

Internal Revenue Bulletin

CUMULATIVE BULLETIN 1962-1

JANUARY-JUNE 1962

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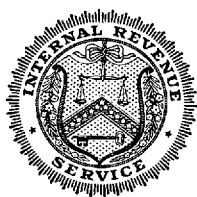
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Internal Revenue Bulletin

Cumulative Bulletin 1962-1

January-June 1962

U.S. Treasury Dept. Internal Revenue



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351.....	Announcement 62-4.....	I.R.B. 1962-1, 17.
352.....	Announcement 62-5.....	I.R.B. 1962-1, 20.
353.....	Announcement 62-7.....	I.R.B. 1962-2, 15.
354.....	Announcement 62-14.....	I.R.B. 1962-6, 48.
355.....	Rev. Rul. 62-5.....	Page 88.
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361.....	Announcement 62-26.....	I.R.B. 1962-9, 25.
362.....	Rev. Proc. 62-7.....	Page 428.
363.....	Announcement 62-28.....	I.R.B. 1962-10, 24.
364.....	Announcement 62-32.....	I.R.B. 1962-13, 25.
365.....	Rev. Rul. 62-43.....	Page 90.
366.....	Announcement 62-33.....	I.R.B. 1962-13, 27.
367.....	Announcement 62-34.....	I.R.B. 1962-13, 28.
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369.....	Rev. Rul. 62-49.....	Page 13.
370.....	Announcement 62-40.....	I.R.B. 1962-17, 13.
372.....	Announcement 62-38.....	I.R.B. 1962-15, 20.
373.....	Rev. Rul. 62-59.....	Page 315.
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380.....	Rev. Rul. 62-68.....	Page 216.
381.....	Rev. Rul. 62-96.....	Page 308.
382.....	Rev. Rul. 62-81.....	Page 153.
383.....	Rev. Rul. 62-82.....	Page 155.
384.....	Rev. Rul. 62-92.....	Page 29.

ABBREVIATIONS

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

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

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

FOREWORD

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

- I. Part I includes rulings and decisions which are based on the application of provisions of the Internal Revenue Code of 1954 and, unless otherwise stated in the ruling or decision, are published without consideration as to any application of the provisions of the Internal Revenue Code of 1939 or other related public laws.
- II. Part II includes rulings and decisions which are based on the application of the Internal Revenue Code of 1939 and other public laws except those pertaining to the various alcohol taxes; and, unless otherwise noted therein, they are published without consideration as to any application of the provisions of the Internal Revenue Code of 1954. Part II is subdivided into two subparts according to matters issued under the Internal Revenue Code of 1939 (Subpart A) and other public laws (Subpart B).
- III. Part III contains rulings and decisions pertaining to the various alcohol taxes. This part is subdivided into two subparts according to matters issued under the Internal Revenue Code of 1954 (Subpart A), and the Federal Alcohol Administration Act (Subpart B).
- IV. Part IV contains treaties and tax legislation, including related Committee and Conference Reports. This part is subdivided into three subparts according to tax conventions and Treasury Decisions issued with respect thereto (Subpart A), legislation (Subpart B), and Committee Reports (Subpart C). House, Senate and Conference Committee Reports printed in the Bulletin do not include the portion entitled "Changes in Existing law."
- V. Part V is devoted to administrative, procedural, and miscellaneous matters. The weekly Internal Revenue Bulletins contained Part VI consisting of items of general interest; those items are not reproduced herein.

INTRODUCTION

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for the announcement of official rulings and procedures of the Internal Revenue Service, and for the publication of Treasury Decisions, Executive Orders, tax conventions, legislation, and court decisions pertaining to internal revenue matters. Other items considered to be of general interest are also published in the Bulletin, such as announcements relating to proposed regulations published with notice of proposed rulemaking, announcements relating to decisions of the Tax Court of the United States, announcements of the disbarment and suspension of attorneys and agents from practice before the Treasury Department, supplements to the Cumulative List of Organizations contributions to which are deductible under section 170 of the Internal Revenue Code of 1954, Delegation Orders, etc.

It is the policy of the Service to publish in the Bulletin all substantive and procedural rulings of importance or of general interest, the publication of which is considered necessary to promote a uniform application of the laws administered by the Service. It is also the policy to publish all rulings and statements of procedures which supersede, revoke, modify, or amend any published ruling or procedure. Except where otherwise indicated, published rulings and procedures apply retroactively. Rulings and statements of procedures relating solely to matters of internal management are not published. However, statements of internal practices and procedures affecting rights or duties of taxpayers, or industry regulation, which appear in internal management documents, are published. Revenue Rulings and Revenue Procedures are based upon rulings and internal management documents prepared in the various divisions of the National Office, including the Office of the Chief Counsel for the Internal Revenue Service. In the preparation of these, caution is exercised to conceal the identity of the taxpayer, as well as any confidential personal and business information.

Revenue Rulings and Revenue Procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations (including Treasury Decisions), but are published to provide precedents to be used in the disposition of other cases, and may be cited and relied upon for that purpose. No unpublished ruling or decision will be cited or relied upon by any officer or employee of the Internal Revenue Service as a precedent in the disposition of other cases.

Since each published ruling represents the conclusion of the Service as to the application of the law to the entire state of facts involved, Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same. In applying rulings and procedures

published in the Bulletin, personnel of the Service and others concerned must consider the effect of subsequent legislation, regulations, court decisions, rulings, and procedures.

Each published ruling is designated as a "Revenue Ruling," and each published procedure is designated as a "Revenue Procedure." These should be cited by reference to the year of issuance and the Bulletin and page where reported. Thus, Revenue Ruling No. 20 for 1962 should be cited as "Rev. Rul. 62-20, C.B. 1962-1, 21." Similarly, Revenue Procedure No. 4 for 1962 should be cited as "Rev. Proc. 62-4, C.B. 1962-1, 425." Revenue Rulings are keyed to the applicable sections of the Internal Revenue Code and regulations.

