilling to give the force of law to the provisions of Part II, which were to take effect at once, if it could not have Part III, which in the absence of agreement between the employers and the miners would never take effect at all. Indeed, the prevailing opinion goes so far, it seems, as to insist that if the least provision of the statute in any of the three chapters is to be set aside as void, the whole statute must go down, for the reason that everything from end to end, or everything at all events beginning with section 4, is part of the Bituminous Coal Code, to be swallowed at a single draught, without power in the commission or even in the court to abate a jot or tittle. One can only wonder what is left of the "presumption of divisibility" which the lawmakers were at pains to establish later on. Codes under the National Recovery Act are not a genuine analogy. The Recovery Act made it mandatory (section 7a) that every code should contain provisions as to labor, including wages and hours, and left everything else to the discretion of the codifiers. Wages and hours in such circumstances were properly described as "essential features of the plan, its very bone and sinew" (*Schechter Poultry Corporation* v. *United States*, supra, concurring opinion, page 555), which taken from the body of a code would cause it to collapse. Here on the face of the statute the price provisions of one part and the labor provisions of the other (the two to be administered by separate agencies) are made of equal rank.

What is true of the sections and subdivisions that deal with wages and the hours of labor is true also of the other provisions of the same chapter of the Act. Employees are to have the right to organize and bargain collectively through representatives of their own choosing, and shall be free from interference, restraint or coercion of employers, or their agents, in the designation of such representatives, or in self-organization or in other concerted activities for the purpose of collective bargaining or other mutual aid or protection, and no employee and no one seeking employment shall be required as a condition of employment to join any company union. No threat has been made by any one to do violence to the enjoyment of these immunities and privileges. No attempt to violate them may be made by the complainants or indeed by any one else in the term of four years during which the Act is to remain in force. By another subdivision employees are to have the right of peaceable assemblage for the discussion of principles of collective bargaining, shall be entitled to select their own check-weighman to inspect the weighing or measuring of coal, and shall not be required as a condition of employment to live in company houses or to trade at the store of the employer. None of these privileges or immunities has been threatened with impairment. No attempt to impair them may ever be made by any one.

Analysis of the statute thus leads to the conclusion that the provisions of Part III, so far as summarized, are separable from Parts I and II, and that any declaration in respect of their validity or invalidity under the commerce clause of the Constitution or under any other section will anticipate a controversy that may never become real. This being so, the proper course is to withhold an expression of opinion until expression becomes necessary. A different situation would be here if a portion of the statute, and a portion sufficient to uphold the regulatory penalty, did not appear to be valid. If the whole statute were a nullity, the complainants would be at liberty to stay the hand of the tax gatherer threatening to collect the penalty, for collection in such circumstances would be a trespass, an illegal and forbidden act. (*Child Labor Tax case*, 259 U. S., 20; *Hill* v. *Wallace*, 259 U. S., 44, 62; *Terrace* v. *Thompson*, 263 U. S., 197, 215; *Pierce* v. *Society of Sisters*, 268 U. S., 510, 536.) It would be no answer to say that the complainants might avert the penalty by declaring themselves code members (section 3) and fighting the statute afterwards. In the circumstances supposed there would be no power in the National Government to put that constraint upon them. The Act by hypothesis being void in all its parts as a regulatory measure, the complainants might stand their ground, refuse to sign anything, and resist the onslaught of the collector as the aggression of a trespasser. But the case as it comes to us assumes a different posture, a posture inconsistent with the commission of a trespass either present or prospective. The hypothesis of complete invalidity has been shown to be unreal. The price provisions being valid, the complainants were under a duty to come in under the code, whether the provisions as to labor are valid or invalid, and their failure to come in has exposed them to a penalty lawfully imposed. They are thus in no position to restrain the acts of the collector, or to procure a judgment defeating the operation of the statute, whatever may be the fate hereafter of particular provisions not presently enforcible. The right to an injunction failing, the suits must be dismissed. Nothing more is needful—no pronouncement more elaborate—for a disposition of the controversy.

A last assault upon the statute is still to be repulsed. The complainants take the ground that the Act may not coerce them through the imposition of a penalty into a seeming recognition or acceptance of the code, if any of the code provisions are invalid, however separable from others. I can not yield assent to a position so extreme. It is one thing to impose a penalty for refusing to come in under a code that is void altogether. It is a very different thing if a penalty is imposed for refusing to come in under a code invalid at the utmost in separable provisions, not immediately operative, the right to contest them being explicitly reserved. The penalty in those circumstances is adopted as a lawful sanction to compel submission to a statute having the quality of law. A sanction of that type is the one in controversy here. So far as the provisions for collective bargaining and freedom from coercion are concerned, the same duties are imposed upon employers by section 9 of the statute whether they come in under the code or not. So far as code members are subject to regulation as to wages and hours of labor, the force of the complainants' argument is destroyed when reference is made to those provisions of the statute in which the effect of recognition and acceptance is explained and limited. By section 3 of the Act, "No producer shall by reason of his acceptance of the code provided for in section 4 or of the drawback of taxes provided for in section 3 of this Act be held to be precluded or estopped from contesting the constitutionality of any provision of said code, or its validity as applicable to said producer." These provisions are reinforced and made more definite by sections 5(c) and 6(b), which so far as presently material are quoted in the margin.[7] For the subscriber to the code who is doubtful as to the validity of some of its requirements, there is thus complete protection. If this might otherwise be uncertain, it would be made clear by our decision in *Ex parte Young* (209 U. S., 123), which was applied in the court below at the instance and for the benefit of one of these complainants to give relief against penalties accruing during suit. (*Helvering* v. *Carter*, No. 651.) Finally, the adequacy of the remedial devices is made even more apparent when one remembers that the attack upon the statute in its labor regulations assumes the existence of a controversy that may never become actual. The failure to agree upon a wage scale or upon maximum hours of daily or weekly labor may make the statutory scheme abortive in the very phases and aspects that the Court has chosen to condemn. What the code will provide as to wages and hours of labor, or whether it will provide anything, is still in the domain of prophecy. The opinion of the Court begins at the wrong end. To adopt a homely form of words, the complainants have been crying before they are really hurt.

My vote is for affirmance.

I am authorized to state that Mr. Justice BRANDEIS and Mr. Justice STONE join in this opinion.

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[7] SEC. 5. (c) Any producer whose membership in the code and whose right to a drawback on the taxes as provided under this Act has been canceled, shall have the right to have his membership restored upon payment by him of all taxes in full for the time during which it shall be found by the commission that his violation of the code or of any regulation thereunder, the observance of which is required by its terms, shall have continued. In making its findings under this subsection the commission shall state specifically (1) the period of time during which such violation continued, and (2) the amount of taxes required to be paid to bring about reinstatement as a code member.

SEC. 6. (b) Any person aggrieved by an order issued by the commission or Labor Board in a proceeding to which such person is a party may obtain a review of such order in the Circuit Court of Appeals of the United States, within any circuit wherein such person resides or has his principal place of business, or in the United States Court of Appeals for the District of Columbia, by filing in such court, within 60 days after the entry of such order, a written petition praying that the order of the commission or Labor Board be modified or set aside in whole or in part. * * * The judgment and decree of the court, affirming, modifying, and enforcing or setting aside, in whole or in part any such order of the commission or Labor Board, as the case may be, shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in sections 239 and 240 of the Judicial Code, as amended (U. S. C., Title 28, sections 346 and 347.)

# CARRIERS TAXING ACT, APPROVED AUGUST 29, 1935 (PUBLIC, NO. 400, SEVENTY-FOURTH CONGRESS).

## SECTION 1.—DEFINITIONS.

REGULATIONS 93, ARTICLE 3: Definition of "employee." XV–26–8147 S. S. T. 8

The receiver operating the business of a carrier is not an "employee" within the meaning of sections 2 and 4 of the Carriers Taxing Act. Accordingly, his compensation is not subject to the taxes imposed by that Act. The receiver is, however, liable for collection of the employees' income tax and for the excise tax imposed by that Act.

Advice is requested whether the compensation of a receiver operating the business of a carrier is subject to the taxes imposed by sections 2 and 4 of the Carriers Taxing Act, approved August 29, 1935 (Public, No. 400, Seventy-fourth Congress).

The employees' income tax imposed by section 2 of the Carriers Taxing Act and the excise tax on carriers imposed by section 4 of that Act are both measured by the "compensation" of "employees" of a "carrier," as such terms are defined by the Act and Regulations 93 issued pursuant thereto.

Section 1(b) of the Act provides in part as follows:

> The term "employee" means (1) each person who at or after the enactment hereof is in the service of a carrier, * * *.

Article 3 of Regulations 93 reads in part as follows:

> * * * When used in these regulations, the term *employee* means a person who at any time after August 28, 1935, performs services for a carrier in an employment as defined in article 4. However, the relationship between the person who performs such services and the carrier must, as to those services, be the legal relationship of employer and employee. The words "employ," "employer," and "employee" are to be taken in their ordinary meaning. * * *

It is held that a receiver operating the business of a carrier is not an "employee" of the carrier within the meaning of section 1(b) of the Carriers Taxing Act and article 3 of Regulations 93. Accordingly, neither the employees' income tax imposed by section 2 of the Act nor the excise tax on carriers imposed by section 4 thereof attaches with respect to the compensation paid to the receiver for services performed as such. The receiver is, however, required to collect the employees' income tax imposed by section 2 of the Act by deducting or causing to be deducted the amount of the tax from the compensation of each employee of the carrier as and when paid, and he is also liable for the carriers' excise tax imposed by section 4 of the Act with respect to the compensation paid to each such employee. The receiver is liable for the employees' income tax whether or not collected from the employees.

## SECTION 3.—DEDUCTION OF TAX FROM WAGES.

REGULATIONS 93, ARTICLE 203: Collection of, and liability for, employees' tax. XV–24–8126 S. S. T. 5
(Also Section 4 and Article 303.)

Carriers' liability for employees' income tax and carriers' excise tax with respect to the compensation of an individual employed by two carriers.

Advice is requested relative to the liability of carriers under sections 3 and 4 of the Carriers Taxing Act, approved August 29, 1935 (Public, No. 400, Seventy-fourth Congress), with respect to the compensation paid to an individual by each of two carriers.

Section 2 of the Act imposes a tax upon the income of every employee of a carrier at the rate of 3½ per cent of the employee's compensation not in excess of $300 per month. Section 3(a) provides that the tax imposed by section 2 shall be collected by the carrier by deducting the amount of the tax from the compensation of the employee as and when paid, and that the carrier shall be liable for the payment of such tax. Section 4 imposes an excise tax upon every carrier at the rate of 3½ per cent of the compensation not in excess of $300 per month paid by it to its employees.

The individual in question is employed by the M Carrier and the N Carrier. The compensation received from each carrier is in excess of $300 per month. The following questions are raised:

1. Whether the M Carrier is required to deduct the tax from the compensation paid by it to the employee if the N Carrier makes such a deduction from the compensation it pays to such employee? If the M Carrier is required to make such deduction and the N Carrier collects and pays over to the United States the tax on the compensation paid by it, is the M Carrier required to pay over to the United States the amount of tax deducted by it or may it return such amount to the employee?

2. If the N Carrier pays the carriers' excise tax imposed by section 4 of the Act, is the M Carrier also required to pay such tax with respect to the compensation paid by it to the employee?

The $300 limitation prescribed in section 2 with respect to the income tax on employees relates to the total compensation of the employee, whether received from one carrier or several carriers. In other words, an employee of two carriers who receives a total compensation in excess of $300 per month from both is required to pay tax on only $300. Accordingly, where the total compensation received from both carriers is $300 or less per month, under section 3(a) of the Act each carrier is required to deduct the tax from the compensation paid by it. If the employee receives more than $300 per month from each carrier, the tax may be collected entirely from one carrier or in part from each carrier, since the Act does not provide for an allocation of the employees' income tax between the two carriers when the same individual is employed by two carriers and receives more than $300 per month from each carrier. In order to prevent an overcollection and overpayment of the employees' income tax and the consequent adjustments in such a case, the carriers may by mutual agreement determine the portion of the tax each shall deduct from the employee's compensation. If the correct amount of the tax is deducted and accounted for by either or both of the carriers, the arrangement between the carriers may be made as their judgment and convenience warrant. In any event, both carriers must maintain records definitely showing how the tax was collected, and must submit such information with their returns on Form 942. If the correct amount of tax is not reported and paid to the collector, each carrier may be held liable for payment of the correct amount of tax due on the compensation paid by it.

In the instant case, if the N Carrier deducted the entire amount of the employees' tax due with respect to the employee's compensation, the M Carrier should return to the employee the amount of such tax deducted from the compensation paid by it.

With respect to the excise tax on carriers imposed under section 4 of the Act, the limitation contained in that section, under which the amount of compensation in excess of $300 per month is not subject to such tax, relates to the total compensation paid by the carrier to its employee, regardless of whether the employee also receives compensation from another carrier. Accordingly, the tax liability of the M Carrier under section 4 of the Act is distinct and is not affected by the tax imposed by that section upon the N Carrier with respect to the compensation paid by it to the employee in question. It follows that the M Carrier and the N Carrier are each liable for the carriers' excise tax at the rate of 3½ per cent of the total amount of compensation not in excess of $300 per month paid by each carrier to the employee.

## SECTION 7.—INCOME TAX ON EMPLOYEES' REPRESENTATIVE.

REGULATIONS 93, ARTICLE 6: Definition of "compensation" [in the case of a representative]. XV–21–8099 S. S. T. 3

Method of computing tax liability of a full-time representative of employees of a carrier.

Advice is requested as to the method of computing the tax under section 7 of the Carriers Taxing Act, approved August 29, 1935 (Public, No. 400, Seventy-fourth Congress), in the case of a full-time representative of an employee organization who is duly designated and authorized to represent employees under and in accordance with the Railway Labor Act.

Section 7 of the Carriers Taxing Act provides:

* * * In addition to other taxes, there shall be levied, collected, and paid upon the compensation of each employees' representative received by such representative an income tax of 7 per centum annually upon that portion of the compensation of such employees' representative not in excess of $300 per month. The compensation of a representative for the purpose of ascertaining the tax thereon shall be determined according to such rules and regulations as the Commissioner of Internal Revenue shall deem just and reasonable and as near as may be shall be the same compensation as if the representative were still in the employ of the last former carrier.

Article 6(*b*) of Regulations 93 reads in part as follows:

* * * When used in these regulations, the term *compensation*, in the case of a representative, means all remuneration received by him for services performed as an officer or other official of the employee organization. If the remuneration of the representative for services performed during any calendar month exceeds $300, the term does not include that part of such remuneration which is in excess of the first $300 thereof. If, however, the representative establishes to the satisfaction of the Commissioner that he would have received a lesser amount of remuneration from his last former carrier employer had he remained continuously in the employ of such carrier, the portion of the remuneration received by him as representative, not in excess of such lesser amount, shall be the representative's compensation. * * *

Under the law and regulations above quoted, $300 per month is the maximum amount of compensation received as an employees' representative which is subject to the tax. Where the representative establishes to the satisfaction of the Commissioner that for the same period for which remuneration was received as a representative less remuneration would have been received as an employee of his last former carrier employer (had he remained continuously in its employ) than that received as a representative, then the tax may be computed at the rate of 7 per cent of the amount that would have been so received as an employee. For example, if the representative's compensation as such is $350 for a given calendar month, only $300 of that amount is taxable. If he would have received $310 for the month from his last former carrier employer had he remained continuously in its employ, the taxable compensation is still $300. If, however, the compensation he would have received from such carrier is $250 or a lesser amount, only $250, or the lesser amount, as the case may be, is subject to the tax.

# NATIONAL FIREARMS ACT (1934), AS AMENDED.

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REGULATIONS 88, ARTICLE 20: Meaning of terms. XV–22–8107
T. D. 4645

Taxes on certain firearms and machine guns.—Section 1(a) of the National Firearms Act approved June 26, 1934, amended by Public, No. 490, Seventy-fourth Congress, approved April 10, 1936.—Article 20 of Regulations 88, approved August 17, 1934, amended.

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

*To Collectors of Internal Revenue and Others Concerned:*

Regulations 88 are amended to give effect to the provisions of Public, No. 490, Seventy-fourth Congress, approved April 10, 1936.

Preceding article 20, and following section 1(k), there shall be inserted the following:

SECTION 1(a) OF THE NATIONAL FIREARMS ACT APPROVED JUNE 26, 1934, AMENDED BY PUBLIC, NO. 490, SEVENTY-FOURTH CONGRESS, APPROVED APRIL 10, 1936.

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,* That subsection (a) of section 1 of the National Firearms Act relating to the definition of "firearms" is amended by inserting after "definition" a comma and the following: "but does not include any rifle which is within the foregoing provisions solely by reason of the length of its barrel if the caliber of such rifle is .22 or smaller and if its barrel is 16 inches or more in length."

Pursuant to the foregoing provisions of law article 20(*a*) of Regulations 88 is amended to read as follows:

(*a*) The terms defined in the above provisions of law shall have the meanings so assigned to them, and the definition of "firearms" contained in subsection (a) above does not include any rifle having a caliber of .22 or smaller if the length of its barrel is 16 inches or more.

This document is issued under the authority contained in section 12 of the National Firearms Act.

GUY T. HELVERING,
*Commissioner of Internal Revenue.*

Approved May 25, 1936.

WAYNE C. TAYLOR,
*Acting Secretary of the Treasury.*

(Filed with the Division of the Federal Register May 27, 1936, 11.59 a. m.)

## NATIONAL INDUSTRIAL RECOVERY ACT.

SECTION 216. XV-3-7917
I. T. 2951

**Computation of excess profits tax liability under the National Industrial Recovery Act for the period January 1 to September 30, 1933, where a corporation changed its accounting period.**

Advice is requested whether the declared value of the M Company's capital stock as disclosed by its capital stock tax return for the year ended June 30, 1933, should be prorated in computing its excess-profits tax liability for the period January 1 to September 30, 1933, under section 216 of the National Industrial Recovery Act, the taxpayer having been granted permission by the Bureau to change its accounting period beginning with the year 1933.

The question arises in view of the fact that section 702 of the Revenue Act of 1934 provides in the case of an excess-profits tax return for an income-tax taxable year which is a period of less than 12 months that the adjusted declared value of the capital stock set forth in the corporation's capital stock tax return shall be reduced to an amount which bears the same ratio thereto as the number of months in the period bears to 12 months, but the National Industrial Recovery Act contains no corresponding provision. It is proposed by the revenue agent to place the income on an annual basis under section 47(c) of the Revenue Act of 1932 and at the same time to prorate or reduce the adjusted declared value of the capital stock.

Section 216 of the National Industrial Recovery Act provides in part as follows:

SEC. 216. (a) There is hereby imposed upon the net income of every corporation, for each income-tax taxable year ending after the close of the first year in respect of which it is taxable under section 215, an excess-profits tax equivalent to 5 per centum of such portion of its net income for such income-tax taxable year as is in excess of 12½ per centum of the adjusted declared value of its capital stock * * * as of the close of the preceding income-tax taxable year * * *. The terms used in this section shall have the same meaning as when used in the Revenue Act of 1932.

(b) The tax imposed by this section shall be assessed, collected, and paid in the same manner, and shall be subject to the same provisions of law (including penalties), as the taxes imposed by Title I of the Revenue Act of 1932.

Section 47(a) of the Revenue Act of 1932 prescribes the returns to be filed for a "short period resulting from change of accounting period." Section 47(c) of that Act reads as follows:

(c) *Income placed on annual basis.*—If a separate return is made under subsection (a) on account of a change in the accounting period, the net income, computed on the basis of the period for which separate return is made, shall be placed on an annual basis by multiplying the amount thereof by 12 and dividing by the number of months included in the period for which the separate return is made. The tax shall be such part of the tax computed on such annual basis as the number of months in such period is of 12 months.

In determining excess-profits tax liability under the provisions of section 216 of the National Industrial Recovery Act, the provisions of the Revenue Act of 1932 are applicable except where they are inconsistent. Accordingly, section 47(c), supra, applies, there being no specific provision in the National Industrial Recovery Act for the reduction of the adjusted declared value of capital stock corresponding to section 702(a) of the Revenue Act of 1934. In the instant case the corporation's net income for the period January 1 to September 30, 1933, was $24,000, and the adjusted declared value of its capital stock (value as of December 31, 1932) for the year ended June 30, 1933, on which the excess-profits tax deduction for the period ended September 30, 1933, is based, was $100,000. The excess-profits tax liability should be computed as follows:

| | |
|---|---|
| (1) Net income for 9-month period | $24,000.00 |
| (2) Item (1) multiplied by 12 | 288,000.00 |
| (3) Net income on annual basis ($288,000÷9) | 32,000.00 |
| (4) Deduction of adjusted declared value (12½ per cent of $100,000) | 12,500.00 |
| (5) Net income subject to excess-profits tax | 19,500.00 |
| (6) Tax on item (5) at 5 per cent—annual basis | 975.00 |
| (7) Amount of tax for period ($975×¾) | 731.25 |

It is held, therefore, that in computing the excess-profits tax liability under the National Industrial Recovery Act for a period of less than a year where a corporation changed its accounting period, the adjusted declared value of its capital stock should not be reduced but its income should be placed on an annual basis. Even though the result may be the same under the National Industrial Recovery Act and under the Revenue Act of 1934, different methods of computation are prescribed by those Acts.

It may be added that the above computation may not be invoked in the case of the first return after organization of a corporation, or the last return upon dissolution, regardless of the fact that the period during which its income is received or earned is less than a full year. (See *Bankers' Trust Co.* v. *Bowers*, 295 Fed., 89, T. D. 3547, C. B. III-1, 237; G. C. M. 2292, C. B. VI-2, 78; G. C. M. 2080, C. B. VI-2, 288; *Louis Hymel Planting & Manufacturing Co.* v. *Commissioner*, 5 B. T. A., 910, acquiescence, C. B. VI-2, 3; I. T. 2817, C. B. XIII-2, 116. Compare G. C. M. 15937, page 146, this Bulletin.)

# THE POTATO ACT OF 1935.

XV–1–7896
T. D. 4620

POTATO JOINT REGULATIONS NO. 1.

Joint regulations pursuant to the provisions of section 209(b) of the Potato Act of 1935 pertaining to the form of, and the terms and conditions relating to the issuance of potato tax-exemption stamps for the allotment year beginning December 1, 1935.

UNITED STATES DEPARTMENT OF AGRICULTURE,
OFFICE OF THE SECRETARY.
UNITED STATES TREASURY DEPARTMENT,
OFFICE OF THE SECRETARY.

By virtue of the authority vested in the Secretary of Agriculture and the Secretary of the Treasury by section 209 (b) of the Potato Act of 1935, being Title II of the Act of Congress approved August 24, 1935, Public, No. 320, Seventy-fourth Congress, we, R. G. TUGWELL, Acting Secretary of Agriculture, and T. J. COOLIDGE, Acting Secretary of the Treasury, do make, prescribe, publish, and give public notice of the following regulations pertaining to the form of, and the terms and conditions relating to, the issuance of potato tax-exemption stamps for the allotment year beginning December 1, 1935, to be in force and effect from the date of approval hereof until amended or superseded by regulations hereafter jointly made by the Secretary of Agriculture and the Secretary of the Treasury under such Act.

IN TESTIMONY WHEREOF I have hereunto set my hand and caused the official seal of the Department of Agriculture to be affixed in the city of Washington this 9th day of December, 1935.

R. G. TUGWELL,
*Acting Secretary of Agriculture.*

IN TESTIMONY WHEREOF I have hereunto set my hand and caused the official seal of the Treasury Department to be affixed in the city of Washington this 30th day of December, 1935.

T. J. COOLIDGE,
*Acting Secretary of the Treasury.*

ARTICLE I.

FORM OF POTATO TAX-EXEMPTION STAMPS.

SECTION 1. *Form of stamps for allotment year commencing December 1, 1935.*—Potato tax-exemption stamps shall be prepared in the form of adhesive stamps and shall be similar in size to the small size United States postage stamp. On the face of such stamps shall appear the expressions, "U. S. Department of Agriculture," "Series 1935," and "Tax-Exempt Potatoes." In addition, the face of each such stamp shall show thereon, in prominent figures followed by the word "Pounds" or "Pound" as the case may be, the denomination of the stamp expressed in the number of pounds of potatoes for which such stamp is calculated to establish an exemption from the tax levied and assessed by the Potato Act of 1935.

SEC. 2. *Denomination of stamps.*—The following denominations of potato tax-exemption stamps are prescribed for use in evidencing tax-exempt potato sales under said Act: One hundred and sixty-five (165) pounds, one hundred and fifty (150) pounds, one hundred (100) pounds, fifty (50) pounds, twenty-five (25) pounds, fifteen (15) pounds, ten (10) pounds, five (5) pounds, four (4) pounds, three (3) pounds, two (2) pounds, and one (1) pound.

## Article II.

### TERMS AND CONDITIONS RELATING TO THE ISSUANCE OF POTATO TAX-EXEMPTION STAMPS.

After apportionments to farms are established in accordance with regulations prescribed by the Secretary of Agriculture, tax-exemption stamps for a quantity of potatoes equal to the apportionment to each such farm shall be issued to the person who, being eligible therefor, executes and files, in the form and manner prescribed by the Secretary of Agriculture, an application for tax-exemption stamps for such farm, a receipt for such stamps, and an agreement relating to the utilization of such stamps by or on behalf of each producer sharing in the potatoes produced for sale on such farm during the allotment year for which such apportionments were made. Such tax-exemption stamps shall be issued in accordance with such procedure as shall be established by the Secretary of Agriculture and through such agents or agencies as shall be designated for such purpose by the Secretary of Agriculture.

## Article III.

### AMENDMENTS.

These regulations, in whole or in part, shall be subject to such modifications, amendments, and additions as may from time to time be jointly approved by the Secretary of Agriculture and the Secretary of the Treasury.

# SOCIAL SECURITY ACT.

## TITLE VIII.—TAXES WITH RESPECT TO EMPLOYMENT.

SECTION 807: Collection and payment of taxes. XV-6-7950
(Also Section 905.) S. S. T. 1

Penalties for misrepresentation concerning the taxes imposed by the Social Security Act.

Titles VIII and IX of the Social Security Act impose taxes at specified rates measured by the amount of "wages" as defined in sections 811 and 907 of the Act. The Act does not prohibit the inclusion of the amount of the tax actually paid or payable in the cost of production of an article or in the price at which an article is sold or leased. However, section 1123 of the Revenue Act of 1926, made applicable by sections 807(c) and 905(b) of the Social Security Act, provides for certain penalties for misrepresentation of any tax imposed under the authority of the United States.

Section 1123 provides as follows:

> * * * Whoever in connection with the sale or lease, or offer for sale or lease, of any article, or for the purpose of making such sale or lease, makes any statement, written or oral, (1) intended or calculated to lead any person to believe that any part of the price at which such article is sold or leased, or offered for sale or lease, consists of a tax imposed under the authority of the United States, or (2) ascribing a particular part of such price to a tax imposed under the authority of the United States, knowing that such statement is false or that the tax is not so great as the portion of such price ascribed to such tax, shall be guilty of a misdemeanor and upon conviction thereof shall be punished by a fine of not more than $1,000 or by imprisonment not exceeding one year, or both.

Any person, as defined in section 1101(a)3 of the Social Security Act, who makes any statement, written or oral, intended or calculated to lead any person to believe that any part of the price for which an article is sold or leased, or offered for sale or lease, consists of a tax imposed under the Social Security Act, knowing that the statement is false or that the amount so represented as the tax is greater than the amount of tax actually paid or payable as such, is subject, upon conviction, to the penalties provided for in section 1123 of the Revenue Act of 1926.

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SECTION 811: Definitions. XV-20-8091
(Also Section 907, Article 206(5)-(6).) S. S. T. 2

The taxes imposed by Titles VIII and IX of the Social Security Act are not applicable with respect to employees of a lighting plant, waterworks, or cemetery owned and operated by a city.

Advice is requested whether liability for the taxes imposed by Titles VIII and IX of the Social Security Act is incurred with respect to services performed in the employ of a lighting plant, waterworks, or cemetery owned and operated by a city.

Titles VIII and IX of the Social Security Act impose taxes at specified rates measured by the amount of "wages" with respect to "employment" as defined in sections 811 and 907 of the Act. Section 811(b) provides that the term "employment" used in Title VIII means any service, of whatever nature, performed within the United States by an employee for his employer, except—

(7) Service performed in the employ of a State, a political subdivision thereof, or an instrumentality of one or more States or political subdivisions;

Section 907(c)6 contains an identical exception with respect to the tax under Title IX.

Article 206(5)-(6) of Regulations 90, relating to the excise tax on employers under Title IX, provides as follows:

* * * *Government employees.*—Services performed by Federal and State employees are excepted. The exception extends to every service performed by an individual in the employ of the United States, the several States, the District of Columbia, or the Territory of Alaska or Hawaii, or any political subdivision or instrumentality thereof, including every unit or agency of government, without distinction between those exercising functions of a governmental nature and those exercising functions of a proprietary nature.

Since the exception in section 811(b)7 is identical with that contained in section 907(c)6, the interpretation of the latter section in article 206(5)-(6) of Regulations 90 is equally applicable to Title VIII.

It is held that neither the income tax on employees nor the excise tax on employers imposed by Title VIII of the Social Security Act will apply with respect to services performed in the employ of a city owned and operated lighting plant, waterworks, or cemetery, and that the excise tax on employers imposed by Title IX of that Act does not attach with respect to such services.

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SECTION 811: Definitions. XV-24-8127
(Also Section 907, Article 206.) S. S. T. 6

Liability of the M Committee, a political organization, for the taxes imposed upon employers and employees by Titles VIII and IX of the Social Security Act.

Advice is requested whether the M Committee, a political organization, is subject to the taxes imposed by the Social Security Act.

The tax imposed by section 801, Title VIII, of the Social Security Act is an income tax equal to the specified percentages of the wages (as defined in section 811) received by every individual after December 31, 1936, with respect to "employment" after such date. The tax imposed by section 804, Title VIII, of the Act is an excise tax on every employer with respect to having individuals in his employ, equal to the specified percentages of the wages paid by him after December 31, 1936, with respect to "employment" after such date. The tax imposed by section 901, Title IX, of the Act is an excise tax on every employer (as defined in section 907(a)), with respect to having individuals in his employ, equal to the specified percentages of the total wages payable by him with respect to "employment" during the calendar year 1936 and succeeding calendar years.

The term "employment" as used in Titles VIII and IX of the Act is defined by section 811(b) and section 907(c) of the Act as meaning any service, of whatever nature, performed within the

United States by an employee for his employer, with the exception of certain services which are specifically set forth in those sections.

Since the taxes imposed by Titles VIII and IX of the Social Security Act are applicable with respect to all "employment," except as provided in sections 811(b) and 907 (a) and (c), and as it does not appear that the services performed for the M Committee by its employees come within any of the excepted services specified in sections 811(b) and 907(c) of the Act, it is held that the M Committee, which qualifies as an "employer," is liable with respect to the taxes imposed upon employers and employees by Titles VIII and IX of the Social Security Act.

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SECTION 811: Definitions. XV-24-8128
(Also Section 907, Article 203.) S. S. T. 7

Exemption of an organization from filing returns of income under the provisions of the income tax laws of the United States does not extend to taxes imposed by the Social Security Act, exemption from which must be determined solely on the basis of the exemption provisions contained in that Act.

Advice is requested whether the M Chamber of Commerce is exempt from taxation under the provisions of the Social Security Act. The inquirer is of the opinion that inasmuch as the M Chamber of Commerce is exempt from income taxation under the various Revenue Acts it is also exempt from taxation under the Social Security Act.

The taxing provisions of the Social Security Act are contained in Titles VIII and IX of that Act. The excise tax under the Social Security Act, equal to specified percentages of the "wages" paid with respect to "employment," is levied on all "employers," regardless of status under the provisions of other taxing Acts, with respect to having individuals in their employ, and the income tax is levied on the "wages" received by every individual, regardless of status under the provisions of other taxing Acts, with respect to "employment" (as defined in the Act).

Section 811(b) of the Act provides as follows:

* * * The term "employment" means any service, of whatever nature, performed within the United States by an employee for his employer, except—

(1) Agricultural labor;

(2) Domestic service in a private home;

(3) Casual labor not in the course of the employer's trade or business;

(4) Service performed by an individual who has attained the age of 65;

(5) Service performed as an officer or member of the crew of a vessel documented under the laws of the United States or of any foreign country;

(6) Service performed in the employ of the United States Government or of an instrumentality of the United States;

(7) Service performed in the employ of a State, a political subdivision thereof, or an instrumentality of one or more States or political subdivisions;

(8) Service performed in the employ of a corporation, community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, 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.

Section 907(c) of the Act provides as follows:

* * * The term "employment" means any service, of whatever nature, performed within the United States by an employee for his employer, except—

(1) Agricultural labor;

(2) Domestic service in a private home;
(3) Service performed as an officer or member of the crew of a vessel on the navigable waters of the United States;
(4) Service performed by an individual in the employ of his son, daughter, or spouse, and service performed by a child under the age of 21 in the employ of his father or mother;
(5) Service performed in the employ of the United States Government or of an instrumentality of the United States;
(6) Service performed in the employ of a State, a political subdivision thereof, or an instrumentality of one or more States or political subdivisions;
(7) Service performed in the employ of a corporation, community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, 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.

Exemption was granted to the M Chamber of Commerce under the income tax laws in view of the specific exemption contained in the various Revenue Acts (for Federal income tax purposes only) applying to business leagues, chambers of commerce, real estate boards, or boards of trade not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual. Although the M Chamber of Commerce has been held to be exempt from filing returns of income under the provisions of the income tax laws, such exemption does not extend to the taxes imposed by the Social Security Act. Exemption, if any, under that Act must be determined solely on the basis of the exemption provisions contained therein. There is no provision in that Act under which the M Chamber of Commerce is entitled to exemption from its taxing provisions.

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## TITLE IX.—TAX ON EMPLOYERS OF EIGHT OR MORE.

SECTION 901: Imposition of tax. XV–22–8105
ARTICLE 200: Nature of tax. S. S. T. 4

Individuals who were pensioned prior to December 31, 1935, and who have performed no services for their former employer since that date are not considered to be employees within the meaning of Title IX of the Social Security Act.

The following question has been submitted by an employer in the State of R:

We have about *y* people whom we pay weekly, having been pensioned off by us for life, the pensions running from *x* dollars to 4*x* dollars per week. The question is, do we have to pay unemployment compensation upon the amount of this pay roll each week, also will we have to make payment against this part of our pay roll for old age assistance?

Section 901 of the Social Security Act provides in part:

* * * On and after January 1, 1936, every employer (as defined in section 907) shall pay for each calendar year an excise tax, with respect to having individuals in his employ, equal to the following percentages of the total wages (as defined in section 907) payable by him (regardless of the time of payment) with respect to employment (as defined by section 907) during such calendar year:

It will be noted from the foregoing that the tax provided by Title IX of the Social Security Act is imposed with respect to "employment." That term is defined by section 907(c) of the Act as being "any service, of whatever nature, performed within the United States by an employee for his employer," with certain exceptions not pertinent to this inquiry. Title IX of the Act, which became effective January 1, 1936, contemplates only those services rendered by employees subsequent to December 31, 1935. Accordingly, individuals who were pensioned prior to December 31, 1935, and who have performed no services for their former employer since that date, are not considered employees within the meaning of Title IX of the Social Security Act and the taxing provisions of that title are not applicable with respect to such individuals.

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SECTION 905: Administration, refunds, and penalties.

Penalties for misrepresentation concerning the taxes imposed by the Social Security Act. (See S. S. T. 1, page 473.)

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SECTION 907: Definitions.
ARTICLE 203: Persons liable for the tax.

Exemption of organizations from taxes imposed by the Social Security Act. (See S. S. T. 7, page 475.)

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SECTION 907: Definitions.
ARTICLE 206: Excepted services generally.

M Committee and employees of that organization. (See S. S. T. 6, page 474.)

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SECTION 907: Definitions.
ARTICLE 206(5)-(6): Government employees.

Employees of a lighting plant, waterworks, or cemetery owned and operated by a city. (See S. S. T. 2, page 473.)

## TOBACCO.

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REGULATIONS 8(1934), ARTICLE 110: Contents of statutory packages. XV-6-7946 T. D. 4623

Contents of statutory packages of tobacco, snuff, cigars, and cigarettes.

Regulations No. 8, relating to the taxes on tobacco, snuff, cigars, and cigarettes, also on cigarette papers and tubes and purchase and sale of leaf tobacco, amended.

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

*To Collectors of Internal Revenue and Others Concerned:*

Article 110 of Regulations No. 8, as revised and approved November 12, 1934, is amended to read as follows:

ART. 110. *Contents of statutory packages.*—(*a*) Manufacturers are required to put up their tobacco, snuff, cigars, or cigarettes in statutory packages. A statutory package of tobacco, snuff, cigars, or cigarettes means a package which contains only that article upon which the tax is paid. The contents of a statutory package must be limited to the net number of pounds or ounces of tobacco or snuff, or the number of cigars, or cigarettes, indicated by the stamp affixed to the package. However, manufacturers may place within their statutory packages containing tobacco, snuff, cigars, or cigarettes small advertising cards, coupons, certificates, paper bands, circulars, trade-mark tin tags, and trade-mark strips which do not materially increase the weight of the contents or the size of the package, and which are intended as an advertisement of the business of the manufacturer and concern the manufacture and sale of his tobacco, snuff, cigars, or cigarettes. The manufacturer's registered factory number, district, and State, or his name and address shall appear upon such cards, coupons, certificates, or other advertising matter. Manufacturers using tissue, foil, cellophane, or other lightweight wrappings for cigars, may print thereon the name and address, or business of the distributor, customer, or consumer.

(*b*) *Lottery features barred.*—The advertising matter to be packed by a manufacturer within his statutory package of tobacco, snuff, cigars, or cigarettes will not be prohibited, although intended to be returned to the manufacturer or to some person designated by him thereon and exchanged for other articles, provided the distribution of the prize articles does not depend upon the event of a lottery. The equality or inequality of the redemption value of coupons, certificates or other advertising matter on the one hand, or cost of redemption thereof to the manufacturer on the other hand, determines whether the statute is violated. Any differentiation as to the character of coupons, certificates or other advertising matter which have a redemption value, to meet varying conditions in different States which bar their use, constitutes a violation of the statute.

(*c*) *Indecent pictures, prints, or words, etc.*—It is not the purpose of the Commissioner to define or decide what pictures, representations, prints, or words shall be regarded as immoral or indecent as distinguished from other pictures, representations, prints, or words that may be regarded as legitimate, and manufacturers must refrain from submitting to the office any question relating to the proposed use of doubtful matter for advance official opinion, and the circulation of advertising matter will be at the risk of the manufacturer inclosing the same in statutory packages of tobacco, snuff, cigars, and cigarettes.

If a manufacturer is found violating the law with respect to lottery tickets and indecent and immoral pictures, representations, prints, or words, the penalties imposed by section 3456 of the Revised Statutes will be invoked.

GUY T. HELVERING,
*Commissioner of Internal Revenue.*

Approved January 30, 1936.