Internal Revenue Cumulative Bulletin 1962-1 contains all rulings, decisions, and procedures pertaining to Internal Revenue matters published in the weekly Internal Revenue Bulletins 1-26, inclusive, for the period January 1 to June 30, 1962. It also contains a cumulative list of announcements relating to decisions of The Tax Court of the United States published in the Internal Revenue Bulletins.

The contents of this publication are not copyrighted and may be reprinted freely. A citation of the <i>Cumulative Bulletin</i> as the source would be appropriate.

THE TAX COURT OF THE UNITED STATES

CUMULATIVE LIST OF ANNOUNCEMENTS RELATING TO DECISIONS OF THE TAX COURT OF THE UNITED STATES PUBLISHED IN THE INTERNAL REVENUE BULLETIN FROM JANUARY 1, 1962, TO JUNE 30, 1962, INCLUSIVE

It is the policy of the Internal Revenue Service to announce in the INTERNAL REVENUE BULLETIN at the earliest practicable date the determination of the Commissioner to acquiesce or not acquiesce in a decision of The Tax Court of the United States which disallows a deficiency in tax determined by the Commissioner to be due. Notice that the Commissioner has acquiesced or nonacquiesced in a decision of The Tax Court relates only to the issue or issues decided adversely to the Government. Actions of acquiescences in adverse decisions should be relied on by Revenue officers and others concerned as conclusions of the Service only to the application of the law to the facts in the particular case. Caution should be exercised in extending the application of the decision to a similar case unless the facts and circumstance are substantially the same, and consideration should be given to the effect of new legislation, regulations, and rulings as well as subsequent court decisions and actions thereon. Acquiescence in a decision means acceptance by the Service of the conclusion reached, and does not necessarily mean acceptance and approval of any or all of the reasons assigned by the Court for its conclusions. No announcements are made in the Bulletin with respect to memorandum opinions of The Tax Court.

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

The Commissioner ACQUIESCES in the following decisions:

Taxpayer	Docket No.	Report	
		Volume	Page
Alabama-Georgia Syrup Co., et al.....	{ 82358 83967 }	36	747
Atchinson, Topeka & Santa Fe Railway Co., The ³	73138	36	584
Basila, Basil F., et ux.....	61738	36	111
Beeghly, L. A., et ux. ³	73163	36	154
Blechman, F. O., et ux.....	54480	36	292
Brout, Albert T.....	54479	36	292
Butler, George A., et ux.....	69489	36	1097
Carpenter, James A., et al.....	{ 79509 79510 }	36	797

ACQUIESCENCES—Continued

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		Volume	Page
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Falk, Emanuel E., et al.....	54777	36	292
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The Commissioner does NOT ACQUIESCE in the following decisions:

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Borner, A. Carl, estate of ^{1 7}	39669	25	584
Borner, Bertha J., executrix of estate of A. Carl Borner ^{1 7}			
Brockway, Don Murillo, estate of ^{1 8}	24446	18	488
Carnall, Edward, estate of ^{1 9}	39556	25	654

NONACQUIESCENCES—Continued

Taxpayer	Docket No.	Report	
		Volume	Page
Commercial Shearing & Stamping Co.-----	{ 76778 84338 85427 }	36	433
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Herr, Robert F. ² -----	{ 64133 64134 }	32	135
Kelley, James B., et al. ¹⁰ -----	{ 77061 81891 }	36	510
Lake Forest, Inc.-----	39556	25	654
Provident Trust Co. of Philadelphia, et al., executors of estate of Edward Carnall ^{1 11} -----	79886	36	577
Shea, J. J., et ux-----	{ 39979 39977 }	27	306
Sullivan, Dorothy (formerly Dorothy Douglas) ¹² -----	55061	35	490
Union National Bank of Youngstown, Ohio, trustee for the Leon A. Beeghly Fund-----	65408	35	1184
Vease, Elizabeth W., estate of ¹ -----	6223	9	990
Vease, James L., executor of estate of Elizabeth W. Vease ¹ -----			
Wier Long Leaf Lumber Co. ¹³ -----			

¹ Estate tax decision.² Gift tax decision.³ Acquiescence in result only. Acquiescence "in result only" means acceptance of the decision of the Court but disagreement with some or all of the reasons assigned for the decision.⁴ Nonacquiescence published in C.B. 1957-2, 8, is withdrawn and the acquiescence published in C.B. 1952-1, 2, is reinstated. See Rev. Rul. 62-13, page 180.⁵ Nonacquiescence published in C.B. 1957-2, 8, is withdrawn and the acquiescence published in C.B. 1951-1, 6, is reinstated. See Rev. Rul. 62-13, page 180.⁶ Nonacquiescence published in C.B. 1957-2, 8, is withdrawn and acquiescence is substituted therefor. See Rev. Rul. 62-13, page 180.⁷ Acquiescence published in C.B. 1957-2, 4, is withdrawn and nonacquiescence is substituted therefor.⁸ Acquiescence published in C.B. 1955-2, 4, is withdrawn and nonacquiescence is substituted therefor.⁹ Acquiescence published in C.B. 1956-1, 3, and C.B. 1956-2, 5, is withdrawn and nonacquiescence is substituted therefor.¹⁰ See Rev. Rul. 62-12, page 321.¹¹ Acquiescence published in C.B. 1956-1, 5, and C.B. 1956-2, 8, is withdrawn and nonacquiescence is substituted therefor.¹² Acquiescence published in C.B. 1957-2, 7, is withdrawn and nonacquiescence substituted therefor in the issue whether the petitioner is liable for an addition to tax for fraud where a joint return was filed for 1947 with her then husband, signed in blank by her, and where the former husband stipulated that the penalty was due. Acquiescence in the remaining issues, published in C.B. 1957-2, 7, remains unchanged.¹³ Acquiescence published in C.B. 1948-1, 3, is withdrawn and nonacquiescence is substituted therefor. See Rev. Rul. 62-92, page 29.