T. J. COOLIDGE,
*Acting Secretary of the Treasury.*

# MISCELLANEOUS RULINGS.

## DISTILLED SPIRITS, ETC.

REGULATIONS 20, ARTICLE 3. XV–11–8001
T. D. 4628

Amendment of article 3, Regulations 20.

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

*To District Supervisors and Others Concerned:*

Regulations 20, article 3, is hereby amended to read as follows:

A general bonded warehouse must be an entire building, suitable for that purpose, or a separate and secure room in a suitable building; but no dwelling house shall be used for such purpose, and no door, window, or other opening shall be made or permitted in the walls of such building or room leading into any other room or building, except that when a room is used the door, when necessary, may lead into a hall or passage way, or elevator shaft; and all doors, except the one on which the Government lock is placed, must be securely closed and barred on the inside, and on all windows iron bars must be placed, or solid shutters which must be securely barred or fastened on the inside.

Such warehouse shall not be under the same roof or in the same building with a distillery, industrial alcohol plant or rectifying establishment, provided, however, the Commissioner of Internal Revenue, may, in instances where the revenue will not be jeopardized thereby, permit a general bonded warehouse to be under the same roof or in the same building with a rectifying establishment, and, except as to such warehouses heretofore established, no distiller or any other person engaged in the production or rectifying of distilled spirits shall be interested in such warehouse as proprietor.

Such warehouse must be a first-class warehouse, according to the classification of fire insurance companies of the city or place, or of the board of fire underwriters where such exists.

GUY T. HELVERING,
*Commissioner.*

Approved March 6, 1936.
WAYNE C. TAYLOR,
*Acting Secretary of the Treasury.*

XV–6–7944
T. D. 4624
(T. D. (Customs) 48104)

Disposition to be made of forfeited distilled spirits (including alcohol), wine, and malt beverages.

TREASURY DEPARTMENT,
OFFICE OF THE SECRETARY OF THE TREASURY,
*Washington, D. C., January 15, 1936.*

*To District Supervisors, Internal Revenue, Collectors of Customs, and Others Concerned:*

Section 9 of the Federal Alcohol Administration Act, approved August 29, 1935, provides as follows:

(a) All distilled spirits, wine, and malt beverages forfeited, summarily or by order of court, under any law of the United States, shall be delivered to the Secretary of the Treasury to be disposed of as hereinafter provided.

(b) The Secretary of the Treasury shall dispose of all distilled spirits, wine, and malt beverages which have been delivered to him pursuant to subsection (a)—

(1) By delivery to such Government agencies as, in his opinion, have a need for such distilled spirits, wine, or malt beverages for medicinal, scientific, or mechanical purposes; or

(2) By gift to such eleemosynary institutions as, in his opinion, have a need for such distilled spirits, wine, or malt beverages for medicinal purposes; or

(3) By destruction.

(c) No distilled spirits, wine, or malt beverages which have been seized under any law of the United States may be disposed of in any manner whatsoever except after forfeiture and as provided in this section.

(d) The Secretary of the Treasury is authorized to make all rules and regulations necessary to carry out the provisions of this section.

Pursuant to the authority contained in the above section of law, the following regulations are prescribed:

1. As used in these regulations the terms—

(*a*) "Alcohol" means that substance known as ethyl alcohol, hydrated oxide of ethyl, or spirit of wine from whatever source or whatever processes produced.

(*b*) "Institution" and "eleemosynary institution" shall mean any nonprofit institution organized and operated for charitable purposes, whose net income does not inure in whole or in part to the benefit of shareholders or individuals, which shall have filed with the Director of Procurement a satisfactory affidavit establishing such status.

(*c*) "Agency" or "Government agency" shall mean any executive department, independent establishment, board, commission, bureau, service, or division of the United States and any corporation in which the United States owns all or a majority of the stock.

2. The Director of Procurement shall dispose of all distilled spirits (including alcohol), wine, and malt beverages which have been reported to him under these regulations by the seizing agencies in the manner outlined in paragraph (b) of section 9 of the Federal Alcohol Administration Act.

3. The Director of Procurement shall maintain lists of all distilled spirits (including alcohol), wine, and malt beverages reported to him, and Government agencies and eleemosynary institutions desiring the transfer thereof shall forward their requisitions in triplicate to the Director of Procurement to cover not more than one year's requirements, specifically stating the kind desired, quantity, place of delivery, and other specifications, if any, required to fill the particular need, and the purpose for which to be used. The heads of the departments or independent establishments of the United States shall submit all requisitions of their agencies.

4. The Director of Procurement shall act upon such requests as he may determine proper, giving preference, however, to the requests of Government agencies. The receiving agency or institution shall pay all costs in connection with packing and transportation.

5. In order to avoid delays and costs incident to possible shipment of distilled spirits (including alcohol), wine, and malt beverages, which will not meet the requirements of the requisitioning agency or institution, it shall, except in the case of alcohol for mechanical use, arrange directly with the seizing agency as soon as transfer is authorized to have samples forwarded for testing before shipment of the entire quantity is undertaken.

6. If it is determined from samples furnished that any such distilled spirits (including alcohol), wine, and malt beverages do not meet the requirements and are not desired, the requisitioning agency or institution will advise the Director of Procurement, in order that other disposition thereof may be made.

7. No forfeited distilled spirits (including alcohol), wine, or malt beverages shall be sold. All prior regulations relating to the sale of forfeited distilled spirits (including alcohol), wine, and malt beverages, and predicated upon other existing law are hereby superseded.

8. No distilled spirits (including alcohol), wine, or malt beverages, seized under any law of the United States, shall be destroyed or otherwise disposed of except after forfeiture and as provided in these regulations. All regulations or instructions relating to destruction or other disposition of seized distilled spirits (including alcohol), wine, or malt beverages, prior to forfeiture, are hereby superseded.

9. Upon consummation of summary or administrative forfeiture, or upon receipt of advice of the entry of a court order decreeing forfeiture and directing delivery to the Secretary of the Treasury, of distilled spirits (including alcohol), wine, or malt beverages the chief officer of the seizing agency will prepare internal-revenue Form 1563 in quintuplet, submitting three copies to the Director of Procurement, sending one copy to the head of his agency, and retaining the remaining copy in his file: *Provided*, That distilled spirits (including alcohol), wine, or malt beverages not fit for human consumption or for scientific or mechanical purposes, and alcohol of less proof than 160 degrees, need not be reported to the Director of Procurement but shall be destroyed.

10. Domestic wine, malt beverages, and distilled spirits (other than alcohol), which are not produced at a registered winery, brewery, or distillery, will be regarded as unfit for human consumption and shall be destroyed after forfeiture. Alcohol of less proof than 160 degrees shall also be destroyed after forfeiture. Foreign wine, malt beverages and distilled spirits (other than alcohol), and domestic wine, malt beverages and distilled spirits (other than alcohol), produced at registered wineries, breweries or distilleries shall not be destroyed, except as provided in paragraph 11 or unless analysis by Government chemists shows that they are unfit for human consumption.

11. Where the amount of distilled spirits (including alcohol), wine, or malt beverages involved in any seizure is less than 5 wine gallons, internal-revenue Form 1563 need not be prepared or submitted to the Director of Procurement, and such distilled spirits (including alcohol), wine, or malt beverages will be destroyed immediately after forfeiture: *Provided*, That distilled spirits (other than alcohol) of any one kind and brand in excess of 1 gallon, shall not be destroyed under this paragraph.

12. Representative samples of all alcohol, and of other distilled spirits, wine, and malt beverages not destroyed under the authority contained in paragraphs (10) and (11) hereof shall be taken from the containers in which seized, and shall be analyzed by the nearest Government chemist. A copy of the chemist's report will be attached to the original of internal-revenue Form 1563 transmitted to the Director of Procurement, and a copy of the report retained in the files of the seizing agency.

13. Forfeited alcohol may be awarded by the Director of Procurement to eleemosynary institutions for medicinal purposes only. It may be awarded by the Director of Procurement to Government agencies (1) for medicinal or scientific purposes, and (2) for mechanical purposes for use by such agencies in instances where, in the judgment of the seizing agency and upon approval of the head thereof, any part or all of a seizure can economically be denatured and transferred. Potable alcohol awarded for transfer to any agency for mechanical purposes shall be denatured in the manner required by the seizing agency, under the supervision of an officer of the seizing agency, prior to release or transfer thereof. The agency designated to receive such alcohol shall purchase all denaturing materials and pay for labor costs incident to such denaturation.

14. When distilled spirits (including alcohol), wine, or malt beverages which have been reported on internal-revenue Form 1563 are not assigned to a Government agency for official use, or disposed of by gift to an eleemosynary institution, field officers submitting the forms will be so advised by the Director of Procurement, and the spirits (including alcohol), wine, or malt beverages shall be destroyed.

15. Field officers will maintain a record of all forfeited spirits (including alcohol), wine, or malt beverages reported to the Director of Procurement. Where authority is not received within a reasonable time to transfer the articles to a Government agency or an eleemosynary institution, a follow-up letter should be sent to the Director of Procurement requesting definite information concerning their ultimate disposition. Prompt disposition should be made to prevent unnecessary storage charges.

16. District supervisors will report on internal-revenue Form 1565, prepared in duplicate, the disposition of all spirits (including alcohol), wine, or malt beverages directed by the Director of Procurement, the original thereof to be sent to the Deputy Commissioner and the copy retained in the district supervisor's files. Collectors of customs shall report such disposition in the manner required by regulations for reporting the transfer of seized property to other agencies for official use.

T. J. Coolidge,
*Acting Secretary of the Treasury.*

XV-15-8040
Ct. D. 1104

TAX ON DISTILLED SPIRITS—REVENUE ACT OF 1926—REVISED STATUTES—DECISION OF SUPREME COURT.

1. FORFEITURE PROCEEDINGS—SALE OF ALCOHOL—PROCEEDINGS TO ENFORCE TAX LIEN AGAINST PROCEEDS—TIMELINESS OF PETITION.

The United States filed a libel in admiralty seeking forfeiture of a cargo of alcohol seized in December, 1932, for violation of customs and navigation laws. The circuit court of appeals, reversing the decree of forfeiture entered by the district court, ordered the alcohol sold free of all Government taxes or tax liens and the proceeds paid into the registry of the court. Later, a petition of the United States, asking that the proceeds of the sale be applied in satisfaction of its tax lien, was denied by the circuit court of appeals on the ground that the question of taxes had not been raised in the libel. Under these facts, deferring the claim for taxes until after final adjudication of the libel proceeding was not dilatory conduct, since, if a forfeiture had been decreed, there would have been no occasion to proceed against the property for taxes.

2. TAX ON ALCOHOL—LIEN.

The tax sought to be recovered was not a penalty imposed for violation of the National Prohibition Act and hence uncollectible because of the repeal of the eighteenth amendment, but was the basic tax upon distilled spirits, irrespective of their legal or illegal origin. The United States has the right to enforce its lien for taxes, which attaches as soon as the alcohol comes into existence as such, continues until the tax is paid, and is valid against all transferees without assessment, distraint, or other administrative proceedings.

3. ESTOPPEL—ELECTION OF REMEDIES—WAIVER.

By instituting forfeiture proceedings the United States was not estopped, because of an election of remedies, from later prosecuting its tax claim, the tax proceeding being founded upon a right distinct from, and entirely consistent with, the rights theretofore asserted. Nor is the United States estopped where the order of sale provided, in effect, that existing liens should attach to the proceeds of the sale, and counsel for the Government had made no agreement to waive the tax lien on the proceeds.

4. JURISDICTION OF COURTS.

The circuit court of appeals sitting in admiralty has jurisdiction to enforce the lien for taxes, the proceeds of the sale being in its custody, and the Supreme Court has jurisdiction to review the decision as to the tax question, which had not theretofore been litigated and which was not barred by the earlier proceedings.

SUPREME COURT OF THE UNITED STATES.

*United States, petitioner,* v. *Frank Rizzo, Claimant of 146,157 Gallons of Alcohol.*

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

[March 9, 1936.]

OPINION.

Mr. Justice BRANDEIS delivered the opinion of the Court.

In December, 1932, a cargo of alcohol was seized by Customs and Coast Guard officials acting together; and the United States filed, in the Federal court for New Jersey, a libel in admiralty praying forfeiture for violation of the customs and navigation laws. Rizzo, as claimant, filed an answer. A decree of forfeiture was entered on the ground that the cargo was carried on a vessel employed in a trade other than that for which she was licensed. The court of appeals reversed, citing *United States* v. *Chambers* (291 U. S., 217). While the Government's petition for a rehearing, later denied, was pending, that court ordered, upon application by Rizzo for sale of the alcohol, that it be sold, "free and clear of all claims of any kind or character"; that the proceeds be deposited in the registry; and that they "be substituted in the place and stead of said 146,157 gallons of alcohol, and that all further proceedings herein shall be against said proceeds of sale."

The marshal sold the alcohol for $1.85 per wine gallon. In confirming the sale, the court ordered (1) that the alcohol be delivered to the purchaser free of all Government taxes or tax liens and customs duties; (2) that it "shall be treated by the United States Government and any of its departments as tax-paid, irrespective of the lack of any stamp or tax certificate affixed thereto on the respective containers in which said alcohol may be deposited or contained"; and (3) that the proceeds of sale be paid into the registry of the court. We denied a writ of certiorari, sought on the ground that the circuit court of appeals lacked authority to include the provision regarding taxes in its order of confirmation. (294 U. S., 709.)

Thereupon, the United States filed in the circuit court of appeals a petition asking that the proceeds of the sale be paid into the Treasury of the United States in satisfaction of the lien for taxes due on the alcohol; made proof that the taxes exceeded the proceeds of the sale; and filed with the clerk notices of levy and warrant for distraint. The court ruled that the petition could not be entertained, because the Government had failed to raise the question of taxes when it filed its libel but had waited until after denial of certiorari to seek such relief. Accordingly, the court directed that the proceeds be paid to the claimant or his assigns.[1] To review this order we granted certiorari, a misconstruction of the statutes concerning tax liens and a departure from the usual course of proceedings being charged. (296 U. S., —.)

First. Rizzo does not attempt here to support the order on the ground stated by the court of appeals. Nor could he well do so. The claim for taxes, being nonmaritime, could not have been set forth in the libel. (Compare *The Steamboat Orleans* v. *Phoebus*, 11 Pet., 175, 182.) To defer presenting the claims for taxes until after the final decree adjudicating the right to the property was not dilatory conduct. Obviously, there would have been no occasion to proceed against the property for collection of the tax if the alcohol had been declared forfeit to the United States.

Second. Rizzo contends that the tax sought to be recovered is a penalty imposed for violation of the National Prohibition Act; hence uncollectible, because of the repeal of the eighteenth amendment. (*United States* v. *Chambers*, 291 U. S., 217.) But this tax is not a penalty. It is the basic tax upon distilled spirits irrespective of their legal or illegal origin. (*United States* v. *One Ford Coupe*, 272 U. S., 321, 328; *Various Items of Personl Property* v. *United States*, 282 U. S., 577, 579.) A lien attaches to alcohol "as soon as it is in existence as such" and continues until the tax is paid. (Revised Statutes, sections 3248, 3251; *Thompson* v. *United States*, 142 U. S., 471, 474.) That lien is valid against all transferees, without assessment, distraint or other administrative proceedings. (*Alkan* v. *Bean*, 1 Fed. Cas. No. 202, 418; *United States* v. *Turner*, 28 Fed. Cas. No. 16,548, 232.)

Rizzo objects here that the alcohol does not appear to have been of domestic manufacture. His answer in the district court stated that it was not imported; and there is no showing that it was. As the alcohol was subject to the tax, the burden rested upon him to prove payment. (Revised Statutes, section 3333, as amended.) No evidence to that effect was introduced. The contrary was established.

Third. Rizzo contends that the United States is estopped from collecting the tax, because it elected to seek forfeiture for violation of the National Prohibition Act. But the Government made no such attempt. The libel sought forfeiture on four grounds. Three of them were for violation of provisions in the Tariff Act of 1930 (June 17, 1930, ch. 497, 46 Stat., 590). The fourth was for violation of the navigation laws. (Revised Statutes, section 4377.) The district court decreed forfeiture on the fourth ground, without passing on the other three. The petition presented to the circuit court of appeals has no relation to navigation or customs laws. It states a claim based solely upon the internal revenue laws. The present proceeding is thus founded on a right distinct from, and entirely consistent with, the rights theretofore asserted. (Compare *United States* v. *One Ford Coupe*, 272 U. S., 321, 327, 333–334.) No

[1] Rizzo had filed with the clerk notices of assignment of the proceeds in amounts aggregating nearly the whole of the deposit.

reference was made in the libel, and no evidence was introduced in the district court, with respect to the tax due upon the domestic production of alcohol. There is no basis for the contention that the United States is estopped by an election of remedies. (Compare *Southern Pacific Co.* v. *Bogert*, 250 U. S., 483, 490–491.)

Fourth. Rizzo contends that the United States is also barred because its counsel agreed, when the terms of sale were framed, that the proceeds should be answerable only to the causes of forfeiture set forth in the libel and that any tax lien should be waived. There was no such agreement. The notice of the "terms and conditions under which the sale will be conducted" (to which counsel for the Government is alleged to have consented) recited: "3. The cargo of alcohol which is being sold is to be sold free and clear of all claims of any kind or character." The order of sale had provided that "all further proceedings herein shall be against said proceeds of sale." Thus it was in the common form authorized by Admiralty Rule 40, which is interpreted as transferring all existing liens from property to proceeds. (Compare *The Lottawanna*, 20 Wall., 201, 211, 221; *Schuchardt* v. *Ship Angelique*, 19 How., 239, 241.) Since counsel did not agree to waive the tax lien on the proceeds, and since the court of appeals made no finding of such a waiver, we need not consider whether a United States attorney had authority to waive the Government's right. (Compare *Utah* v. *United States*, 284 U. S., 534, 545–546.)

Fifth. Rizzo contends that the circuit court of appeals sitting in admiralty lacks jurisdiction to enforce the lien for taxes. The argument is that collection of internal revenue taxes must be effected in accordance with prescribed statutory methods; and that the Act of February 26, 1926 (ch. 27, section 1115, 44 Stat., 117), and Revised Statutes section 838 provide specifically for collection by the collector of internal revenue through proceedings specified. (But compare Revised Statutes, section 3213.) The order of the appellate court confirming the sale deprived the Government of two of the statutory methods. First, the right to forfeit the alcohol even after it had been transferred to a bona fide purchaser while in a container not properly stamped (Act of January 11, 1934, ch. 1, Title II, section 206, 48 Stat., 317). Second, the right to collect the taxes from the purchaser under the court's order (Revised Statutes, section 3334, as amended by Act of March 1, 1879, ch. 125, section 5, 20 Stat., 340). But in ordering sale of the alcohol free of liens, the court of appeals in effect provided, in accord with the common practice, that existing liens should attach to the proceeds. (Compare *Terre Haute & L. Ry.* v. *Harrison*, 96 Fed., 907, 911.) These being *in custodia legis*, it was proper to petition that they be applied towards satisfaction of the tax. (Compare *Marshall* v. *New York*, 254 U. S., 380, 384–385; *In re Tyler*, 149 U. S., 164, 182–183, 187.) The practice prevails in admiralty as in other courts. In *Schuchardt* v. *Ship Angelique* (19 How., 239, 241), where proceeds of the sale of a mortgaged ship had been paid into the registry, the court, refusing to entertain a "libel simply to foreclose a mortgage, or to enforce the payment of a mortgage," said: "As the fund is in the custody of the Admiralty, the application must necessarily be made to that court by any person setting up an interest in it. This application by petition is frequently entertained for proceeds in the registry, in cases where a suit in the Admiralty would be wholly inadmissible." (Admiralty Rule 42; compare *The Lottawanna*, 21 Wall., 558, 582–583; *The J. E. Rumbell*, 148 U. S., 1, 15.) The practice prevails in appellate courts as well as in courts of original jurisdiction. (Compare *In re Antigo Screen Door Co.*, 123 Fed., 249, 251–252.)

Sixth. Finally, Rizzo contends that this Court lacks jurisdiction because the order appealed from does no more than carry out another order not here for review. This is not true. The United States seeks to enforce against property in the possession of the circuit court of appeals a right which had not theretofore been litigated, and which was not barred by earlier proceedings. If the Government had been a stranger to the litigation it would have been entitled to intervene (compare *Savannah* v. *Jesup*, 106 U. S., 563, 564–565; *Krippendorf* v. *Hyde*, 110 U. S., 276, 282–283; *Gumbel* v. *Pitkin*, 113 U. S., 545, 547–548; 124 U. S., 131); and a denial of intervention would have been reviewable as a final judgment (compare *Central Trust Co.* v. *Grant Locomotive Works*, 135 U. S., 207, 224–225; *Credits Commutation Co.* v. *United States*, 177 U. S., 311, 315–316; *Clark* v. *Williard*, 292 U. S., 112, 117–119). Its right to have the new issue adjudicated is not to be denied because it was already a party to the suit. (Compare *In the Matters of Howard*, 9 Wall., 175, 183.) The cases which hold that merely administrative proceedings under a decree may not be brought here for review have no application. (See *Wynkoop, etc., Co.* v. *Gaines*, 227 U. S., 4. Compare *Collins* v. *Miller*, 252 U. S., 364, 370–371; *Farmers' Loan & Trust Co., petitioner*, 129 U. S., 206.)

The order is reversed with direction to the circuit court of appeals to pay to the United States the proceeds of the sale now in the registry after deducting the usual court charges.

Reversed.

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XV–20–8093
T. D. 4642

Stamps indicating tax payment of distilled spirits in bottles.

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

*To Collectors of Internal Revenue, District Supervisors, and Others Concerned:*

1. Effective June 1, 1936, the placing (by printing, writing, perforating, rubber-stamping, or other method) of the name and address (or symbol number) of the bottler of domestic spirits, or any other information, on strip stamps prescribed by the Liquor Taxing Act of 1934 is prohibited: *Provided, however*, That the name and address of the importer and the brand and kind of distilled spirits shall continue to be overprinted on strip stamps to be affixed to bottles of imported spirits in accordance with present regulations.

2. All overprinted strip stamps on hand June 1, 1936, may be used.

3. All Treasury decisions inconsistent herewith are amended accordingly.

GUY T. HELVERING,
*Commissioner of Internal Revenue.*

Approved May 7, 1936.

WAYNE C. TAYLOR,
*Acting Secretary of the Treasury.*

(Filed with the Division of the Federal Register May 11, 1936, 1.32 p. m.)

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XV–23–8118
T. D. 4647

Stamps indicating tax payment of distilled spirits in bottles.

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

*To Collectors of Internal Revenue, District Supervisors, and Others Concerned:*

1. The effective date of Treasury Decision 4642 [above], prohibiting the overprinting of red strip stamps for domestic spirits is hereby extended from June 1, 1936, to July 1, 1936.

GUY T. HELVERING,
*Commissioner of Internal Revenue.*

Approved June 1, 1936.

WAYNE C. TAYLOR,
*Acting Secretary of the Treasury.*

(Filed with the Division of the Federal Register June 4, 1936, 10.02 a. m.)

REGULATIONS 8 (Alcohol): Cistern room. XV–18–8072
T. D. 4639

Pipe lines connecting receiving cisterns.

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

*To District Supervisors and Others Concerned:*

The first paragraph on page 12 of Regulations 8, under the caption "Cistern Room," is hereby amended to read as follows:

These cisterns must not be connected with each other, and must be so constructed as to leave an open space of at least 3 feet between the top and the roof or floor above, and a space of not less than 18 inches between the bottom and the floor below, and they must be separated so that the officer may pace around them, and so constructed as always to be exposed to the view of the officer; provided, however, that a connecting pipe line between receiving cisterns will be permitted in order to prevent loss of spirits by overflow. Such connecting pipe line must be located as close to the top of each cistern as the construction of the cistern will permit, and must be closed and all connections therein brazed or otherwise effectually sealed to prevent abstraction of spirits without evidence of tampering. A valve in the connecting pipe, equipped for locking with Government lock, must be provided and same must be closed and locked before the spirits are proofed and while the spirits are being drawn off.

GUY T. HELVERING,
*Commissioner of Internal Revenue.*

Approved April 29, 1936.
WAYNE C. TAYLOR,
*Acting Secretary of the Treasury.*

(Filed with the Division of the Federal Register May 1, 1936, 11.40 a. m.)

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XV–12–8012
T. D. 4631

Marking packages of distilled spirits, other than alcohol.—Amendment of Gauging Manual.

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

*To District Supervisors and Others Concerned:*

Effective April 1, 1936, paragraph 71 of the Gauging Manual, as amended by Treasury Decision 26 (Bureau of Industrial Alcohol), is hereby amended to read as follows:

PAR. 71. (a) The kind (class and type) of the spirits will be branded on the package according to the standards of identity for distilled spirits fixed by the Federal Alcohol Administration.

(b) The distiller will mark on the head of each package of whisky the proof at which the spirits were distilled. This will be done by stenciling, cutting or burning the words "Distilled not over 160 Proof" or "Distilled over 160 Proof," as the case may be, in letters not less than ½ inch in height. Such marking may be suitably abbreviated, as "D not over 160 P" and "D over 160 P." The proof of the spirits in the cistern room, prior to reduction, will be taken as the proof at which the spirits were distilled.

(c) When packages of whisky, filled on and after April 1, 1936, or filled prior thereto and not marked "Straight" at the time of filling, meet the requirements of the classification "Straight Whisky" at the time of withdrawal, the distiller will cut or stencil the word "Straight" on the package immediately before the designation "Whisky," "Rye Whisky," etc.

(d) Where packages of whisky, filled prior to April 1, 1936, were marked "Straight" at the time of filling and meet the requirements of the classification "Straight Whisky" at the time of withdrawal, the designation "Straight" may remain on the package, but where the spirits are not entitled to such designation at the time of withdrawal, the distiller will scrape off the word "Straight" prior to shipment of the packages.

GUY T. HELVERING,
*Commissioner of Internal Revenue.*

Approved March 13, 1936.
WAYNE C. TAYLOR,
*Acting Secretary of the Treasury.*

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REGULATIONS 13, ARTICLE 1: Definitions. XV-20-8092
T. D. 4641

Regulations 13 amended.

TREASURY DEPARTMENT,
OFFICE OF THE SECRETARY OF THE TREASURY,
*Washington, D. C.*

*To District Supervisors, Internal Revenue, and Others Concerned:*

Article 1, paragraph (e), and Appendix B, of Regulations 13, issued under the provisions of joint resolution approved June 18, 1934, entitled "Joint resolution to protect the revenue by regulation of the traffic in containers of distilled spirits," are hereby amended to read as follows:

ARTICLE 1. (*e*) "Liquor bottle" shall mean any glass container for packaging distilled spirits for sale at retail, of a capacity of one-half pint or greater, conforming to these regulations and to the regulations prescribed by the Federal Alcohol Administration, the regulations in that regard promulgated by the Federal Alcohol Administration being hereby adopted as a part of these regulations.

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## APPENDIX B.

### DIGEST OF CERTAIN PORTIONS OF REGULATIONS OF THE FEDERAL ALCOHOL ADMINISTRATION RELATING TO STANDARD BOTTLES FOR DISTILLED SPIRITS.

1. The standard bottles prescribed by regulations of the Federal Alcohol Administration are bottles of such size that they hold distilled spirits in an amount equal to one of the standards of fill set forth in paragraph 2, with a head space not in excess of 8 per centum of the total capacity of the bottle after closure.

2. The standards of fill for distilled spirits in liquor bottles are as follows, subject to the tolerances set forth in paragraph 3 (fills in amounts less than ½ pints omitted):

For all distilled spirits, whether domestically manufactured, domestically bottled, or imported:

1 gallon.
½ gallon.
1 quart.
⅘ quart.
1 pint.
½ pint.

In addition, for Scotch and Irish whisky and Scotch and Irish type whisky; and for brandy and rum:

⅘ pint.

3. The following tolerances shall be allowed:

(*a*) Discrepancies due exclusively to errors in measuring which occur in filling conducted in compliance with good commercial practice.

(*b*) Discrepancies due exclusively to differences in the capacity of bottles, resulting solely from unavoidable difficulties in manufacturing such bottles so as to be of uniform capacity: *Provided,* That no greater tolerance shall be allowed in case of bottles which, because of their design, can not be made of approximately uniform capacity than is allowed in case of bottles which can be manufactured so as to be of approximately uniform capacity.

(*c*) Discrepancies in measure due exclusively to differences in atmospheric conditions in various places and which unavoidably result from the ordinary and customary exposure of alcoholic beverages in bottles to evaporation. The reasonableness of discrepancies under this paragraph shall be determined on the facts in each case.

4. Distilled spirits domestically bottled prior to January 1, 1935, and imported distilled spirits entered in customs bond in bottles prior to March 1, 1935, shall be regarded as being in conformity with the prescribed standards of fill (1) if the bottle, or the label on the bottle, contains a conspicuous statement of the net contents thereof, and (2) if the actual capacity of the bottle is not substantially less than the capacity it appears to have upon visual examination under ordinary conditions of purchase or use.

5. As used with reference to standard bottles, the term "gallon" means United States gallon of 231 cubic inches of alcoholic beverages at 68° F. (20° C.), and all other units of liquid measure are subdivisions of the gallon as so defined.

6. The standards of fill herein set forth do not apply to the following:

(*a*) Distilled spirits imported as vintage spirits under permit issued by a district supervisor of the Alcohol Tax Unit of the Bureau of Internal Revenue pursuant to Regulations 13 (Liquor Bottle Regulations) issued by the Secretary of the Treasury.

(*b*) Cordials and liqueurs, and cocktails, highballs, gin fizzes, bitters, and such other specialties as are specified from time to time by the Administrator.

7. Copies of the regulations of the Federal Alcohol Administration relating to standards of fill for bottled distilled spirits (Labeling and Advertising of Distilled Spirits, Regulations No. 5) may be obtained from the Federal Alcohol Administration, Department of Justice Building, Washington, D. C.

8. This Treasury decision shall be in force and effect on and after August 15, 1936.

WAYNE C. TAYLOR,
*Acting Secretary of the Treasury.*

Approved May 6, 1936.

(Filed with the Division of the Federal Register May 9, 1936, 12.35 p. m.)

# INDUSTRIAL ALCOHOL.

REGULATIONS 3 (Alcohol), ARTICLE 117: Sale and use of completely denatured alcohol.

XV-1-7897
T. D. 4621

Treasury Decision 4553 [C. B. XIV-1, 524] amended.

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

*To District Supervisors and Others Concerned:*

The time within which stocks of completely denatured alcohol, formula No. 5, made prior to June 1, 1935, which are in the hands of producers or controlled by them, must be disposed of, is hereby extended from January 1, 1936, to April 1, 1936.

GUY T. HELVERING,
*Commissioner of Internal Revenue.*

Approved December 31, 1935.

T. J. COOLIDGE,
*Acting Secretary of the Treasury.*

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XV-23-8119
T. D. 4648

Authorizing completely denatured alcohol formulae 11, 12, and 13.

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

*To District Supervisors and Others Concerned:*

Pursuant to authority conferred by the Act of June 7, 1906, and Title III of the National Prohibition Act, the following completely denatured alcohol formulae are hereby authorized:

*Completely denatured alcohol formula No. 11.*

To every 100 parts by volume of ethyl alcohol of not less than 160° proof add:
8 parts by volume of "Pontol-K," or a compound similar thereto.
8 parts by volume of "ST-115," or a compound similar thereto.
1 part by volume of gasoline.
0.5 part by volume of "Agdite" or a compound similar thereto, or 1 part by volume of "Hydronol" or a compound similar thereto.

*Completely denatured alcohol formula No. 12.*

To every 100 parts by volume of ethyl alcohol of not less than 160° proof add:
4 parts by volume of "Pontol-K," or a compound similar thereto.
2 parts by volume of methyl isobutyl ketone.
1 part by volume of gasoline.
1 part by volume of "Agdite" or a compound similar thereto, or 2 parts by volume of "Hydronol" or a compound similar thereto.

*Completely denatured alcohol formula No. 13.*

To every 100 parts by volume of ethyl alcohol of not less than 160° proof **add:**
4 parts by volume of "ST-115," or a compound similar thereto.
2 parts by volume of methyl isobutyl ketone.
1 part by volume of gasoline.
0.5 part by volume of "Agdite" or a compound similar thereto, or 1 part by volume of "Hydronol" or a compound similar thereto.

All completely denatured alcohol formulae heretofore authorized are hereby revoked, except that the formulae for the modification of existing stocks of completely denatured alcohol formulae Nos. 5–A and 10 prescribed by Treasury Decision 4646, approved May 27, 1936 [page 491, this Bulletin], shall remain in effect until such stocks are so modified.

This regulation shall become effective July 1, 1936.

Guy T. Helvering,
*Commissioner of Internal Revenue.*

Approved June 3, 1936.

Wayne C. Taylor,
*Acting Secretary of the Treasury.*

(Filed with the Division of the Federal Register June 5, 1936, 9.45 a. m.)

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XV–22–8108
T. D. 4644

Amending specially denatured alcohol formulae 25 and 25–A

Treasury Department,
Office of Commissioner of Internal Revenue,
*Washington, D. C.*

*To District Supervisors and Others Concerned:*

Pursuant to authority conferred by the Act of June 7, 1906, and Title III of the National Prohibition Act, specially denatured alcohol formulae 25 and 25–A are hereby amended to read as follows effective at once:

*Specially denatured alcohol formula No. 25.*

To every 100 gallons of ethyl alcohol add:
20 pounds of iodine, U. S. P., and
15 pounds of potassium iodide, U. S. P., or
15 pounds of sodium iodide, U. S. P.

*Specially denatured alcohol formula No. 25–A.*

To every 100 gallons of ethyl alcohol add:
A solution composed of 20 pounds of iodine, U. S. P.
15 pounds of potassium iodide, U. S. P., or
15 pounds of sodium iodide, U. S. P., and
15 pounds of water.

Guy T. Helvering,
*Commissioner of Internal Revenue.*

Approved May 25, 1936.

Wayne C. Taylor,
*Acting Secretary of the Treasury.*

(Filed with the Division of the Federal Register May 27, 1936, 11.58 a. m.)

XV-22-8111
T. D. 4646

Modifying completely denatured alcohol formulae 5-A and 10 and further denaturing stocks of these formulae on hand.

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

*To District Supervisors and Others Concerned:*

Pursuant to authority conferred by the Act of June 7, 1906, and Title III of the National Prohibition Act, completely denatured alcohol formulae 5-A and 10 authorized by Treasury Decision No. 10, approved June 30, 1932, are modified to read as follows, effective from the date of approval hereof to July 1, 1936:

*Completely denatured alcohol formula No. 5-A modified.*

To every 100 parts by volume of ethyl alcohol of not less than 160° proof add:
2.5 parts by volume of denaturing grade isopropanol.
3 parts by volume of the compound pontol or a compound similar thereto.
2 parts by volume of methyl isobutyl ketone.
0.5 parts by volume either aldehol grade A or denatol or a compound similar thereto.
0.5 parts by volume of the compound calorite or a compound similar thereto.
0.25 parts by volume of commercial alpha terpineol, denaturing grade.

*Completely denatured alcohol formula No. 10 modified.*

To every 100 parts by volume of ethyl alcohol of not less than 160° proof add:
5 parts by volume of the compound tecsol or a compound similar thereto.
2.5 parts by volume of the compound pontol or a compound similar thereto.
2.5 parts by volume of denaturing grade isopropanol.
2 parts by volume of methyl isobutyl ketone.
0.5 parts by volume of aviation gasoline.

Except as to that packaged in drums or smaller containers all stocks of completely denatured alcohol formulae Nos. 5-A and 10 on the premises or in the possession or under the control of denaturers, including stocks sold on consignment and remaining in the hands of the denaturers or their consignees, must be immediately further denatured by having added thereto 1.75 gallons of methyl isobutyl ketone to every 100 gallons. This denatured alcohol must be marked and branded Completely Denatured Alcohol Formula No. 5-A Modified or Completely Denatured Alcohol Formula No. 10 Modified, respectively.

*Specifications for methyl isobutyl ketone.*

*Acidity.*—Not more than 0.02 per cent as acetic acid.
*Specific gravity.*—0.799 to 0.804 at 20/20° C.
*Color.*—Water-white.
*Boiling range (760 mm.).*—None should come over below 113° C. or none above 119° C. when distilled by the A. S. T. M. method.

GUY T. HELVERING,
*Commissioner of Internal Revenue.*

Approved May 27, 1936.
WAYNE C. TAYLOR,
*Acting Secretary of the Treasury.*

(Filed with the Division of the Federal Register May 27, 1936, 4.35 p. m.)

XV–14–8033
T. D. 4632

Form 1477.—Treasury Decision 4551 [C. B. XIV–1, 542] amended.

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

*To District Supervisors and Others Concerned:*

Treasury Decision 4551 is hereby amended to read as follows:

Form 1477, "Application for permit to procure specially denatured alcohol," by persons holding permits on Form 1476 or Form 1481, will hereafter be approved by district supervisors for one year. Not more than one-twelfth of the amount of specially denatured alcohol authorized by a permit Form 1477 may be procured in any one calendar month, and withdrawals must be so regulated that the permittee will not have on hand, in transit and unaccounted for, during any calendar month, more than the quantity fixed in his basic permit, Form 1476 or Form 1481: *Provided, however*, the district supervisor may, in his discretion, upon proper showing of necessity therefor, (1) in the case of a seasonal business, authorize the withdrawal during any one month of more than one-twelfth but not to exceed one-sixth of the total quantity of specially denatured alcohol authorized by the permittee's basic permit to be withdrawn during the year, or (2) issue to the permittee, in lieu of an annual permit, one or more withdrawal permits, Form 1477, for a specified quantity or period, subject to the above restrictions as to the maximum quantity that may be withdrawn during any one month; but the total quantity authorized under (1) and (2) shall not exceed the total quantity specified in the permittee's basic permit, Form 1476 or 1481, to be withdrawn during the year.

GUY T. HELVERING,
*Commissioner of Internal Revenue.*

Approved March 31, 1936.
WAYNE C. TAYLOR,
*Acting Secretary of the Treasury.*

(Filed with the Division of the Federal Register April 2, 1936.)

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XV–6–7945
T. D. 4625
(T. D. (Customs) 48105)

Reports, requests for assignment, and disposition of forfeited and abandoned property

TREASURY DEPARTMENT,
OFFICE OF THE DIRECTOR OF PROCUREMENT,
*Washington, D. C.*

*To Collectors of Internal Revenue, Collectors of Customs, District Supervisors, and Others Concerned:*

The following regulations relating to abandoned and forfeited property are hereby prescribed pursuant to the provisions of Title III of the Liquor Law Repeal and Enforcement Act, approved August 27, 1935 (Public 347, Seventy-fourth Congress):

ARTICLE I.

DEFINITIONS.

The following terms shall have the meaning set forth below whenever used in these regulations:

(*a*) "Director" means the Director of the Procurement Division of the Treasury Department of the United States.

(*b*) "Federal agency" includes any executive department, independent establishment, board, commission, bureau, service, or division of the United States, and any corporation in which the United States owns all or a majority of the stock.

(*c*) "Abandoned" means voluntarily abandoned to any Federal agency in such manner as to vest title to the property in the United States.