PART I

RULINGS AND DECISIONS UNDER THE INTERNAL REVENUE CODE OF 1954

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

SUBTITLE A.—INCOME TAXES

CHAPTER 1.—NORMAL TAXES AND SURTAXES

SUBCHAPTER A.—DETERMINATION OF TAX LIABILITY

PART I.—TAX ON INDIVIDUALS

SECTION 4.—RULES FOR OPTIONAL TAX

26 CFR 1.4-2: Elections.

Regulations relating to the election to use the optional tax table amended to eliminate authority for the use of Form 1040W, for taxable years ending on or after December 31, 1961. See T.D. 6581, page 281.

SUBCHAPTER B.—COMPUTATION OF TAXABLE INCOME

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

SECTION 61.—GROSS INCOME DEFINED

26 CFR 1.61-1: Gross income.

Rev. Rul. 62-16

The proceeds from the sale or exchange of cattle and other livestock raised by an Indian on his allotted and restricted lands while such lands are held for him by the United States, as trustee, in accordance with section 5 of the General Allotment Act of 1887, are exempt from income tax, with a specified exception.

Revenue Ruling 58-64, C.B. 1958-1, 12, and Revenue Ruling 60-377, C.B. 1960-2, 13, revoked; Revenue Ruling 56-342, C.B. 1956-2, 20, amplified.

Revenue Ruling 56-342, C.B. 1956-2, 20, which is based upon the decision of the Supreme Court of the United States in *Squire v. Horton Capoeman et ux.*, 351 U.S. 1, Ct. D. 1796, C.B. 1956-1, 605, holds that income held in trust for or received by the patent holder which is derived directly from allotted and restricted Indian lands while such lands are held by the United States, as trustee, in accordance with section 5 of the General Allotment Act, 25 U.S.C. 348, as amended, is exempt from Federal income tax. In interpreting the *Capoeman* decision, that Ruling holds that such exempt income includes rentals (including crop rentals), royalties, proceeds of sales of the natural resources of such land, and income from the sale of crops grown upon the land and from the use of the land for grazing purposes.

Revenue Ruling 56-342 was amplified by Revenue Ruling 58-64, C.B. 1958-1, 12, which holds that the term "income from the use of the land for grazing purposes" in Revenue Ruling 56-342 does not refer to income received from the sale of cattle raised on the allotted lands.

The effect of Revenue Ruling 58-64 was to deny a tax exemption to Indians who raise cattle and other livestock on their own allotments, while Indians who lease their allotments were entitled to treat their grazing fees as exempt income under Revenue Ruling 56-342. Revenue Ruling 58-64 accordingly was modified by Revenue Ruling 60-377, C.B. 1960-2, 13, which allows an exemption for certain proceeds from the sale of livestock but only to the extent of an amount equivalent to the grazing fees that the holder of the trust allotment might have received had the land been leased for grazing purposes.

Upon further consideration and in view of the difficulties under the formula set forth in Revenue Ruling 60-377 in allocating the portion of livestock sales proceeds attributable to the land and the portion attributable to other factors, such as labor, the use of equipment, and the like, the determination has been made to treat the full sums received as "derived directly" from the lands within the meaning of Revenue Ruling 56-342, just as in similar circumstances, under that Ruling, proceeds from the sale of crops grown upon trust allotments are so treated.

Accordingly it is held that income held in trust for or received by an Indian from the sale or exchange of cattle and other livestock raised on his allotted and restricted Indian lands while such lands are held in trust for him by the United States, as trustee, in accordance with section 5 of the General Allotment Act is exempt from Federal income tax. Unless otherwise provided by law, the exemption described herein will not be applicable in those instances where the Indian has obtained his interest in the exempt lands through an arm's length purchase rather than, for example, through allotment, gift, devise, or inheritance.

Revenue Ruling 58-64, C.B. 1958-1, 12, and Revenue Ruling 60-377, C.B. 1960-2, 13, are hereby revoked, and Revenue Ruling 56-342, C.B. 1956-2, 20, is amplified.

Recovery of portion of premium paid for a lost securities bond in a subsequent taxable year. See Rev. Rul. 62-21, page 37

26 CFR 1.61-2: Compensation for services, including fees, commissions and similar items. Rev. Rul. 62-2
(Also Sections 62, 117, 162, 262, 911; 1.62-1, 1.117-1, 1.162-1, 1.262-1, 1.911-1.)

Amounts received by an American citizen, under the so-called Fulbright Act and the United States Information and Educational Exchange Act of 1948, to lecture in a foreign university, constitute compensation for services rendered, includible in gross income under section 61 of the Internal Revenue Code of 1954. Such amounts do not constitute scholarship or fellowship grants under section 117 of the Code. The value of transportation furnished in kind and any cash advances to cover transportation expenses are likewise includible in gross income.

However, the taxpayer may deduct his traveling expenses in computing adjusted gross income, including the cost of his meals and lodging on the round trip to and from the university and during his stay there, if he can show that they are reasonable and necessary and that they are incurred while away from "home" in the pursuit of his trade or business. Transportation expenses of other members of the taxpayer's family, as well as their living expenses while in the foreign country, are not deductible.

Advice has been requested with respect to the status, for Federal income tax purposes, of amounts received by a taxpayer who was appointed as a lecturer in a foreign university under the circumstances described below.

The taxpayer, an American citizen and a professor on sabbatical leave from an American university, was appointed by the United States Department of State as a lecturer in a university in France and received a grant under the provisions of the Act of August 1, 1946, 60 Stat. 754, 50 U.S.C. 1641 (so-called Fulbright Act). The stipend for the academic year of ten months was paid in francs in monthly payments. The entire payment was designated as maintenance allowance for the taxpayer and dependent (taxpayer's wife). He also received a supplemental grant under the United States Information and Educational Exchange Act of 1948, 62 Stat. 6, 22 U.S.C. 1431, 1471 (so-called Smith-Mundt Act), paid in American currency. The United States Government furnished the taxpayer with transportation in kind to the port of debarkation in France and advanced cash for his rail fare from the port to the university. The taxpayer paid the transportation expenses of his wife.

Section 61 of the Internal Revenue Code of 1954 provides that, except as otherwise provided by statute, gross income means all income from whatever source derived. Section 117(a) of the Code excludes from gross income amounts received as a scholarship or fellowship grant, subject to certain limitations.