(*d*) "Forfeited" includes forfeitures whether by summary process or by order of court pursuant to any law of the United States.

(*e*) "Property" means all personal property, including but not limited to vessels, vehicles, aircraft, and abandoned alcoholic beverages, except—

(1) *Forfeited* distilled spirits (including alcohol), wine, and malt beverages, as defined in section 17(a) of the Federal Alcohol Administration Act.

(2) Arms or munitions of war condemned pursuant to the provisions of section 4 of Title VI of the Act entitled "An Act to punish acts of interference with the foreign relations, the neutrality, and the foreign commerce of the United States, to punish espionage, and better to enforce the criminal laws of the United States, and for other purposes" (40 Stat., 223), approved June 15, 1917, as amended.

(3) Opium, coca leaves, cocaine, or any salt, derivative, or preparation of opium, coca leaves, or cocaine.

(4) Shotguns or rifles having barrels less than 18 inches in length, or any other weapon (except a pistol or revolver) from which a shot is discharged by an explosive if such weapon is capable of being concealed on the person, or a machine gun, and includes a muffler or silencer for any firearm whether or not such firearm is included within the foregoing definition, and any weapon which shoots, or is designed to shoot, automatically or semiautomatically, more than one shot, without manual reloading, by a single function of the trigger.

## ARTICLE II.

### REPORTS, REQUESTS FOR ASSIGNMENT, AND DISPOSITION.

SECTION 1. *Annual reports.*—There shall be submitted to the Director not later than July 15, of each year, an itemized report covering the following property forfeited and abandoned during the preceding fiscal year, giving estimated values but not describing it in detail:

(*a*) Abandoned property which the Federal agency to which it was abandoned retained for official use.

(*b*) Property forfeited otherwise than by court decree and not ordered by competent authority to be returned to any claimant, which the seizing Federal agency retained for official use.

(*c*) Forfeited and abandoned property whose condition was such that it had no value except as scrap material, and was, as hereby authorized, disposed of under existing law and regulations.

(*d*) Money and valuable securities, which shall be disposed of under existing law and regulations.

(*e*) Perishable commodities and prohibited articles including but not limited to indecent or obscene articles which were, as hereby authorized, disposed of under existing law and regulations.

SEC. 2. *Reports required promptly upon abandonment or action looking toward forfeiture.*—All abandoned or forfeited property, except that specified in section 1 of this article, including the following:

(*a*) Abandoned property which the Federal agency to which it was abandoned does not desire to retain for official use.

(*b*) Property forfeited otherwise than by court decree and not ordered by competent authority to be returned to any claimant, which the seizing Federal agency does not desire to retain, and

(*c*) Property concerning which court proceedings are being or have been commenced for forfeiture by court decree, whether or not the property is desired for official use by the seizing Federal agency shall be reported promptly to the Director by the head of the Federal agency by which the property was seized or to which it was abandoned, except that if a seizure made by one Federal agency is adopted by another for prosecution under the laws enforced by the adopting Federal agency, the report shall be made only by the adopting Federal agency.

Reports made pursuant to this section shall contain the following information:

(*a*) Name of the reporting Federal agency.

(*b*) Status of the property, whether (1) voluntarily abandoned, (2) forfeited otherwise than by court decree, or (3) proceedings are being or have been commenced for forfeiture by court decree.

(*c*) Place and date of abandonment or forfeiture, or place and judicial district of court from which decree will be issued.

(*d*) Statute or statutes under which abandoned or forfeited or under which forfeiture proceedings will be prosecuted.

(*e*) Present official custodian of property, and street, city, and State address where located.

(*f*) Condition of the property.

(*g*) Estimated value.

(*h*) Existence or likelihood of lien or claim of lien, and amount involved.

(*i*) Charges incurred for hauling, transporting, towing and storage to date of report, and rate of storage charges.

(*j*) If the property is a vehicle, reports shall also show (1) type, (2) make, (3) model or year, (4) body, (5) color, (6) capacity, (7) speedometer reading, (8) number of wheels, (9) extra equipment, (10) motor number, (11) nature and probable cost of repairs necessary to put in serviceable condition, (12) condition of tires.

(*k*) If the property is a vessel or an aircraft, reports shall also show (1) type, (2) manufacturer, (3) identifying official name or number, (4) age, (5) description.

(*l*) If the property is abandoned alcoholic beverages, the reports shall also contain the following data: (1) Name of person from whom seized, (2) qualities and kinds (whether ethyl alcohol or hydrated oxide of ethyl; rye or bourbon or other whisky and its brand, if any; sparkling or still wine and its color or brand; cordial, brandy, gin, etc.), (3) proof rating and other qualities shown by test, (4) number and size of containers, (5) condition (whether fit for medicinal, scientific or mechanical purposes), and basis therefor, (6) condition for shipping.

(*m*) Other property shall be sufficiently described to enable a decision to be made regarding its desirability and utility.

SEC. 3. *Requests for assignment of property.*—All requests for assignment of forfeited and abandoned property, for official use, shall be filed promptly with the Director by the head of the Federal agency desiring the same (and not by the head of any field activity). When property desired by the seizing Federal agency is in the custody of another Federal agency which has adopted the seizure for forfeiture, the seizing Federal agency shall apply to the adopting Federal agency for delivery of the property in the event of forfeiture, and (*a*) if forfeited otherwise than by court decree and not ordered by competent authority to be returned to any claimant, the adopting agency shall deliver same to the seizing agency without reference to the Director, but (*b*) if proceedings are commenced for forfeiture by court decree, the adopting agency shall request the Director to petition the court, before entry of a decree, for delivery of the property to the seizing agency in the event of forfeiture.

Each such request (except requests submitted by seizing agencies) must be accompanied by a statement describing the need for the property in question and justifying the request.

SEC. 4. *Disposition of forfeited and abandoned property.*—All property reported to the Director pursuant to the provisions of section 2 of this article shall be disposed of as follows:

(*a*) If such property has been abandoned or forfeited otherwise than by court decree and not ordered by competent authority to be returned to any claimant, the Director will cause the same to be delivered to any Federal agency which has filed request therefor pursuant to the provisions of section 3 hereof, and which, in his judgment should receive the property; or, in the absence of such request, clear the same for disposition by the holding agency as otherwise provided by law.

(*b*) If proceedings are being or have been commenced for the forfeiture of the property by court decree, the Director will promptly and before entry of the decree apply to the court to order delivery of such property:

(1) To the seizing Federal agency if it has theretofore filed a request for such property for its official use; or

(2) To any other Federal agency which has filed a request therefor pursuant to the provisions of section 3 hereof, and which in the judgment of the Director, should be given such property if the seizing agency has not filed a request therefor; or

(3) To the seizing agency to be retained in its custody, if the Federal agency which seized such property has not requested it, and no other Federal agency has requested, and in the judgment of the Director should be given, such

property, and, if in the judgment of the Director, the property may later become necessary for any Federal agency for official use. Thereafter, the Director will, within a reasonable time, order such agency to deliver the property to any other Federal agency which requests and in his judgment should be given such property, or to dispose of it as otherwise provided by law.

SEC. 5. *Availability of appropriations for acquisition, maintenance, etc., of forfeited and abandoned property.*—(*a*) Section 305 of Title III of the Liquor Law Repeal and Enforcement Act reads as follows:

"The appropriation available to any agency for the purchase, hire, operation, maintenance, and repair of property of any kind shall be available for the payment of expenses of operation, maintenance, and repair of property of the same kind received by it under any provision of this title for official use; for the payment of any lien recognized and allowed pursuant to law, and for the payment of all moneys found to be due any person upon the duly authorized remission or mitigation of any forfeiture; and for reimbursement of other agencies as hereafter provided. The costs of hauling, transporting, towing, and storage of such property shall be paid by the agency which has seized such property or to which it has been abandoned; and, if such property is later delivered to another agency for official use under sections 302, 303, or 304 of this title, the latter shall make reimbursement for all such costs incurred prior to the date of delivery to it of such property."

(*b*) When a seizure of property is adopted for forfeiture purposes by another than the seizing agency, the adopting agency shall be entitled to the same reimbursement for costs incurred by it as is allowed the seizing agency under the provisions of law quoted above.

SEC. 6. *Custody of property.*—The Procurement Division will not in any case undertake custody of the property pending delivery to another Federal agency. The holding agency shall have custody of, and be responsible for, such property until shipped or delivered to the receiving Federal agency or otherwise disposed of after clearance by the Director. This provision shall apply to property turned over to the holding Federal agency by court order to be retained until disposed of upon order of the Director. All questions involving shipping or delivery instructions, reimbursements for costs and like matters, shall be handled between the holding and receiving agencies.

SEC. 7. *Status of property assigned under these regulations.*—Any property, when authorized for official use under the provisions of law and these regulations, loses its identity as abandoned or forfeited property and becomes the property of the United States. When no longer needed for official use, such property shall be disposed of as surplus property in the manner provided in section G of the Regulations Governing the Operation of the Procurement Division, Branch of Supply.

C. J. PEOPLES,
*Director of Procurement.*

Approved January 15, 1936.

T. J. COOLIDGE,
*Acting Secretary of the Treasury.*

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REGULATIONS 12, ARTICLE 80: Contents not to be disclosed without permission. XV–18–8073 T. D. 4640

Investigators permitted to testify in State courts.

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

*To District Supervisors and Others Concerned:*

The second paragraph of article 80, Regulations 12, revised October 1, 1920, is hereby amended to read as follows:

Internal-revenue officers are hereby prohibited from giving out any records, or any copies thereof, to private persons or to local officers, or to produce such records or copies thereof in a State court, whether in answer to subpoena duces tecum or otherwise, or to testify to facts coming to their knowledge in their official capacities without express authority from the Commissioner: *Provided, however,* That if the interests of the United States will not be jeopardized thereby, and if information will not be divulged contrary to section 3167, Revised Statutes, as amended, district supervisors of the Alcohol Tax Unit may upon receipt of subpoenas or requests of State authorities, and at the expenses of the State, authorize investigators and other employees under their supervision to attend trials and administrative hearings in liquor cases in which the State is a party, produce records and testify as to facts coming to their knowledge in their official capacities.

GUY T. HELVERING,
*Commissioner of Internal Revenue.*

Approved April 29, 1936.

WAYNE C. TAYLOR,
*Acting Secretary of the Treasury.*

(Filed with the Division of the Federal Register May 1, 1936, 11.41 a. m.)

# MISCELLANEOUS.

XV-4-7924
Mim. 4411

Exemption of pensions and other benefits paid to veterans and retired emergency officers.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
*Washington, D. C., January 4, 1936.*

*Collectors of Internal Revenue, Internal Revenue Agents in Charge, and Others Concerned:*

1. Section 3 of an Act of Congress approved August 12, 1935 (49 Stat., 607, Public, No. 262, Seventy-fourth Congress), entitled "An Act to safeguard the estates of veterans derived from payments of pension, compensation, emergency officers' retirement pay and insurance, and for other purposes," provides:

> * * * Payments of benefits due or to become due shall not be assignable, and such payments made to, or on account of, a beneficiary under any of the laws relating to veterans shall be exempt from taxation, shall be exempt from the claims of creditors, and shall not be liable to attachment, levy, or seizure by or under any legal or equitable process whatever, either before or after receipt by the beneficiary. Such provisions shall not attach to claims of the United States arising under such laws nor shall the exemption herein contained as to taxation extend to any property purchased in part or wholly out of such payments. * * *

2. Section 5 of the Act referred to provides:

> * * * That this Act shall take effect and be in force from and after its passage, but the provisions hereof shall apply to payments made heretofore under any of the Acts mentioned herein.

3. Section 2 of the Act mentions the War Risk Insurance Act, as amended, the World War Veterans' Act, 1924, as amended, the Emergency Officers' Retirement Act, as amended, the World War Adjusted Compensation Act, as amended, the pension laws in effect prior to March 20, 1933, Public Law No. 2, Seventy-third Congress, as amended, Public Law No. 484, Seventy-third Congress, and any Act or Acts amendatory of such Acts.

4. In accordance with the above-quoted provisions of law, benefits paid to or on account of any beneficiary under any of the Acts mentioned in section 2 of the Act of August 12, 1935, or any other laws relating to veterans, are exempt from Federal income tax under all the Revenue Acts.

5. Any person claiming exemption under the Act of August 12, 1935, of any payment or benefit paid by the United States, when required by the Commissioner, shall show by competent evidence that such payment or benefit was paid and received under one of the Acts mentioned in section 2 of that Act or under other laws relating to veterans.

6. Claims for refund based on the exemption provided by the Act of August 12, 1935, of amounts paid by the United States to veterans may be filed by taxpayers but may be allowed only if filed within the statutory period of limitation provided by the Revenue Act applicable to the year for which the tax was paid. Each claim filed

shall, when required by the Commissioner, be supported by competent evidence showing the Act or laws relating to veterans under which the amounts were paid. Any such claim shall be filed with the collector of internal revenue in whose district the return was filed, and shall be forwarded by the collector to the Income Tax Unit in Washington for appropriate action. If the claim relates to a return made on Form 1040A which is in the collector's office, the collector will transmit the return with the claim to Washington.

7. Correspondence and inquiries regarding the provisions of this mimeograph should refer to the number and the symbols IT: E: CTR.

CHAS. T. RUSSELL,
*Acting Commissioner.*

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XV-8-7967
Mim. 4429

Exemption from Federal income tax of payments to veterans under the Adjusted Compensation Payment Act, 1936.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
*Washington, D. C., February 4, 1936.*

*Collectors of Internal Revenue, Internal Revenue Agents in Charge, and Others Concerned:*

The Adjusted Compensation Payment Act, 1936 (Public, No. 425, Seventy-fourth Congress), sometimes referred to as the "World War Veterans' Bonus Act," provides in part:

That notwithstanding the provisions of the World War Adjusted Compensation Act, as amended (U. S. C., 1934 edition, title 38, ch. 11), the adjusted-service certificates issued under the authority of such Act are hereby declared to be immediately payable. * * *

* * * * * * *

SEC. 4. The amount certified pursuant to section 1 of this Act shall be paid to the veteran or his estate on or after June 15, 1936, by the Secretary of the Treasury by the issuance of bonds of the United States, registered in the name of the veteran only, in denominations of $50 having a total face value up to the highest multiple of $50 in the amount certified as due the veteran, and the difference between the amount certified as due the veteran and the face amount of the bonds so issued shall be paid to the veteran or his estate by the Secretary of the Treasury out of the fund created by section 505 of the World War Adjusted Compensation Act, as amended. The bonds shall be dated June 15, 1936, and shall mature on June 15, 1945, but shall be redeemable at the option of the veteran or his estate at any time, at such places, including post offices, as the Secretary of the Treasury may designate. Such bonds shall be issued under the authority and subject to the provisions of the Second Liberty Bond Act, as amended, and shall not be transferable, assignable, subject to attachment, levy, or seizure under any legal or equitable process and shall be payable only to the veteran or, in case of death or incompetence of the veteran, to the representative of his estate. Interest on each bond issued hereunder shall accrue at the rate of 3 per centum per annum from June 15, 1936, to date of maturity or payment of the principal of the bond, whichever is earlier, and will be paid with such principal: *Provided, however,* That no interest will be paid on any bond redeemed prior to June 15, 1937. The provisions of this section shall be carried out subject to regulations of the Secretary of the Treasury to be issued from time to time to effectuate the purposes of this Act.

Section 308, chapter 157, of the World War Adjusted Compensation Act, approved May 19, 1924 (43 Stat., 125), as amended by section 3(a), chapter 751, of the Act of July 3, 1926 (44 Stat., 827), codified as section 618 of chapter 11 of title 38 in the United States Code, 1934 edition, provides:

No sum payable under this chapter to a veteran or his dependents, or to his estate, or to any beneficiary named under Part V of this chapter, no adjusted-service certificate, and no proceeds of any loan made on such certificate shall be subject to attachment, levy, or seizure under any legal or equitable process, or to National or State taxation, and no deductions on account of any indebtedness of the veteran to the United States shall be made from the adjusted-service credit or from any amounts due under this chapter.

In view of the foregoing, it is held that payments to veterans under the Adjusted Compensation Payment Act, 1936, whether in the form of bonds as provided in section 4, or payments in redemption thereof, or interest, are exempt from Federal income tax.

Correspondence and inquiries regarding the provisions of this mimeograph should refer to the number and to the symbols IT:E: RR:CTR.

GUY T. HELVERING,
*Commissioner.*

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XV-7-7957
G. C. M. 16092

The cash surrender values of veterans' war risk insurance policies are not subject to distraint proceedings to collect internal revenue taxes due the United States.

An opinion is requested whether, in order to collect taxes due the United States, the cash surrender values of veterans' war risk insurance policies are subject to distraint proceedings.

Section 22 of the World War Veterans' Act of 1924 (43 Stat., 607) provided as follows:

SEC. 22. That the compensation, insurance, and maintenance and support allowance payable under Titles II, III, and IV, respectively, shall not be assignable; shall not be subject to the claims of creditors of any person to whom an award is made under Titles II, III, or IV; and shall be exempt from all taxation: *Provided,* That such compensation, insurance, and maintenance and support allowance shall be subject to any claims which the United States may have, under Titles II, III, IV, and V, against the person on whose account the compensation, insurance, or maintenance and support allowance is payable.

That the provisions of this section shall not be construed to prohibit the assignment by any person to whom converted insurance shall be payable under Title III of such Act of his interest in such insurance to any other member of the permitted class of beneficiaries.

Section 4747 of the Revised Statutes, not directly involved in the question under consideration, also contained certain provisions relative to exemption from attachment, levy, or seizure by or under legal or equitable process of moneys due to pensioners.

On August 12, 1935, an Act of Congress (Public, No. 262, Seventy-fourth Congress, 49 Stat., 607) entitled "An Act to safeguard the estates of veterans derived from payments of pension, compensation, emergency officers' retirement pay and insurance, and for other purposes," became effective. As shown by the report of the Committee on World War Veterans' Legislation and the report of the Senate Committee on Finance, which reports accompanied H. R. 3979, enacted into law as Public, No. 262, Seventy-fourth Congress, it was one of the purposes of that bill to replace section 22 of the

World War Veterans' Act of 1924 and section 4747 of the Revised Statutes by a new section (section 3 of H. R. 3979) in order that the same protection, immunity, and exemption might be provided for all benefits to pensioners and other veterans. Section 3 of the Act which became effective August 12, 1935, reads as follows:

SEC. 3. Payments of benefits due or to become due shall not be assignable, and such payments made to, or on account of, a beneficiary under any of the laws relating to veterans shall be exempt from taxation, shall be exempt from the claims of creditors, and shall not be liable to attachment, levy, or seizure by or under any legal or equitable process whatever, either before or after receipt by the beneficiary. Such provisions shall not attach to claims of the United States arising under such laws nor shall the exemption herein contained as to taxation extend to any property purchased in part or wholly out of such payments. Section 4747 of the Revised Statutes and section 22 of the World War Veterans' Act, 1924, are hereby repealed, and all other Acts inconsistent herewith are hereby modified accordingly. The provisions of this section shall not be construed to prohibit the assignment by any person, to whom converted insurance shall be payable under Title III of the World War Veterans' Act, 1924, of his interest in such insurance to any other member of the permitted class of beneficiaries.

Prior to the enactment of Public, No. 262, in view of section 22 of the World War Veterans' Act of 1924, a lien of the United States for internal revenue taxes did not attach to a taxpayer's converted war risk insurance policy, and claims of the Government, except the classes of claims mentioned in section 22, were not enforceable against such a policy. Titles II, III, IV, and V of the World War Veterans' Act of 1924, referred to in section 22 of that Act, relate respectively to compensation and treatment, insurance, vocational rehabilitation, and penalties. Any claim of the United States based upon an indebtedness arising out of such compensation and treatment, insurance, vocational rehabilitation, and penalties is chargeable against the value of a converted policy, but except as to claims so arising, it is evident that *any claim of a different character* made by the United States against the value of the policy *is not enforceable. The specification by name of the classes of claims cognizable under the statute excludes all other classes not mentioned.*

Although the language employed in section 22 of the World War Veterans' Act was different from that used in section 3 of the Act of August 12, 1935, the intent under the latter Act (section 3) to exempt payments and benefits (with specific exceptions) due or to become due under a veteran's policy issued by the United States is just as clear as it was in the repealed section. It is clearly the intent of that section to limit claims which are chargeable against such benefit payments to claims of the United States arising "under any of the laws relating to veterans." Were a Federal tax claim enforceable against the cash surrender value of such a policy, the enforcement obviously would deprive the person entitled thereto of benefits payable under the policy. Such enforcement would indirectly accomplish that which the statute specifically prohibits.

Accordingly, it is the opinion of this office that in view of the provisions of section 3 of the Act of August 12, 1935, the cash surrender values of veterans' war risk insurance policies are not subject to distraint proceedings to collect internal revenue taxes due the United States.

HERMAN OLIPHANT,
*General Counsel for the Department of the Treasury.*

# SECTION 3 OF THE VINSON ACT (PUBLIC, NO. 135, SEVENTY-THIRD CONGRESS).

XV-10-7988
Mim. 4431

**Determination, assessment, and collection of excess profits on Navy contracts under the Vinson Act.**

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
*Washington, D. C., February 15, 1936.*

*Collectors of Internal Revenue, Internal Revenue Agents in Charge, and Others Concerned:*

Treasury Decision 4434 (C. B. XIII-1, 540), promulgated under section 3 of the Vinson Act (Public, No. 135, Seventy-third Congress, H. R. 6604), delegates to the Commissioner of Internal Revenue the duty of determining the profit, and the excess profit, if any, on contracts entered into under that Act; and provides that if the Commissioner determines in respect of any such contract that there is an excess profit in an amount exceeding the excess profit voluntarily paid into the Treasury, the Commissioner may proceed to collect the amount of such unpaid excess profit under the usual methods employed under the internal revenue laws to collect Federal income taxes.

Pursuant to the foregoing, the following procedure for the determination, assessment, and collection of the excess profit, if any, on contracts entered into under the Vinson Act is hereby prescribed:

The procedure for the determination of the profit, and the excess profit, if any, and for the assessment and collection of any excess profit on Navy contracts entered into under the Vinson Act will be, in general, the same as the established procedure for the examination of income tax returns and the determination of the tax liability, including opportunities for protests and conferences. As far as practicable, the reports of contractors covering completed contracts will be associated with the income tax returns of respective contractors for the related year or years. Whether or not a copy of a report of a completed contract is filed with the collector as required by Treasury Decision 4434, the profit, and the excess profit, if any, on any completed contract will be determined, as far as practicable, at the same time as the income tax liability of the contractor for the related year or years is determined. The results of field investigations of completed contracts will be reported separately from the results of the investigations of income tax returns. In no case will appropriate action in respect of either the income tax liability or the excess profit liability, which has been finally determined by the Commissioner, be delayed pending a final determination of the other liability.

A review by the United States Board of Tax Appeals of the determination of excess profits on Navy contracts entered into under the Vinson Act is not authorized under that Act. Accordingly, regardless of whether or not the excess profit has been fully paid, no statutory notice of the Commissioner's final determination thereof is required as in the case of a deficiency in the Federal income tax. (See section 272, Revenue Act of 1934.) However, if an excess profit in an amount which exceeds the excess profit reported by the contractor and/or previously assessed is finally determined by the Commissioner, the contractor will be advised of the final determination by letter and such excess profit will be promptly assessed on the Commissioner's assessment list, and will be collected under the usual methods employed under the internal revenue laws to collect Federal income taxes.

Correspondence and inquiries regarding the provisions of this mimeograph should refer to the number and the symbols IT : E : CTR.

GUY T. HELVERING,
*Commissioner.*

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## OLEOMARGARINE.

XV-5-7934
MS. 171

*Schedule of oleomargarine produced and materials used during the month of December, 1935, as compared with December, 1934.*

| | December, 1935. | December, 1934. |
|---|---|---|
| | *Pounds.* | *Pounds.* |
| Total production of uncolored oleomargarine | [1] 33, 322, 515 | [2] 30, 346, 741 |
| Total withdrawn tax-paid | 33, 388, 096 | 29, 769, 335 |
| Ingredient schedule for uncolored oleomargarine: | | |
| Babassue oil | 931, 806 | |
| Butter | | 150 |
| Coconut oil | 14, 926, 840 | 13, 730, 137 |
| Corn oil | 30, 115 | |
| Cottonseed oil | 9, 096, 433 | 7, 513, 698 |
| Derivative of glycerine | 89, 218 | 71, 808 |
| Lecithin | 2, 363 | 733 |
| Milk | 6, 888, 475 | 6, 843, 414 |
| Neutral lard | 158, 607 | 405, 117 |
| Oleo oil | 1, 248, 422 | 2, 051, 074 |
| Oleo stearine | 191, 375 | 283, 565 |
| Oleo stock | 139, 019 | 171, 356 |
| Palm oil | | 2, 525 |
| Palm kernel oil | 94, 054 | |
| Peanut oil | 377, 170 | 316, 160 |
| Salt | 1, 725, 450 | 1, 799, 543 |
| Sesame oil | 8, 353 | |
| Soda (benzoate of) | 14, 177 | 10, 487 |
| Soya bean oil | 271, 080 | 24, 413 |
| Vegetable oil | | 175 |
| Total | 36, 192, 957 | 33, 224, 353 |
| Total production of colored oleomargarine | [3] 183, 496 | 123, 137 |
| Total withdrawn tax-paid | 49, 188 | 57, 334 |
| Ingredient schedule for colored oleomargarine: | | |
| Babassue oil | 400 | |
| Butter | | 35 |
| Coconut oil | 96, 775 | 41, 047 |
| Color | 199 | 101 |
| Cottonseed oil | 23, 609 | 19, 384 |
| Derivative of glycerine | 148 | 271 |
| Milk | 43, 376 | 36, 634 |
| Neutral lard | 5, 607 | 10, 453 |
| Oleo oil | 20, 582 | 29, 446 |
| Oleo stearine | 625 | 140 |
| Oleo stock | 1, 810 | 395 |
| Palm oil | 3, 100 | 200 |
| Peanut oil | 50 | 1, 190 |
| Salt | 14, 035 | 8, 596 |
| Soda (benzoate of) | 16 | 3 |
| Sunflower seed oil | 2, 170 | |
| Total | 212, 502 | 147, 895 |

[1] Of the amount produced, 32,411 pounds were reworked.
[2] Of the amount produced, 28,931 pounds were reworked.
[3] Of the amount produced, 64 pounds were reworked.

XV-9-7979
MS. 172

*Schedule of oleomargarine produced and materials used during the month of January, 1936, as compared with January, 1935.*

| | January, 1936. | January, 1935. |
|---|---|---|
| | *Pounds.* | *Pounds.* |
| Total production of uncolored oleomargarine | [1] 36,364,235 | [2] 33,338,518 |
| Total withdrawn tax-paid | 36,017,532 | 33,126,541 |
| Ingredient schedule for uncolored oleomargarine: | | |
| Babassue oil | 655,045 | |
| Butter | | 368 |
| Coconut oil | 17,875,651 | 14,351,756 |
| Cottonseed oil | 8,578,194 | 8,980,979 |
| Derivative of glycerine | 99,112 | 88,875 |
| Lecithin | 2,175 | 1,326 |
| Milk | 7,345,554 | 7,636,998 |
| Neutral lard | 182,568 | 415,534 |
| Oleo oil | 1,349,979 | 2,199,924 |
| Oleo stearine | 408,409 | 240,842 |
| Oleo stock | 179,200 | 229,085 |
| Palm oil | 103,838 | |
| Palm kernel oil | 15,861 | |
| Peanut oil | 468,969 | 383,686 |
| Salt | 1,948,392 | 1,951,698 |
| Sesame oil | 9,180 | |
| Soda (benzoate of) | 16,353 | 15,846 |
| Soya bean oil | 242,199 | 6,931 |
| Total | 39,480,979 | 36,503,848 |
| Total production of colored oleomargarine | 194,240 | [3] 293,785 |
| Total withdrawn tax-paid | 54,270 | 68,052 |
| Ingredient schedule for colored oleomargarine: | | |
| Babassue oil | 1,410 | |
| Butter | | 25 |
| Coconut oil | 70,164 | 76,405 |
| Color | 175 | 172 |
| Cottonseed oil | 48,201 | 34,057 |
| Derivative of glycerine | 252 | 273 |
| Milk | 50,584 | 94,191 |
| Neutral lard | 6,712 | 17,412 |
| Oleo oil | 28,953 | 95,042 |
| Oleo stearine | | 4,475 |
| Oleo stock | 1,815 | 1,780 |
| Palm oil | 1,300 | |
| Peanut oil | 311 | 4,567 |
| Salt | 14,207 | 21,041 |
| Soda (benzoate of) | 43 | 12 |
| Sunflower seed oil | 910 | 13,750 |
| Total | 225,037 | 363,202 |

[1] Of the amount produced, 27,474 pounds were reworked.
[2] Of the amount produced, 8,513 pounds were reworked.
[3] Of the amount produced, 12 pounds were reworked.

XV-13-8023
MS. 173

*Schedule of oleomargarine produced and materials used during the month of February, 1936, as compared with February, 1935.*

| | February, 1936. | February, 1935. |
|---|---|---|
| | *Pounds.* | *Pounds.* |
| Total production of uncolored oleomargarine | [1] 38,528,731 | [2] 41,551,563 |
| Total withdrawn tax-paid | 37,974,385 | 41,599,445 |
| Ingredient schedule for uncolored oleomargarine: | | |
| Babassue oil | 974,689 | |
| Butter | | 600 |
| Coconut oil | 16,960,525 | 17,187,775 |
| Corn oil | 5,064 | |
| Cottonseed oil | 10,665,426 | 12,121,444 |
| Derivative of glycerine | 106,581 | 165,241 |
| Lecithin | 1,809 | 1,308 |
| Milk | 7,474,878 | 9,512,070 |
| Neutral lard | 284,257 | 491,331 |
| Oleo oil | 1,486,203 | 2,512,820 |
| Oleo stearine | 246,573 | 213,727 |
| Oleo stock | 171,016 | 309,668 |
| Palm oil | 101,271 | |
| Palm kernel oil | 27,171 | |
| Peanut oil | 559,343 | 613,714 |
| Salt | 1,973,760 | 2,448,348 |
| Sesame oil | 6,318 | |
| Soda (benzoate of) | 16,749 | 20,796 |
| Soya bean oil | 347,861 | 26,022 |
| Vegetable oil | | 39,805 |
| Total | 41,409,494 | 45,664,669 |
| Total production of colored oleomargarine | [3] 306,510 | [4] 343,027 |
| Total withdrawn tax-paid | 58,710 | 120,946 |
| Ingredient schedule for colored oleomargarine: | | |
| Babassue oil | 1,200 | |
| Butter | | 44 |
| Coconut oil | 147,204 | 94,104 |
| Color | 300 | 286 |
| Cottonseed oil | 34,444 | 49,869 |
| Derivative of glycerine | 338 | 492 |
| Milk | 80,287 | 109,824 |
| Neutral lard | 7,621 | 13,972 |
| Oleo oil | 53,903 | 103,077 |
| Oleo stearine | | 3,107 |
| Oleo stock | 3,408 | 6,260 |
| Palm oil | 5,150 | |
| Peanut oil | 578 | 424 |
| Salt | 23,716 | 24,731 |
| Soda (benzoate of) | 109 | 21 |
| Sunflower seed oil | 3,605 | 7,750 |
| Total | 361,863 | 413,961 |

[1] Of the amount produced, 10,971 pounds were reworked.
[2] Of the amount produced, 30,369 pounds were reworked.
[3] Of the amount produced, 20 pounds were reworked.
[4] Of the amount produced, 12 pounds were reworked.

XV-17-8063
MS. 174

*Schedule of oleomargarine produced and materials used during the month of March, 1936, as compared with March, 1935.*

| | March, 1936. | March, 1935. |
|---|---|---|
| | *Pounds.* | *Pounds.* |
| Total production of uncolored oleomargarine | [1] 33, 541, 659 | [2] 33, 907, 010 |
| Total withdrawn tax-paid | 33, 991, 252 | 33, 668, 036 |
| Ingredient schedule for uncolored oleomargarine: | | |
| Babassue oil | 2, 849, 728 | |
| Butter | | 289 |
| Coconut oil | 13, 160, 094 | 14, 475, 864 |
| Corn oil | 98, 672 | |
| Cottonseed oil | 8, 783, 733 | 9, 818, 353 |
| Derivative of glycerine | 89, 245 | 121, 978 |
| Lecithin | 1, 767 | 1, 680 |
| Milk | 6, 564, 464 | 7, 647, 073 |
| Neutral lard | 202, 358 | 364, 248 |
| Oleo oil | 1, 239, 851 | 1, 687, 587 |
| Oleo stearine | 277, 492 | 224, 021 |
| Oleo stock | 191, 499 | 215, 576 |
| Palm oil | 174, 776 | |
| Peanut oil | 400, 195 | 378, 218 |
| Salt | 1, 746, 526 | 1, 915, 780 |
| Sesame oil | 9, 234 | 7, 238 |
| Soda (benzoate of) | 15, 120 | 15, 102 |
| Soya bean oil | 289, 814 | 118, 206 |
| Total | 36, 094, 568 | 36, 991, 213 |
| Total production of colored oleomargarine | [3] 252, 603 | [4] 292, 543 |
| Total withdrawn tax-paid | 60, 716 | 89, 748 |
| Ingredient schedule for colored oleomargarine: | | |
| Babassue oil | 6, 561 | |
| Butter | | 15 |
| Coconut oil | 128, 454 | 84, 300 |
| Color | 216 | 258 |
| Corn oil | 33 | |
| Cottonseed oil | 34, 005 | 35, 527 |
| Derivative of glycerine | 235 | 343 |
| Milk | 57, 640 | 53, 339 |
| Neutral lard | 5, 138 | 9, 810 |
| Oleo oil | 30, 326 | 88, 359 |
| Oleo stearine | 600 | 4, 080 |
| Oleo stock | 2, 617 | 4, 025 |
| Palm oil | 2, 300 | |
| Peanut oil | 359 | 333 |
| Salt | 20, 695 | 20, 372 |
| Soda (benzoate of) | 89 | 15 |
| Soya bean oil | 550 | |
| Sunflower seed oil | | 12, 250 |
| Total | 289, 818 | 313, 026 |

[1] Of the amount produced, 15,426 pounds were reworked.
[2] Of the amount produced, 20,491 pounds were reworked.
[3] Of the amount produced, 32 pounds were reworked.
[4] Of the amount produced, 1,824 pounds were reworked.

XV–22–8110
MS. 175

*Schedule of oleomargarine produced and materials used during the month of April, 1936, as compared with April, 1935.*

| | April, 1936. | April, 1935. |
|---|---|---|
| | *Pounds.* | *Pounds.* |
| Total production of uncolored oleomargarine | [1] 31,975,375 | [2] 37,177,814 |
| Total withdrawn tax-paid | 31,936,612 | 37,159,911 |
| Ingredient schedule of uncolored oleomargarine: | | |
| Babassue oil | 2,859,125 | |
| Butter | | 296 |
| Coconut oil | 12,168,147 | 15,864,015 |
| Corn oil | 291,079 | |
| Cottonseed oil | 8,509,822 | 10,962,009 |
| Derivative of glycerine | 91,229 | 174,309 |
| Lecithin | 1,617 | 3,493 |
| Milk | 6,443,712 | 8,584,149 |
| Neutral lard | 178,466 | 321,857 |
| Oleo oil | 1,253,798 | 1,663,749 |
| Oleo stearine | 291,792 | 160,296 |
| Oleo stock | 133,207 | 217,943 |
| Palm oil | 63,483 | |
| Palm kernel oil | 71,374 | |
| Peanut oil | 221,298 | 496,171 |
| Rape seed oil | 8,786 | |
| Salt | 1,701,939 | 2,161,022 |
| Sesame oil | 4,880 | 5,410 |
| Soda (benzoate of) | 14,711 | 19,041 |
| Soya bean oil | 376,851 | 156,979 |
| Vegetable oil | | 408 |
| Total | 34,685,316 | 40,791,147 |
| Total production of colored oleomargarine | 326,441 | [3] 241,673 |
| Total withdrawn tax-paid | 54,943 | 100,937 |
| Ingredient schedule of colored oleomargarine: | | |
| Babassue oil | 4,925 | |
| Coconut oil | 165,646 | 80,538 |
| Color | 312 | 227 |
| Corn oil | 11 | |
| Cottonseed oil | 37,072 | 42,824 |
| Derivative of glycerine | 642 | 412 |
| Lecithin | | 7 |
| Milk | 85,011 | 60,871 |
| Neutral lard | 5,041 | 12,717 |
| Oleo oil | 49,660 | 59,061 |
| Oleo stearine | | 1,330 |
| Oleo stock | 2,982 | 3,660 |
| Peanut oil | 1,251 | 587 |
| Salt | 21,763 | 21,989 |
| Soda (benzoate of) | 43 | 58 |
| Soya bean oil | 1,225 | 64 |
| Sunflower seed oil | | 4,750 |
| Total | 375,584 | 289,095 |

[1] Of the amount produced, 14,206 pounds were reworked.
[2] Of the amount produced, 31,459 pounds were reworked.
[3] Of the amount produced, 181 pounds were reworked.

XV-26-8149
MS. 176

*Schedule of oleomargarine produced and materials used during the month of May, 1936, as compared with May, 1935.*

| | May, 1936. | May, 1935. |
|---|---|---|
| | *Pounds.* | *Pounds.* |
| Total production of uncolored oleomargarine | [1] 25,265,493 | [2] 30,105,563 |
| Total withdrawn tax-paid | 25,452,311 | 30,054,178 |
| Ingredient schedule of uncolored oleomargarine: | | |
| Babassue oil | 1,034,517 | |
| Butter | | 100 |
| Coconut oil | 9,793,729 | 13,729,043 |
| Corn oil | 226,196 | |
| Cottonseed oil | 7,332,137 | 7,784,953 |
| Derivative of glycerine | 70,871 | 92,280 |
| Lecithin | 1,441 | 3,269 |
| Milk | 4,971,350 | 6,950,601 |
| Neutral lard | 135,251 | 251,154 |
| Oleo oil | 1,085,333 | 1,417,177 |
| Oleo stearine | 316,449 | 213,222 |
| Oleo stock | 117,844 | 176,019 |
| Palm oil | 71,096 | |
| Palm kernel oil | 215,542 | |
| Peanut oil | 168,364 | 842,128 |
| Salt | 1,297,137 | 1,727,004 |
| Sesame oil | 1,400 | 4,800 |
| Soda (benzoate of) | 11,030 | 17,755 |
| Soya bean oil | 299,135 | 149,517 |
| Total | 27,148,822 | 32,859,020 |
| Total production of colored oleomargarine | [3] 314,700 | 232,919 |
| Total withdrawn tax-paid | 44,670 | 60,102 |
| Ingredient schedule of colored oleomargarine: | | |
| Babassue oil | 766 | |
| Coconut oil | 185,493 | 74,724 |
| Color | 242 | 259 |
| Corn oil | 41 | |
| Cottonseed oil | 28,835 | 34,211 |
| Derivative of glycerine | 391 | 422 |
| Milk | 57,266 | 61,665 |
| Neutral lard | 3,389 | 6,800 |
| Oleo oil | 28,717 | 56,436 |
| Oleo stearine | 5,000 | 3,885 |
| Oleo stock | 2,663 | 1,660 |
| Peanut oil | 1,046 | 522 |
| Salt | 22,798 | 17,602 |
| Soda (benzoate of) | 55 | 33 |
| Soya bean oil | 923 | |
| Sunflower seed oil | | 11,000 |
| Total | 337,625 | 269,219 |

[1] Of the amount produced, 35,231 pounds were reworked.
[2] Of the amount produced, 14,461 pounds were reworked.
[3] Of the amount produced, 382 pounds were reworked.