The grants under consideration are for the professional services of a lecturer, who, in accordance with the grant, is required to lecture at a university in a foreign country. Therefore, in the instant case the amounts received under both Acts cited above represent compensation for services rendered. Accordingly, it is held that

amounts so received do not constitute scholarship or fellowship grants within the meaning of section 117 of the Code. See section 1.117-4(c)(1) of the Income Tax Regulations. Furthermore, since the amounts are paid by the United States, they are not excludable from gross income under section 911(a) of the Code. The amounts received represent compensation for services rendered or to be rendered and are includible in the recipient's gross income under section 61 of the Code, even though they may be paid in blocked or restricted foreign currency.

A further problem to be resolved is the extent to which traveling expenses incurred by the lecturer are deductible, including the cost of his meals and lodging on the round trip to and from the university in France and during his stay there.

Section 162(a) of the Code provides that among the ordinary and necessary business expenses paid or incurred during the taxable year and allowable as deductions in computing taxable income are "traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business."

In order for traveling expenses to be deductible under section 162(a) of the Code, they must satisfy three conditions, namely, (1) they must be reasonable and necessary, (2) they must be incurred while away from home, and (3) they must be incurred in pursuit of a trade or business. See *Commissioner v. J. N. Flowers*, 326 U.S. 465, Ct. D. 1659, C.B. 1946-1, 57, and Rev. Rul. 60-189, C.B. 1960-1, 60.

A taxpayer's principal post of duty or place of employment is considered his "home" for the purposes of this deduction. If the taxpayer in the instant case can show that he has retained his regular place of employment in the United States and will return thereto at the expiration of the lecture period, his regular place of employment in the United States would be his "home."

As stated above, the amounts received as grants constitute compensation for services rendered which amounts are includible in the recipient's gross income under section 61 of the Code. However, under section 162 of the Code, he may deduct his traveling expenses, including expenses incurred for meals and lodging on the round trip to and from the university in France and during his stay there, if the expenses meet the three conditions stated above. Traveling expenses which are allowable deductions under section 162 of the Code may be subtracted from gross income in computing adjusted gross income under section 62 of the Code. However, transportation expenses of members of the taxpayer's family, as well as their living expenses, are nondeductible personal expenses under section 262 of the Code.

Furthermore, the amounts received in cash for rail fare from the port of debarkation to the university, and the value of transportation to the foreign country furnished in kind by the Government, should also be included in the taxpayer's gross income; and proper deductions should be claimed for the value of the transportation furnished in kind, and the expenses actually incurred by him, to the extent attributable to his own transportation as distinguished from that of his family.

(Also Sections 104, 165, 1341;
1.104-1, 1.165-1, 1.1341-1.)

Rev. Rul. 62-14

Where a taxpayer is awarded disability compensation by the Veterans' Administration, no portion of the regular Army retirement pay based on years of service previously received by him is excludable from his gross income merely because the effective date of the award is made retroactive.

Further, if the taxpayer voluntarily refunds a portion of his previously received retirement pay to the Army in order to receive an equal amount of disability compensation from the Veterans' Administration, section 1341 of the Internal Revenue Code of 1954, relating to restoration of amounts received under a claim of right, will not be applicable in computing his income tax liability for the taxable year in which the repayment is made. Neither will the voluntary return to the Army of previously received retirement pay give rise to a deduction under section 165 of the Code.

Advice has been requested regarding the Federal income tax consequences of a retroactive disability compensation award by the Veterans' Administration, under the circumstances described below, with respect to regular Army retirement pay previously received.

A taxpayer was retired from the United States Army some time prior to 1958 on the basis of length of service and his retirement pay was computed on that basis. On September 29, 1958, the taxpayer filed a claim with the Veterans' Administration for compensation based on physical disability. On August 10, 1960, the Veterans' Administration determined that the taxpayer was entitled to disability compensation and authorized the payment thereof. Under the Veterans' Administration regulations, the determination was effective on September 29, 1958, the date the taxpayer's claim was filed.

Shortly after receiving notice of the disability compensation award, the taxpayer filed a waiver, pursuant to section 1005 of the Veterans' Benefits Act of 1957, 38 U.S.C. 3105, for reduction of his retirement pay in an amount equal to the disability compensation award. Effective on the date of the waiver, the taxpayer received the disability compensation from the Veterans' Administration and reduced retirement pay from the Army.

The specific issues presented in this case are (1) whether the taxpayer may, by reason of the retroactive disability compensation determination by the Veterans' Administration, exclude from gross income any portion of his regular Army retirement pay previously received, or (2) if the taxpayer refunds an amount of previously received retirement pay to the Army and receives an equal amount of disability compensation from the Veterans' Administration for such prior period, whether section 1341 or 165 of the Internal Revenue Code of 1954 will be applicable in computing his income tax liability for the taxable year in which the repayment is made.

Section 61(a) of the Code provides the general rule that gross income includes all income from whatever source derived.

Section 1.61-2 of the Income Tax Regulations provides, in part, that pay of persons in the military or naval forces of the United States, retired pay of employees, pensions and retirement allowances are income to the recipients unless excluded by law. See also section 1.61-11 of the regulations.

Section 1001(a) of the Veterans' Benefits Act of 1957, 38 U.S.C. 3101(a), provides, in part, "Payments of benefits due or to be-

come due under any law administered by the Veterans' Administration * * * made to, or on account of, a beneficiary shall be exempt from taxation, * * *."

Section 104(a) (4) of the Code provides, in part, that gross income does not include amounts received as a pension, annuity, or similar allowance for personal injuries or sickness resulting from active service in the Armed Forces of any country. Section 104(a) (4) of the Code does not apply to retirement pay not constituting amounts paid on account of personal injuries and sickness.

Between the effective date of the disability compensation award and the effective date of the waiver of retirement pay in this case, the taxpayer was entitled by statute to a specific amount of retirement pay based on length of service, which he received in full as such, with every claim of right and without any restrictions. No benefits due under any law administered by the Veterans' Administration were paid to the taxpayer during this period. Nor was there any obligation on the part of the taxpayer at any time to execute a waiver of any portion of his retired pay. Further, the taxpayer was not retired from the Armed Forces for a physical disability, nor was there any question that he could have or should have been so retired. Thus, the taxpayer did not receive any amounts during the period in question as a pension, annuity, or similar allowance for personal injuries or sickness incurred in active service in the Armed Forces within the meaning of section 104(a) (4) of the Code.

Accordingly, it is held that no portion of the amount already received as retirement pay is excludable from the taxpayer's gross income and no adjustment in his tax may be made for the taxable years involved on account of the retroactive disability compensation determination by the Veterans' Administration.

Section 1341(a) of the Code provides rules for computing the tax for a taxable year if an item was included in a taxpayer's gross income for a prior taxable year or years because it appeared that the taxpayer had an unrestricted right to such item, and if a deduction in excess of \$3,000 is allowable for the taxable year because it was established, after the close of such taxable year or years, that the taxpayer did not have an unrestricted right to such item or to a portion thereof.

Section 1.1341-1(a) (2) of the regulations provides, "For the purpose of this section 'income included under a claim of right' means an item included in gross income because it appeared from all the facts available in the year of inclusion that the taxpayer had an unrestricted right to such item, and 'restoration to another' means a restoration resulting because it was established after the close of such prior taxable year (or years) that the taxpayer did not have an unrestricted right to such item (or portion thereof)."

Section 1341 of the Code is intended to apply where the taxpayer has included an item in gross income because it appeared at that time that he had an unrestricted right to such item but it later developed that he did not actually have such a right. See Rev. Rul. 58-226, C.B. 1958-1, 318. Further, section 1341 applies only where it is determined in a subsequent taxable year that the taxpayer does not have an unrestricted right to the income reported and he is compelled or required to refund or repay such item. See *Stewart H. Holbrook*,

et ux v. Commissioner, 194 Fed. Supp. 252 (1961). Thus, the restoration of the item included in the taxpayer's gross income for the prior taxable year must be involuntary on the part of the taxpayer. See Rev. Rul. 58-546, C.B. 1958-2, 415.

Since the taxpayer in the instant case is not obliged or required to repay any amount of his retired pay to the Army, any such repayment would be voluntary.

Accordingly, it is further held that a repayment of retirement pay by the taxpayer in the instant case will not constitute a transaction meeting the requirements of section 1341 of the Code. Accordingly, the provisions of that section will not be applicable in the computation of his income tax liability for the taxable year in which the repayment is made. Neither will a voluntary return of the previously received retirement pay to the Army give rise to any deduction allowable to the taxpayer under section 165 of the Code, relating to losses.

Rev. Rul. 62-49 ¹

The Internal Revenue Service has called attention to the application of the rules of section 1.61-2(d)(1) and section 1.61-2(d)(2) of the Income Tax Regulations to compensatory bargain purchases by independent contractors in cases which do not involve options.

In some cases, independent contractors receive compensation for their services in the form of stock, or other property, which is transferred to them either without cost or for a charge which is less than fair market value. For example, a firm which underwrites securities may receive a portion of its underwriting fee in the form of shares of stock of the issuing corporation which it is permitted to purchase at a nominal cost.

When there is no charge for the stock, section 1.61-2(d)(1) of the regulations requires the fair market value of the stock so acquired to be reported as compensation.

When the independent contractor, as a part of his compensation, is permitted to purchase the stock for less than its fair market value, the bargain purchase is governed by the principles of section 1.61-2(d)(2) of the regulations. Although this provision is written in terms of bargain purchases by employees, a compensatory bargain purchase by anyone is governed by similar rules. Accordingly, if the services of an independent contractor are paid for by a transfer of stock or other property for a charge less than fair market value, the difference between the amount paid for the stock or other property and its fair market value on the date of the transfer is includible in the gross income of the independent contractor.

SECTION 62.—ADJUSTED GROSS INCOME DEFINED

26 CFR 1.62-1: Adjusted gross income.

Rev. Rul. 62-85

A salesman who is required by his employer as a regular part of his employment to engage in selling activities at his employer's

¹ Based on Technical Information Release 369, dated March 15, 1962.

place of business does not qualify as an outside salesman for the purpose of section 62(2)(D) of the Internal Revenue Code of 1954.

Advice has been requested whether a full-time salesman, who is required by his employer as a regular part of his employment to engage in any selling activities at his employer's place of business, can qualify as an "outside salesman" with the meaning of section 62(2)(D) of the Internal Revenue Code of 1954.

Section 62 of the Code defines the term "adjusted gross income" in the case of an individual as gross income minus certain deductions. Among the allowable deductions are (1) trade and business deductions allowed by chapter 1 which are attributable to a trade or business carried on by a taxpayer, if such trade or business does not consist of the performance of services by the taxpayer as an employee and (2) certain trade and business deductions of an employee.

With respect to allowable deductions of an employee, section 62(2) of the Code provides, in part, as follows:

(D) OUTSIDE SALESMEN.—The deductions allowed * * * which are attributable to a trade or business carried on by the taxpayer, if such trade or business consists of the performance of services by the taxpayer as an employee and if such trade or business is to solicit, away from the employer's place of business, business for the employer.

Senate Report No. 1622, 83rd Congress, Second Session, at pages 10 and 169, explains the meaning of the term "outside salesman" as follows:

* * * An "outside salesman" is defined as an employee engaged principally in the solicitation of business for his employer at places other than the employer's place of business.

* * * Outside salesmen's expenses are provided for in subparagraph (D). Under this subparagraph expenses which are ordinary and necessary expenses paid or incurred during the taxable year in carrying on a trade or business as an "outside salesman" will be deductible in arriving at adjusted gross income. An "outside salesman" is an individual who is a full-time salesman who solicits business away from his employer's place of business. It does not include a salesman, a principal part of whose activities consist of service and delivery. Thus, a bread driver-salesman or a milk driver-salesman would not be included within the definition. Also not within the definition are salesmen whose principal activities consist of selling at the employer's place of business but who incidentally make outside calls and sales. * * * Outside salesmen who have incidental activities at the employer's place of business, such as writing up and transmitting orders, spending short periods at the employer's place of business to make or receive telephone calls, will still be eligible for the deduction allowed to "outside salesmen." A full-time "outside salesman" may deduct such expenses as those for telephone and telegraph, secretarial help, and entertainment. * * *

In the development of section 62(2)(D) of the Code, the intent of Congress was to place a traveling salesman who was technically an employee on the same footing, for income tax deduction purposes, as a traveling salesman who was technically an independent contractor.