# TOBACCO.

XV-1-7894
T. 18

*Statement of manufactured tobacco produced, by classes, during the month of October, 1935, as compared with October, 1934.*

| | October, 1935. | October, 1934. | | October, 1935. | October, 1934. |
|---|---|---|---|---|---|
| | *Pounds.* | *Pounds.* | | *Pounds.* | *Pounds.* |
| Plug | 5, 928, 206 | 5, 517, 732 | Smoking | 18, 280, 680 | 17, 792, 319 |
| Twist | 543, 396 | 426, 637 | Total | 29, 280, 643 | 27, 680, 800 |
| Fine-cut chewing | 460, 703 | 378, 330 | | | |
| Scrap chewing | 4, 067, 658 | 3, 565, 782 | | | |

NOTE.—These figures are subject to revision until published in the Commissioner's annual report.

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XV-6-7947
T. 19

*Statement of manufactured tobacco produced, by classes, during the month of November, 1935, as compared with November, 1934.*

| | November, 1935. | November, 1934. | | November, 1935. | November, 1934. |
|---|---|---|---|---|---|
| | *Pounds.* | *Pounds.* | | *Pounds.* | *Pounds.* |
| Plug | 4, 726, 630 | 4, 878, 830 | Smoking | 14, 811, 607 | 16, 141, 488 |
| Twist | 437, 994 | 443, 883 | Total | 23, 752, 541 | 25, 169, 108 |
| Fine-cut chewing | 368, 346 | 241, 328 | | | |
| Scrap chewing | 3, 407, 964 | 3, 463, 579 | | | |

NOTE.—These figures are subject to revision until published in the Commissioner's annual report.

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XV-10-7989
T. 20

*Statement of manufactured tobacco produced, by classes, during the month of December, 1935, as compared with December, 1934.*

| | December, 1935. | December, 1934. | | December, 1935. | December, 1934. |
|---|---|---|---|---|---|
| | *Pounds.* | *Pounds.* | | *Pounds.* | *Pounds.* |
| Plug | 4, 052, 361 | 4, 159, 842 | Smoking | 13, 883, 600 | 13, 152, 883 |
| Twist | 457, 084 | 370, 551 | Total | 21, 870, 664 | 20, 952, 621 |
| Fine-cut chewing | 393, 977 | 211, 651 | | | |
| Scrap chewing | 3, 083, 642 | 3, 057, 694 | | | |

NOTE.—These figures are subject to revision until published in the Commissioner's annual report.

XV-15-8042
T. 21

*Statement of manufactured tobacco produced, by classes, during the month of January, 1936, as compared with January, 1935.*

| | January, 1936. | January, 1935. | | January, 1936. | January, 1935. |
|---|---|---|---|---|---|
| | *Pounds.* | *Pounds.* | | *Pounds.* | *Pounds.* |
| Plug | 4, 596, 069 | 5, 108, 497 | Smoking | 15, 797, 188 | 16, 431, 140 |
| Twist | 444, 667 | 450, 252 | | | |
| Fine-cut chewing | 413, 101 | 252, 919 | Total | 24, 867, 640 | 26, 012, 301 |
| Scrap chewing | 3, 616, 615 | 3, 769, 493 | | | |

NOTE.—These figures are subject to revision until published in the Commissioner's annual report.

XV-19-8082
T. 22

*Statement of manufactured tobacco produced, by classes, during the month of February, 1936, as compared with February, 1935.*

| | February, 1936. | February, 1935. | | February, 1936. | February, 1935. |
|---|---|---|---|---|---|
| | *Pounds.* | *Pounds.* | | *Pounds.* | *Pounds.* |
| Plug | 4, 804, 301 | 4, 710, 520 | Scrap chewing | 3, 459, 671 | 3, 169, 622 |
| Twist | 520, 856 | 441, 442 | Smoking | 15, 433, 634 | 14, 657, 768 |
| Fine-cut chewing | 353, 138 | 191, 817 | Total | 24, 571, 599 | 23, 171, 169 |

NOTE.—These figures are subject to revision until published in the Commissioner's annual report.

XV-22-8109
T. 23

*Statement of manufactured tobacco produced, by classes, during the month of March, 1936, as compared with March, 1935.*

| | March, 1936. | March, 1935. | | March, 1936. | March, 1935. |
|---|---|---|---|---|---|
| | *Pounds.* | *Pounds.* | | *Pounds.* | *Pounds.* |
| Plug | 4, 987, 982 | 4, 907, 117 | Smoking | 17, 281, 200 | 15, 424, 215 |
| Twist | 561, 499 | 430, 334 | | | |
| Fine-cut chewing | 379, 414 | 367, 678 | Total | 26, 757, 933 | 24, 613, 441 |
| Scrap chewing | 3, 547, 838 | 3, 484, 097 | | | |

NOTE.—These figures are subject to revision until published in the Commissioner's Annual Report.

## BOARD OF TAX APPEALS.

XV-13-8021

**Rule 47.—Depositions upon written interrogatories (as amended February 28, 1936).**

Depositions may be taken in the discretion of the Board upon written interrogatories in substantially the same manner as provided in rules 45 and 46 for depositions upon oral examinations. An original and five copies of the interrogatories must be filed with the application. The clerk will serve one copy of the application and of the interrogatories upon the opposite party. If the opposite party desires to file objections or cross-interrogatories, he must do so within 10 days after the application and interrogatories have been served upon him. Cross-interrogatories must consist of an original and five copies. The clerk will serve one copy thereof upon the opposite party who, if he has any objection thereto, must file his objections within 10 days thereafter. No objections to the interrogatories or cross-interrogatories will be considered at the hearing unless timely filed in accordance with this rule.

No person other than the witness, a stenographic reporter, and the officer taking the deposition upon written interrogatories and cross-interrogatories shall be present at the examination of the witness. This fact shall be certified by the officer taking the deposition. That officer shall propound the interrogatories and cross-interrogatories to the witness in their order and reduce the testimony to writing in the witness's own words.

Depositions obtained in foreign countries must be taken upon written interrogatories, except as otherwise directed by the Board for cause shown.

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## MISCELLANEOUS.

XV-12-8013

FEDERAL REGISTER ACT [PUBLIC, NO. 220, SEVENTY-FOURTH CONGRESS; 49 STAT., 500-503].

An Act to provide for the custody of Federal proclamations, orders, regulations, notices, and other documents, and for the prompt and uniform printing and distribution thereof.

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled*, That the Archivist of the United States, acting through a division established by him in the National Archives Establishment, hereinafter referred to as the "Division," is charged with the custody and, together with the Public Printer, with the prompt and uniform printing and distribution of the documents required or authorized to be published under section 5. There shall be at the head of the Division a director, appointed by the President, who shall act under the general direction of the Archivist of the United States in carrying out the provisions of this Act and the regulations prescribed hereunder, who shall receive a salary, to be fixed by the President, not to exceed $5,000 a year.

SEC. 2. The original and two duplicate originals or certified copies of any document required or authorized to be published under section 5 shall be filed with the Division, which shall be open for that purpose during all hours of the working days when the Archives Building shall be open for official business. The Director of the Division shall cause to be noted on the original and duplicate originals or certified copies of each document the day and hour of filing thereof: *Provided*, That when the original is issued, prescribed, or promulgated outside of the District of Columbia and certified copies are filed before the filing of the original, the notation shall be of the day and hour of filing of the certified copies. Upon such filing, at least one copy shall be immediately available for public inspection in the office of the Director of the Division. The original shall be retained in the archives of the National Archives Establishment and shall be available for inspection under regulations to be prescribed by the Archivist. The Division shall transmit immediately to the Government Printing Office for printing, as provided in this Act, one duplicate original or certified copy of each document required or authorized to be published under section 5. Every Federal agency shall cause to be transmitted for filing as herein required the original and the duplicate originals or certified copies of all such documents issued, prescribed, or promulgated by the agency.

SEC. 3. All documents required or authorized to be published under section 5 shall be printed and distributed forthwith by the Government Printing Office in a serial publication designated the "Federal Register." It shall be the duty of the Public Printer to make available the facilities of the Government Printing Office for the prompt printing and distribution of the Federal Register in the manner and at the times required in accordance with the provisions of this Act and the regulations prescribed hereunder. The contents of the daily issues shall be indexed and shall comprise all documents, required or authorized to be published, filed with the Division up to such time of the day immediately preceding the day of distribution as shall be fixed by regulations hereunder. There shall be printed with each document a copy of the notation, required to be made under section 2, of the day and hour when, upon filing with the Division, such document was made available for public inspection. Distribution shall be made by delivery or by deposit at a post office at such time in the morning of the day of distribution as shall be fixed by such regulations prescribed hereunder. The prices to be charged for the Federal Register may be fixed by the administrative committee established by section 6 without reference to the restrictions placed upon and fixed for the sale of Government publications by section 1 of the Act of May 11, 1922, and section 307 of the Act of June 30, 1932 (U. S. C., title 44, sections 72 and 72a), and any amendments thereto.

SEC. 4. As used in this Act, unless the context otherwise requires, the term "document" means any Presidential proclamation or Executive order and any order, regulation, rule, certificate, code of fair competition, license, notice, or similar instrument issued, prescribed, or promulgated by a Federal agency; the terms "Federal agency" or "agency" mean the President of the United States, or any executive department, independent board, establishment, bureau, agency, institution, commission, or separate office of the administrative branch of the Government of the United States but not the legislative or judicial branches of the Government; and the term "person" means any individual, partnership, association, or corporation.

SEC. 5. (a) There shall be published in the Federal Register (1) all Presidential proclamations and Executive orders, except such as have no general applicability and legal effect or are effective only against Federal agencies or persons in their capacity as officers, agents, or employees thereof; (2) such documents or classes of documents as the President shall determine from time to time have general applicability and legal effect; and (3) such documents or classes of documents as may be required so to be published by Act of the Congress: *Provided*, That for the purposes of this Act every document or order which shall prescribe a penalty shall be deemed to have general applicability and legal effect.

(b) In addition to the foregoing there shall also be published in the Federal Register such other documents or classes of documents as may be authorized to be published pursuant hereto by regulations prescribed hereunder with the approval of the President, but in no case shall comments or news items of any character whatsoever be authorized to be published in the Federal Register.

SEC. 6. There is established a permanent Administrative Committee of three members consisting of the Archivist or Acting Archivist, who shall be chairman, an officer of the Department of Justice designated by the Attorney General, and the Public Printer or Acting Public Printer. The Director of the Division shall act as secretary of the committee. The committee shall prescribe, with the approval of the President, regulations for carrying out the provisions of this Act. Such regulations shall provide, among other things: (a) The manner of certification of copies required to be certified under section 2, which certification may be permitted to be based upon confirmed communications from outside of the District of Columbia; (b) the documents which shall be authorized pursuant to section 5(b) to be published in the Federal Register; (c) the manner and form in which the Federal Register shall be printed, reprinted, compiled, indexed, bound, and distributed; (d) the number of copies of the Federal Register which shall be printed, reprinted, and compiled, the number which shall be distributed without charge to Members of Congress, officers and employees of the United States, or any Federal agency for their official use, and the number which shall be available for distribution to the public; and (e) the prices to be charged for individual copies of, and subscriptions to, the Federal Register and reprints and bound volumes thereof.

SEC. 7. No document required under section 5(a) to be published in the Federal Register shall be valid as against any person who has not had actual knowledge thereof until the duplicate originals or certified copies of the document shall have been filed with the Division and a copy made available for public inspection as provided in section 2; and, unless otherwise specifically provided by statute, such filing of any document, required or authorized to be published under section 5, shall, except in cases where notice by publication is insufficient in law, be sufficient to give notice of the contents of such document to any person subject thereto or affected thereby. The publication in the Federal Register of any document shall create a rebuttable presumption (a) that it was duly issued, prescribed, or promulgated; (b) that it was duly filed with the Division and made available for public inspection at the day and hour stated in the printed notation; (c) that the copy contained in the Federal Register is a true copy of the original; and, (d) that all requirements of this Act and the regulations prescribed hereunder relative to such document have been complied with. The contents of the Federal Register shall be judicially noticed and, without prejudice to any other mode of citation, may be cited by volume and page number.

SEC. 8. Whenever notice of hearing or of opportunity to be heard is required or authorized to be given by or under an Act of the Congress, or may otherwise properly be given, the notice shall be deemed to have been duly given to all persons residing within the continental United States (not including Alaska), except in cases where notice by publication is insufficient in law, if said notice shall be published in the Federal Register at such time that the period between the publication and the date fixed in such notice for the hearing or for the termination of the opportunity to be heard shall be (a) not less than the time specifically prescribed for the publication of the notice by the appropriate Act of the Congress; or (b) not less than 15 days when no time for publication is specifically prescribed by the Act, without prejudice, however, to the effectiveness of any notice of less than 15 days where such shorter period is reasonable.

SEC. 9. Every payment made for the Federal Register shall be covered into the Treasury as a miscellaneous receipt. The cost of printing, reprinting, wrapping, binding, and distributing the Federal Register and any other expenses incurred by the Government Printing Office in carrying out the duties placed upon it by this Act shall be borne by the appropriations to the Government Printing Office and such appropriations are hereby made available, and are authorized to be increased by such additional sums as are necessary for such purposes, such increases to be based upon estimates submitted by the Public Printer. The purposes for which appropriations are available and are authorized to be made under section 10 of the Act entitled "An Act to establish a National Archives of the United States Government, and for other purposes" (48 Stat., 1122), are enlarged to cover the additional duties placed upon the National Archives Establishment by the provisions of this Act. Copies of the Federal Register mailed by the Government shall be entitled to the free use of the United States mails in the same manner as the official mail of the executive departments of the Government. The cost of mailing the Federal Register to officers and employees of Federal agencies in foreign countries shall be borne by the respective agencies.

SEC. 10. The provisions of section 2 shall become effective 60 days after the date of approval of this Act and the publication of the Federal Register shall begin within three business days thereafter: *Provided*, That the appropriations involved have been increased as required by section 9 of this Act. The limitations upon the effectiveness of documents required, under section 5(a), to be published in the Federal Register shall not be operative as to any document issued, prescribed, or promulgated prior to the date when such document is first required by this or subsequent Act of the

Congress or by Executive order to be published in the Federal Register.

SEC. 11. Within six months after the approval of this Act each agency shall prepare and file with the committee a complete compilation of all documents which have been issued or promulgated prior to the date documents are required or authorized by this Act to be published in the Federal Register and which are still in force and effect and relied upon by the agency as authority for, or invoked or used by it in the discharge of, any of its functions or activities. The committee shall within 60 days thereafter report with respect thereto to the President, who shall determine which of such documents have general applicability and legal effect, and shall authorize the publication thereof in a special or supplemental edition or issue of the Federal Register. Such special or supplemental editions or issues shall be distributed in the same manner as regular editions or issues, and shall be included in the bound volumes of the Federal Register as supplements thereto.

SEC. 12. Nothing in this Act shall be construed to apply to treaties, conventions, protocols, and other international agreements, or proclamations thereof by the President.

SEC. 13. All Acts or parts of Acts in conflict with this Act are hereby repealed insofar as they conflict herewith.

SEC. 14. This Act may be cited as the "Federal Register Act."

Approved, July 26, 1935.

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[Extract from Public Law No. 440, Seventy-fourth Congress, approved February 11, 1936.]

GOVERNMENT PRINTING OFFICE.

Public printing and binding: For the printing and distribution of the Federal Register and such documents as may be required to be printed and distributed by the Division of the Federal Register during the fiscal year 1936, in accordance with the provisions of Public Act Numbered 220, Seventy-fourth Congress, approved July 26, 1935, $100,000: *Provided*, That the provisions of section 2 of the Federal Register Act shall become effective 30 days after said appropriations become available and the publication of the Federal Register shall begin within two business days thereafter.

EXECUTIVE ORDER—REGULATIONS GOVERNING THE PREPARATION, PRESENTATION, FILING, AND DISTRIBUTION OF EXECUTIVE ORDERS AND PROCLAMATIONS.

By virtue of and pursuant to the authority vested in me by the Federal Register Act, approved July 26, 1935 (49 Stat., 500), and as President of the United States, I hereby prescribe the following regulations governing the preparation, presentation, filing, and distribution of Executive orders and proclamations:

1. Proposed Executive orders and proclamations shall be prepared in accordance with the following requirements:

(*a*) A suitable title for the order or proclamation shall be provided.

(*b*) The authority under which the order or proclamation is promulgated shall be cited in the body thereof.

(*c*) Punctuation, capitalization, orthography, and other matters of style shall conform to the most recent edition of the Style Manual of the United States Government Printing Office.

(*d*) The spelling of geographic names shall conform to the most recent official decisions made pursuant to Executive Orders No. 27–A, of September 4, 1890, No. 399, of January 23, 1906, and No. 6680, of April 17, 1934.

(*e*) Descriptions of tracts of lands shall conform, so far as practicable, with the most recent edition of the "Specifications for Descriptions of Tracts of Land for Use in Executive Orders and Proclamations," published by the Federal Board of Surveys and Maps.

(*f*) Proposed Executive orders and proclamations shall be typewritten on paper approximately 8 by 12½ inches, shall have a left-hand margin of approximately 2 inches and a right-hand margin of approximately 1 inch, and shall be double-spaced, except that quotations, tabulations, or descriptions of land may be single-spaced.

2. The proposed Executive order or proclamation shall first be submitted to the Director of the Bureau of the Budget. If the Director of the Bureau of the Budget approves it, he shall transmit it to the Attorney General for his consideration as to both form and legality. If the Attorney General approves it, he shall transmit it to the Director of the Division of the Federal Register, the National Archives. If it conforms to the requirements of paragraph 1 hereof, the Director of the Division of the Federal Register shall transmit it and three copies thereof to the President. If it is disapproved by the Director of the Bureau of the Budget or the Attorney General, it shall not thereafter be presented to the President unless it is accompanied by the statement of the reasons for such disapproval.

3. If the order or proclamation is signed by the President, the original and two copies thereof shall be forwarded to the Director of the Division of the Federal Register for appropriate action in conformity with the provisions of the Federal Register Act: *Provided, however,* That the seal of the United States shall be affixed to the originals of all proclamations prior to such forwarding. The Division of the Federal Register shall cause to be placed upon the copies of all Executive orders and proclamations the following notation, to be signed by the Director or by some person authorized by him: "Certified to be a true copy of the original." The Division of the Federal Register shall number and shall supervise the promulgation, publication, and distribution of all Executive orders and proclamations.

4. The Division of the Federal Register shall cause a limited number of copies of the Executive orders and proclamations not required or authorized to be filed and published under the provisions of the Federal Register Act to be made available in slip form to the appropriate agencies of the Government.

5. The Division of the Federal Register shall file in the National Archives the originals of all Executive orders and proclamations.

6. The signed originals and copies of all Executive orders and proclamations heretofore promulgated and now in the custody of the Department of State shall be transferred to the National Archives.

7. Nothing in this order shall be construed to apply to treaties, conventions, protocols, and other international agreements, or proclamations thereof by the President.

8. This order shall become effective on March 12, 1936, and shall thereupon supersede Executive Order No. 6247, of August 10, 1933.

FRANKLIN D. ROOSEVELT.