At hearings before the Ways and Means Committee of the House of Representatives, it was pointed out that the term "traveling salesman" might be too restrictive inasmuch as it might be interpreted so as to discriminate against a salesman whose territory comprised the metropolitan area in which he resided and who would not normally be engaged in "travel away from home." To avoid this discrimination

the term "traveling salesman" was broadened to read "outside salesman." See Hearings before the Committee on Ways and Means, House of Representatives, 83d Congress, 1st Session, Part 1, pages 210-220, and Senate Hearings, H.R. 8300, 83d Congress, 2d Session, Parts 3 and 4, page 2394.

Section 1.62-1(h) of the Income Tax Regulations provides, in part, as follows:

* * * An outside salesman is an individual who solicits business as a full-time salesman for his employer away from his employer's place of business.
 * * * However, an outside salesman may perform incidental inside activities at his employer's place of business, such as writing up and transmitting orders and spending short periods at the employer's place of business to make and receive telephone calls, without losing his classification as an outside salesman.

The salesman who is in charge of a metropolitan area and who uses his employer's home office or branch office as a base of operations will normally qualify as an "outside salesman" despite the fact that he might perform incidental inside activities at his employer's place of business. Such a salesman would not normally be required to "man the show floor" of his employer because his duties are the solicitation of business outside the business premises. Such a salesman could make sporadic or occasional sales at his employer's place of business without losing his "outside salesman" status.

However, where an employee is *required* as a regular part of his employment to engage in selling activities at his employer's place of business for a specified period of time each week, such inside selling activities are not merely incidental to his overall employment but represent, instead, an integral part of his employment so as to disqualify him as an "outside salesman." "Incidental" implies an element of chance which is not present when an employee is required as a condition of employment to spend a certain period of time selling in the home office.

Accordingly, it is held that a salesman who is required by his employer as a regular part of his employment to engage in selling activities at his employer's place of business does not qualify as an outside salesman for the purpose of section 62(2) (D) of the Code.

Expenses paid in connection with traveling to a foreign country in order to lecture. See Rev. Rul. 62-2, page 9.

PART II.—ITEMS SPECIFICALLY INCLUDED IN GROSS INCOME

SECTION 71.—ALIMONY AND SEPARATE MAINTENANCE PAYMENTS

26 CFR 1.71-1: Alimony and separate maintenance; income to wife or former wife.
 (Also Sections 164, 215; 1.164-1, 1.215-1.)

Rev. Rul. 62-38

That portion of an alimony award paid by the husband and allocated by the decree of limited divorce for payment, by the wife, of insurance and real estate taxes with respect to a residence

owned by the divorced parties as tenants by the entirety is not considered as a payment in the nature of alimony includible in the gross income of the wife under section 71 of the Internal Revenue Code of 1954 and deductible by the husband under section 215 of the Code.

However, that portion of the award paid by the husband which was allocated and paid with respect to real estate taxes on the residence is deductible by the husband under section 164 of the Code, provided he itemizes his deductions.

Revenue Ruling 58-52, C.B. 1958-1, 29, modified.

Reconsideration has been given to that part of Revenue Ruling 58-52, C.B. 1958-1, 29, which deals with the portion of an alimony award paid by the husband which was allocated by the decree of limited divorce for payment by the wife of insurance and real estate taxes on a residence acquired by the divorced parties as tenants by the entirety. The decree of limited divorce did not dissolve the tenancy by the entirety.

Revenue Ruling 58-52 holds, in part, that the portion of the alimony award paid by the husband which was allocated by the decree for payment by the wife of insurance and real estate taxes on a residence owned by the divorced parties as tenants by the entirety is includible in the wife's gross income under section 71 of the Internal Revenue Code of 1954 and deductible by the husband under section 215 of the Code. That Ruling further holds that the portion of the award allocated by the decree for payment by the wife of installments of principal and interest due upon a note secured by a deed of trust, which is a first lien upon the residence owned as tenants by the entirety, is not considered as a payment in the nature of alimony includible in the gross income of the wife and deductible by the husband.

Where property is held as tenants by the entirety the benefit inuring to the wife from payments by the husband on an encumbrance on such property is contingent in the sense that her title is subject to being divested by her predeceasing her former spouse since the husband retains a survivorship interest in the property. Therefore, where a tenancy by the entirety is involved, the situation is analogous to the life insurance premium payment cases where the husband pays the premiums on a life insurance policy in which he retains valuable rights and which is not assigned to his former wife who is only a contingent beneficiary. Under such circumstances it was held that the premium payments are neither includible in the gross income of the wife as alimony nor deductible as such by the husband. I.T. 4001, C.B. 1950-1, 27.

Upon reconsideration, it is concluded that the treatment prescribed in Revenue Ruling 58-52 with respect to insurance and real estate taxes is inconsistent with the survivorship or contingency aspect of a tenancy by the entirety. When the estate is a tenancy by the entirety, the husband is at least in part protecting his own interest in the property by paying, either directly or through the wife, all of the insurance and taxes on such property, and, as with the payments of principal and interest, any benefit to the wife is contingent upon her surviving him.

Accordingly, it is held that that portion of an alimony award paid by the husband and allocated by the decree of limited divorce for payment, by the wife, of insurance and real estate taxes with respect

to a residence owned by the divorced parties as tenants by the entirety is not considered a payment in the nature of alimony includible in the gross income of the wife under section 71 of the Code and deductible by the husband under section 215 of the Code.

However, that portion of the award paid by the husband which was allocated and paid with respect to real estate taxes on the residence is deductible by the husband under section 164 of the Code provided he itemizes his deductions in filing his income tax returns.

Revenue Ruling 58-52 is modified to eliminate the conclusion that the portion of the alimony award allocated to the payment of insurance and real estate taxes is includible in the wife's gross income under section 71 of the Code and deductible by the husband under section 215 of the Code.

(Also Sections 163, 164, 215; 1.163-1, 1.164-1,
1.215-1.)

Rev. Rul. 62-39

Treatment, for Federal income tax purposes, of an alimony award partially allocated by the decree of absolute divorce for the payment of installments of principal and interest on a note secured by a deed of trust on a residence owned by the divorced parties as tenants in common and for the payment of taxes, insurance and utility expenses with respect to such property.

Revenue Ruling 58-52, C.B. 1958-1, 29, distinguished.

Advice has been requested with respect to the treatment, for Federal income tax purposes, of a portion of an alimony award which is allocated by the decree for payments of principal and interest due upon an indebtedness secured by a deed of trust on a residence owned by the divorced parties as tenants in common and for the payment of taxes, insurance and utility expenses with respect to such property.

Pursuant to a decree of absolute divorce, it was ordered that the husband pay the wife a specified amount per month as alimony. It was further ordered that out of the amount paid to the wife she must pay the installments of principal and interest due upon a note secured by a deed of trust upon a residence owned by the husband and wife as tenants in common and the insurance, real estate taxes and all utility charges with respect to the residence. Under the decree, the wife was granted exclusive possession and enjoyment of the residence as a home.

Section 71 of the Internal Revenue Code of 1954 provides, in effect, that a wife's gross income includes periodic payments received under a decree of divorce or of separate maintenance in discharge of a legal obligation which, because of the marital or family relationship, is imposed on or incurred by the husband under the decree or under a written instrument incident to such divorce or separation.

Section 215 of the Code provides, in part, that in the case of a husband described in section 71 of the Code, there shall be allowed as a deduction amounts includible under section 71 in the gross income of his wife, payment of which is made within the husband's taxable year.

Revenue Ruling 58-52, C.B. 1958-1, 29, as modified by Revenue Ruling 62-38, page 15, this Bulletin, holds, in part, that the portion of an alimony award allocated by the decree of limited divorce for payment by the wife of installments of principal and interest due upon a

note secured by a deed of trust, which is a first lien upon a residence acquired jointly by the divorced parties as tenants by the entirety, together with insurance and taxes on such property, is not considered as a payment in the nature of alimony includible in the wife's gross income under section 71 of the Code and deductible by the husband under section 215 of the Code. The decree of limited divorce did not dissolve the tenancy by the entirety.

This position is based primarily upon the fact that in a tenancy by the entirety the husband retains a survivorship interest in the property. Thus, a tenancy by the entirety situation is analogous to the life insurance premium payment case where the husband pays premiums on a life insurance policy in which he retains valuable rights and which is not assigned to his former wife who is only a contingent beneficiary. In such case it is held that the premiums are neither includible in the gross income of the wife nor deductible by the husband. I.T. 4001, C.B. 1950-1, 27.

However, the instant case involves property held by divorced parties as tenants in common. Under a tenancy in common, there is no element of survivorship or contingency as between the parties since each has a separate and distinct claim to one-half of the property and the wife's one-half interest in the property is not subject to divestiture if she predeceases her spouse. Where the husband makes payments of principal, interest, taxes and insurance with respect to all of the property held as tenants in common, the wife realizes an economic benefit to the extent of the portion of the payments made by the husband applicable to her one-half ownership of the property since such payments increase her equity in such one-half interest. Thus, with respect to the wife's one-half of the property owned as tenants in common, the situation is analogous to the life insurance premium payment case where the husband pays the premiums on a life insurance policy absolutely assigned to his former wife who is the irrevocable beneficiary. In such case it is held that the premiums are includible in the gross income of the wife and are deductible by the husband. I.T. 4001. Revenue Ruling 58-52 is, therefore, clearly distinguishable from the instant case, because of the different types of estates involved.

Accordingly, it is held that the portion of the award in this case which is allocated to payments of principal, interest, insurance and taxes with respect to the residence owned as tenants in common is considered a payment in the nature of alimony to the extent of one-half of the amount of such payments. Therefore, one-half of the amount of the payments for such items is includible in the wife's gross income under section 71 of the Code and is deductible by the husband under section 215 of the Code, provided that the payments are to cover a period of more than 10 years from the date of the decree (or otherwise qualify as periodic payments). However, the one-half of the payments for interest and the one-half of the payments for taxes which are includible in the wife's gross income under section 71 of the Code are deductible by her under sections 163 and 164 of the Code, respectively, if she itemizes her deductions.

It is further held that the portion of the payments of principal, interest, insurance and taxes allocable to the husband's one-half ownership of the property does not constitute alimony. See *James Parks Bradley, et ux. v. Commissioner*, 30 T.C. 701 (1958). However, the

one-half of the payments for interest and the one-half of the payments for taxes allocable to the husband's interest in the property are deductible by him under sections 163 and 164 of the Code, respectively, if he itemizes his deductions.

Regardless of the state of title of the property, payments for utilities are considered expenses of current enjoyment of the property. Accordingly, where the wife is in sole and exclusive possession of the property, utility charges paid by the husband are considered periodic payments, includible in her gross income under section 71 of the Code and deductible by him under section 215 of the Code.

Revenue Ruling 58-52, C.B. 1958-1, 29, is distinguished.

Treatment of alimony payments and payments for support of children. See Rev. Rul. 62-53, page 41.

SECTION 74.—PRIZES AND AWARDS

26 CFR 1.74-1: Prizes and awards.

Rev. Rul. 62-89

Revenue Ruling 61-92, C.B. 1961-1, 11, holds that under the revised Rockefeller Public Service Awards program, an award of \$3,500 made to a selected civilian employee of the Federal Government, primarily in recognition of outstanding past accomplishments in public service, is excludable from the gross income of the recipient under section 74(b) of the Internal Revenue Code of 1954.

Held, where the only change in the revised Rockefeller Public Service Awards program is an increase in the amount of the award, the total amount of the award is excludable from the gross income of the recipient under section 74(b) of the Code.

Revenue Ruling 61-92, C.B. 1961-1, 11, is modified to remove the reference to the dollar amount of the award.