THE WHITE HOUSE,
*February 18, 1936.*

[No. 7298]

REGULATIONS PRESCRIBED BY THE ADMINISTRATIVE COMMITTEE OF THE FEDERAL REGISTER, AND APPROVED BY THE PRESIDENT, PURSUANT TO THE AUTHORITY CONTAINED IN SECTION 6 OF THE FEDERAL REGISTER ACT (49 STAT., 500).

## I. DEFINITIONS.

As used herein, unless the context otherwise requires:

(*a*) The term "Act" means the Federal Register Act, approved July 26, 1935 (49 Stat., 500).

(*b*) The terms "agency" or "Federal agency" mean the President of the United States, or any executive department, independent board, establishment, bureau, agency, institution, commission, or separate office of the administrative branch of the Government of the United States, but not the legislative or judicial branches of the Government.

(*c*) The terms "Committee" or "Administrative Committee" mean the Administrative Committee established under section 6 of the Act.

(*d*) The term "Director" means the Director of the Division of the Federal Register, The National Archives.

(*e*) The terms "date of issue" or "distribution day" mean Tuesday, Wednesday, Thursday, Friday, and Saturday, excepting where such days follow a legal holiday.

(*f*) The term "Division" means the Division of the Federal Register, The National Archives.

(*g*) The term "document" means any Presidential proclamation or Executive order, and any order, regulation, rule, certificate, code of fair competition, license, notice, or similar instrument issued, prescribed, or promulgated by a Federal agency.

(*h*) The term "Federal Register" means the daily issue of the Federal Register.

(*i*) The term "Federal Register Supplement" means the documents published under the provisions of section 11 of the Act.

(*j*) The term "person" means any individual, partnership, association, or corporation.

## II. DOCUMENTS REQUIRED TO BE FILED IN THE OFFICE OF THE DIRECTOR AND PUBLISHED IN THE FEDERAL REGISTER.

A. There shall be filed in the office of the Director and published in the Federal Register:

(*a*) Such documents or classes of documents as may be required so to be published by Act of Congress.

(*b*) All Executive orders and proclamations having general applicability and legal effect, except such as are effective only against Federal agencies or persons in their capacity as officers, agents, or employees thereof.

(*c*) The following documents or classes of documents, except Executive orders and proclamations, issued by the following Federal agencies:

* * * * * * *

DEPARTMENT OF THE TREASURY.

* * * * * * *

BUREAU OF INTERNAL REVENUE.

Regulations and Treasury Decisions, so entitled, prescribed or approved by the Secretary of the Treasury, with respect to internal revenue, issued under authority of any law or laws or Executive orders relating to internal revenue.

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B. All other documents having general applicability and legal effect issued, prescribed, or promulgated by any Federal agency not designated in section II A(*c*) of these Regulations shall be forwarded by the agency issuing the same to the Division. There shall also be forwarded to the Division any document having general applicability and legal effect issued, prescribed, or promulgated by any Federal agency pursuant to authority delegated to such agency subsequent to the approval of these regulations.

The Director shall, under the direction of the Administrative Committee, examine the documents forwarded to the Division pursuant to the above paragraph, and if, under such direction, it is determined that the documents have general applicability and legal effect, shall cause such documents to be filed in accordance with the regular routine and published in the daily issue of the Federal Register.

### III. Documents Effective Only Against Federal Agencies, Etc.

No documents effective only against Federal agencies or persons in their capacity as officers, agents, or employees thereof shall be filed in the office of the Director or forwarded to the Division pursuant to the provisions of section II A(*c*) or II B of these regulations.

### IV. Documents Forwarded to the Division Having No General Applicability and Legal Effect.

All documents, except Executive orders and proclamations, forwarded to the Division pursuant to section II B of these regulations, which the Administrative Committee shall determine to have no general applicability and legal effect, shall be returned by the Division to the agency issuing the same.

### V. Documents Prescribed Jointly by Two or More Federal Agencies.

Documents bearing the signature of officers of two or more Federal agencies, shall, for the purposes of these regulations, be deemed to have been issued, prescribed, or promulgated by the officer last signing the same, and the duty of filing such documents in the office of the Director, or forwarding such documents to the Division, shall rest upon such officer. Where necessary such officer shall make the appropriate arrangements for keeping the other agency or agencies informed regarding the filing.

VI. Executive Orders and Proclamations.

The preparation, presentation, promulgation, and distribution of Executive orders and proclamations shall conform to the procedure prescribed in Executive Order No. 7298, dated February 18, 1936.

VII. Preparation of Documents.

All documents required to be filed in the office of the director or forwarded to the Division shall be prepared as follows:

(*a*) A suitable title shall be provided.

(*b*) The authority under which the document is promulgated shall be cited in the body thereof.

(*c*) Punctuation, capitalization, orthography, and other matters of style shall conform to the most recent edition of the Style Manual of the United States Government Printing Office.

(*d*) The spelling of geographic names shall conform to the most recent official decisions made pursuant to Executive Orders, No. 27–A of September 4, 1890, No. 399 of January 23, 1906, and No. 6680 of April 17, 1934.

(*e*) Descriptions of tracts of land shall conform, so far as practicable, with the most recent edition of the Specifications for Descriptions of Tracts of Land for Use in Executive Orders and Proclamations, published by the Federal Board of Surveys and Maps.

(*f*) All documents shall be typewritten on paper 8 by 12½ inches, shall have a left-hand margin of approximately 2 inches and a right-hand margin of approximately 1 inch, and shall be double-spaced, except that quotations, tabulations, or descriptions of land may be single-spaced. Where it is the established practice of an agency to cause the originals of its documents to be put in print before they are signed, such printed originals and duplicates thereof may be received if the style and form have been duly approved by the Director.

(*g*) There shall be attached to the original or confirmed copy, except Executive orders and proclamations, three certified copies thereof.

VIII. Affixation of Seal.

The seal, if any, of the agency issuing the same shall be affixed to the original and certified copies of all documents required to be filed in the office of the Director or forwarded to the Division.

IX. Certification.

The certified copies of all documents required to be filed in the office of the Director or forwarded to the Division, except Executive orders and proclamations, shall be certified as follows: "Certified to be a true copy of the original," and each such certification shall be signed by the officer signing the original or by an officer or employee designated by him; provided, that notice of such designation be filed with the Division.

X. Documents Issued Outside of the District of Columbia.

In the case of documents issued, prescribed, or promulgated outside of the District of Columbia which are required to be filed in the office of the Director or forwarded to the Division, there may be filed or forwarded, in lieu of the original, a confirmed copy of such document. There shall be on such copy so filed or forwarded the notation "Confirmed," which notation shall be signed by an officer or employee designated for that purpose by the head of the agency concerned; provided, that notice of such designation shall be filed with the Division.

XI. Forwarding and Filing Documents.

Documents required to be filed in the office of the Director or forwarded to the Division shall be forwarded by messenger to the Division and received only during the hours of the working days when the National Archives Building shall be open for official business, i. e., 9 a. m. to 4.30 p. m. (Saturday 9 a. m. to 1 p. m.).

XII. Receipt and Disposition of Documents.

(*a*) Immediately upon the receipt of those documents required to be filed and published in the Federal Register, there shall be placed upon the original and certified copies the day and hour of filing.

(*b*) The originals of such documents shall be forwarded to the National Archives for custody.

(*c*) One certified copy shall be made immediately available for public inspection in the office of the Director.

(*d*) One certified copy shall be forwarded to the Government Printing Office.

XIII. Treaties, Etc., not Affected.

Nothing in these regulations shall be construed to apply to treaties, conventions, protocols, and other international agreements or proclamations thereof by the President.

XIV. Time of Publication of Documents Filed.

Documents required to be filed and published in the Federal Register, which are filed in the office of the Director prior to 1 p. m., shall be published in the issue of the Federal Register appearing the following distribution day. Documents required to be filed and published in the Federal Register which are filed in the office of the Director subsequent to 1 p. m., shall be published in the issue of the Federal Register appearing the second following distribution day.

XV. Illustrations.

The inclusion of illustrations as a part of documents required or authorized to be published in the Federal Register should be avoided wherever possible. Illustrations accompanying such documents, when published, shall be reduced to a size not greater than 7 by 10 inches and be line cuts only. Copy for illustrations must be forwarded to the Division with the documents of which they are a part.

XVI. Dates of Publication of Federal Register.

The Federal Register shall be distributed by the Government Printing Office every Tuesday, Wednesday, Thursday, Friday, and Saturday morning, excepting days following legal holidays, and shall be in the general form, style, and size of the Congressional Record.

XVII. Contents and Indexing of Federal Register.

The contents of the Federal Register shall be indexed daily, monthly, quarterly, annually, and at such other times as the Director may prescribe.

XVIII. Distribution.

Distribution of the Federal Register shall be made by delivery or by deposit at a post office at or before 9 a. m. of the day of distribution.

XIX. Copies for Official Use.

Copies of the Federal Register shall be distributed without charge to Members of Congress, officers and employees of the United States, or any Federal agency for their official use.

XX. Requests for Copies.

All requests for copies of the Federal Register shall be addressed to the Superintendent of Documents, Government Printing Office, Washington, D. C.

XXI. Notices.

Notwithstanding anything in these regulations to the contrary, no notices shall be published in the Federal Register except those which issue, amend, or repeal regulations; or those which prescribe a penalty; or notices or orders for a public hearing or opportunity for a public hearing with respect to any proceeding to which a Federal agency is required or authorized by statute to admit as a party any State or political subdivision thereof, or any authorities thereof, or representatives of investors, consumers, or other interested class or classes of persons.

These regulations shall become effective immediately and shall supersede the regulations approved by me on March 2, 1936.

Approved:

Franklin D. Roosevelt.

The White House,
*March 11, 1936.*

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XV–9–7977

S. 3934. PUBLIC, NO. 433, SEVENTY-FOURTH CONGRESS.

An Act to repeal the Kerr Tobacco Act, the Bankhead Cotton Act of 1934, and the Potato Act of 1935.

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled*, That Public Law

Numbered 483, Seventy-third Congress, as amended, known as the Kerr Tobacco Act, and Public Law Numbered 169, Seventy-third Congress, as amended, known as the Bankhead Cotton Act of 1934, except section 24 thereof, and sections 201 to 233, both inclusive, of Public Law Numbered 320, Seventy-fourth Congress, known as the Potato Act of 1935, be, and the same hereby are, repealed; and all liens for taxes imposed as provided in subdivision (f) of section 4 of Public Law Numbered 169 are hereby canceled and released.

Approved February 10, 1936.

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XV–15–8041

S. 3227. PUBLIC, NO. 470, SEVENTY-FOURTH CONGRESS.

An Act to amend section 3 of the Act approved May 10, 1928, entitled "An Act to extend the period of restriction in lands of certain members of the Five Civilized Tribes, and for other purposes," as amended February 14, 1931.

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled*, That section 3 of the Act of May 10, 1928, entitled "An Act to extend the period of restriction in lands of certain members of the Five Civilized Tribes, and for other purposes," as amended February 14, 1931, be amended to read as follows:

SEC. 3. That all minerals, including oil and gas, produced on or after April 26, 1931, from restricted allotted lands of members of the Five Civilized Tribes in Oklahoma, or from inherited restricted lands of full-blood Indian heirs or devisees of such lands, shall be subject to all State and Federal taxes of every kind and character the same as those produced from lands owned by other citizens of the State of Oklahoma; and the Secretary of the Interior is hereby authorized and directed to cause to be paid, from the individual Indian funds held under his supervision and control and belonging to the Indian owners of the lands, the tax or taxes so assessed against the royalty interest of the respective Indian owners in such oil, gas, and other mineral production: *Provided*, That nothing in this Act shall be construed to impose or provide for double taxation and, in those cases where the machinery or equipment used in producing oil or other minerals on restricted Indian lands are subject to the ad valorem tax of the State of Oklahoma for the fiscal year ending June 30, 1931, the gross production tax which is in lieu thereof shall not be imposed prior to July 1, 1931: *Provided further*, That in the discretion of the Secretary of the Interior, the tax or taxes due the State of Oklahoma may be paid in the manner provided by the statutes of the State of Oklahoma.

Approved March 12, 1936.

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XV–16–8054

S. 3978. PUBLIC, NO. 482, SEVENTY-FOURTH CONGRESS.

An Act relating to taxation of shares of preferred stock, capital notes, and debentures of banks while owned by the Reconstruction Finance Corporation and reaffirming their immunity.

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled*, That section 304 of the Act entitled "An Act to provide relief in the existing national emergency in banking and for other purposes," approved March 9, 1933, as amended, be further amended by adding at the end thereof the following:

Notwithstanding any other provision of law or any privilege or consent to tax expressly or impliedly granted thereby, the shares of preferred stock of national banking associations, and the shares of preferred stock, capital notes, and debentures of State banks and trust companies, heretofore or hereafter acquired by Reconstruction Finance Corporation, and the dividends or interest derived therefrom by the Reconstruction Finance Corporation, shall not, so long as Reconstruction Finance Corporation shall continue to own the same, be subject to any taxation by the United States, by any Territory, dependency, or possession thereof, or the District of Columbia, or by any State, county, municipality, or local taxing authority, whether now, heretofore, or hereafter imposed, levied, or assessed, and whether for a past, present, or future taxing period.

SEC. 2. Effective upon the date of enactment of this Act, interest charges on all loans by the Reconstruction Finance Corporation to closed banks and trust companies, now in force, or made subsequent to the date of enactment of this Act, shall not exceed 3½ per centum per annum on condition that the rate of interest charged debtors of such banks or trust companies shall not exceed 4½ per centum per annum; otherwise such interest rate shall be as fixed by the Reconstruction Finance Corporation: *Provided, however*, That no provision of this Act shall be construed to authorize a reduction in the rate of interest on such loans by the Reconstruction Finance Corporation retroactive from the date of enactment of this Act.

SEC. 3. If any provision, word, or phrase of this Act, or the application thereof to any condition or circumstance, is held invalid, the remainder of the Act, and the application of this Act to other conditions or circumstances, shall not be affected thereby.

Approved March 20, 1936.

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XV–18–8071

H. R. 11365. PUBLIC, NO. 510, SEVENTY-FOURTH CONGRESS.

An Act relating to the filing of copies of income returns, and for other purposes.

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled*, That section 54 of the Revenue Act of 1934, as amended, is amended by inserting at the end thereof the following new subsection:

(d) COPIES OF RETURNS.—If any person, required by law or regulations made pursuant to law to file a copy of any income return for any taxable year beginning after December 31, 1934, fails to file such copy at the time required, there shall be due and assessed against such person $5 in the case of an individual return or $10 in the case of a fiduciary, partnership, or corporation return, and the collector with whom the return is filed shall prepare such copy. Such amount shall be collected and paid, without interest, in the same manner as the amount of tax due in excess of that shown by the taxpayer upon a return in the case of a mathematical error appearing on the face of the return. In case of a person who filed a return for any taxable year not beginning after December 31, 1935, such amount of $5 or $10 shall be due and assessed only if the copy is not filed before the expiration of fifteen days after the mailing by the collector in whose office the return is filed, of a request to such person for the filing of the copy. Copies of returns filed or prepared pursuant to this subsection shall remain on file for a period of not less than two years from the date they are required to be filed, and may be destroyed at any time thereafter under the direction of the Commissioner.

Approved April 10, 1936.

XV–6–7948
D. C. 230 (Revised)

LAWS AND REGULATIONS GOVERNING THE RECOGNITION OF ATTORNEYS, AGENTS, AND OTHER PERSONS REPRESENTING CLAIMANTS AND OTHERS BEFORE THE TREASURY DEPARTMENT AND OFFICES THEREOF.

[Department Circular No. 230 of 1934 (Revised)[1] (1936 Amendment). Committee on Enrollment and Disbarment.]

TREASURY DEPARTMENT,
OFFICE OF THE SECRETARY,
*Washington, January 15, 1936.*

Department Circular No. 230 (Revised)[1] of October 1, 1934, section 1, is hereby amended to provide for the appointment of a part-time member or members of the Committee on Enrollment and Disbarment. As amended paragraph 1 of section 1 will read as follows:

SECTION 1. *Committee on Enrollment and Disbarment.*—A Committee on Enrollment and Disbarment is hereby created consisting of three members who shall be appointed by the Secretary of the Treasury. The Secretary of the Treasury shall designate a chairman and vice chairman of the committee. The Secretary in his discretion also shall appoint a part-time member or members of the committee, and whenever in his judgment such action is necessary, the Secretary shall appoint some person to serve temporarily as a substitute for a regular member of the committee. The committee shall have such powers to prescribe rules for its own government and procedure as are set forth elsewhere in these regulations. The committee shall meet at such times as it may designate or at the call of the chairman. Two members of the committee shall constitute a quorum. Hearings for the purpose of taking testimony in proceedings for reprimand, suspension, or disbarment may be held by a single member of the committee at such places as the committee may designate, but all findings of fact and recommendations thereon shall be made by the committee, a quorum being present.

HENRY MORGENTHAU, JR.,
*Secretary of the Treasury.*

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[1] Effective October 1, 1934. This circular supersedes Treasury Department Circular No. 230, dated July 1, 1927, and the amendments thereof and supplements thereto.

[1] XV-16-8055

*Disbarments and suspensions from practice before Treasury Department of attorneys and agents.*[2]

DISBARMENTS.

The Secretary of the Treasury, after due notice and opportunity for hearing, has ordered the disbarment from further practice before the Treasury Department of the following-named attorneys and agents:

| Name. | Address. | Date of disbarment. |
|---|---|---|
| Gorham, Jr., Fred A | Grand Rapids, Mich | Mar. 6, 1935 |
| Green, Charles J | Philadelphia, Pa | Aug. 29, 1935 |
| Hinds, Ralph L | Cincinnati, Ohio | Mar. 26, 1936 |
| Hoffmann, Arthur J | 11 West Forty-second Street, New York, N. Y. | Apr. 30, 1935 |
| Kent, Jr., Robert C | Beacon, N. Y | Mar. 6, 1935 |
| Landreau, Norman B | Washington, D. C | Mar. 6, 1935 |
| Leavitt, Benjamin D | Chicago, Ill | Mar. 6, 1935 |
| McElhill, Frank B | Formerly New York, N. Y., now Larchmont, N. Y. | Mar. 26, 1936 |
| Ober, Harry | Formerly Boston, Mass., now Brookline, Mass. | June 27, 1935 |

SUSPENSIONS.

The Secretary of the Treasury, after due notice and opportunity for hearing, has ordered the suspension from practice before the Treasury Department for the period stated in each case of the following-named attorneys and agents:

| Name. | Address. | Period of suspension. |
|---|---|---|
| Ellmore, D. Carroll | Sheboygan, Wis | 90 days, from Jan. 10, 1936. |
| Fleischer, A. Alvin | New York, N. Y | 6 months, from Jan. 29, 1936. |
| Kirtley, Fred H | Formerly Washington, D. C., now Miami, Fla. | 5 years, from Aug. 3, 1934. |
| Mahler, Benjamin | New York, N. Y | 6 months, from Jan. 29, 1936. |
| O'Connor, Raymond A | Niagara Falls, N. Y | 6 months, from Jan. 29, 1936. |
| Thompson, Donald A | Lancaster, Ohio | 6 months, from Jan. 29, 1936. |

[1] This ruling (8055) includes also rulings Nos. 7895, 7905, 7916, 7925, 7932, 7949, 7959, 7969, 7978, 7990, 8002, 8014, 8022, 8032, and 8044. These rulings have been thus consolidated because publication of each one separately would be largely duplication.

[2] This list includes all attorneys and agents whose disbarment from practice before the Treasury Department was published during the period ended April 20, 1936, and all suspensions in effect during the period January 1 to April 20, 1936, inclusive. It does not include those barred from practice by reason of disapproval of their application for enrollment.

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