Cash prize paid in installments from noninterest bearing escrow account. See Rev. Rul. 62-74, page 68.

PART III.—ITEMS SPECIFICALLY EXCLUDED FROM GROSS INCOME

SECTION 104.—COMPENSATION FOR INJURIES OR SICKNESS

26 CFR 1.104-1: Compensation for injuries or sickness.

Retroactive disability compensation determination by the Veterans' Administration with respect to an individual retired for length of service. See Rev. Rul. 62-14, page 11.

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

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

Premium paid for the purchase of a lost securities bond. See Rev. Rul. 62-21, page 37.

SECTION 117.—SCHOLARSHIPS AND FELLOWSHIP GRANTS

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

Amounts received under provisions of so-called Fulbright Act and under the United States Information and Educational Exchange Act of 1948. See Rev. Rul. 62-2, page 9.

PART IV.—STANDARD DEDUCTION FOR INDIVIDUALS**SECTION 142.—INDIVIDUALS NOT ELIGIBLE FOR STANDARD DEDUCTION**

26 CFR 1.142—1: Husband and wife.

Regulations relating to the use of the standard deduction by a husband and wife amended to eliminate authority for use of Form 1040W, for taxable years ending on or after December 31, 1961. See T.D. 6581, page 281.

SECTION 144.—ELECTION OF STANDARD DEDUCTION

26 CFR 1.144—1: Manner and effect of election to take the standard deduction.

Regulations relating to the manner of signifying an election to take the standard deduction amended to eliminate the authority for use of Form 1040W, for taxable years ending on or after December 31, 1961. See T.D. 6581, page 281.

PART VI.—ITEMIZED DEDUCTIONS FOR INDIVIDUALS AND CORPORATIONS**SECTION 162.—TRADE OR BUSINESS EXPENSES**

26 CFR 1.162—1: Business expenses.

Traveling expenses incurred by a professional lecturer at a foreign university. See Rev. Rul. 62-2, page 9.

Federal income tax treatment of amounts equal to dividends paid or incurred by a trader in securities with respect to stock borrowed to cover a short sale. See Rev. Rul. 62-42, page 8.

26 CFR 1.162-11: Rentals.
(Also Section 461; 1.461-1.)

Rev. Rul. 62-20

The total rental costs of television films, paid by a television station under a rental agreement which permits the station to show the films over a limited period of time, are deductible, in aliquot amounts, over the period of the rental agreement.

Advice has been requested as to the proper treatment, for Federal income tax purposes, of rental costs of films paid by a television station under the circumstances described below.

A television station, as lessee, entered into film rental contracts with certain motion picture studios and producers. Under each of those contracts, the television station acquired rights to the televising of a group or "package" of films for a gross contract price payable in installments.

The two principal types of contracts permit the television station to show the pictures for a limited number of times within a limited period, or permit the station to show the films an unlimited number of times within a limited period. The lessee has complete freedom to determine which pictures in a "package" will be televised.

With respect to those contracts limiting the number of showings, the number of showings in any taxable year does not exceed the number that would be properly allocable to such taxable year if the aggregate number of showings permitted under the contract were ratably allocated to the entire lease term.

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

Section 1.162-1(a) of the Income Tax Regulations provides, in part, that among the items included in business expenses are rental for business property.

Section 1.162-11(a) of the regulations provides, in part, that if a leasehold is acquired for business purposes for a specified sum, the purchaser may take as a deduction in his return an aliquot part of such sum each year, based on the number of years the lease has to run.

Based upon the facts of the instant case, it is held that the total rental costs of the television films are deductible by the television station, in aliquot amounts, over the period of the rental agreement, in accordance with the provisions of section 1.162-11(a) of the regulations.

26 CFR 1.162-17: Reporting and substantiation of traveling and other business expenses of employees.

Rev. Rul. 58-453
Supplement XIII

Revenue Ruling 58-453, C.B. 1958-2, 67, relating to certain fixed mileage allowances or per diem allowances received by employees, refers to the Standardized Government Travel Regulations in con-

nection with the maximum per diem allowance in lieu of subsistence authorized to be paid by the Federal Government while traveling outside the continental United States. The following rates, obtained from official Government sources, are published as a supplement to Revenue Ruling 58-453 and may be amended or supplemented from time to time.

STANDARDIZED GOVERNMENT TRAVEL REGULATIONS

Appendix I, Revised—Maximum Per Diem Rates in Lieu of Subsistence for Travelers in Alaska, Hawaii, the Commonwealth of Puerto Rico, the Canal Zone, and the Territories and Possessions of the United States

* * * * *

The changes, identified by asterisks, are effective February 1, 1962.

<i>Locality</i>	<i>Maximum per diem rates</i>	<i>Locality</i>	<i>Maximum per diem rates</i>
*Alaska:		Guam	\$15
*Anchorage	\$23	Hawaii	16
*Cold Bay	23	Midway	15
*Fairbanks	23	Puerto Rico:	
*Juneau	23	San Juan	24
*Nome	23	Other	18
Umiat	24	Virgin Islands:	
*Other	19	(May–Nov. incl.)	20
American Samoa	11	(Dec.–Apr. incl.)	30
Canal Zone	13	Wake	15
Canton Island	15	Other Localities	9

Rev. Rul. 62-1

The practice of (1) charging the employer's account with the expenses incurred by an employee while traveling on behalf of the employer, (2) the vendor's submission of bills for such charges directly to the employer, and (3) the payment of the bills by the employer without requiring any showing from the employee as to the business nature and amount of the expenses paid, does not meet the requirements for accounting to the employer under section 1.162-17(b) of the Income Tax Regulations. Compare Rev. Rul. 59-410, C.B. 1959-2, 64.

SECTION 163.—INTEREST

26 CFR 1.163-1: Interest deduction in general.

T.D. 6593¹

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

Amendment of the Income Tax Regulations under section 163 of
the Internal Revenue Code of 1954.

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

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

On September 1, 1961, notice of proposed rulemaking with respect
to the amendment of paragraph (b) of § 1.163-1 of the Income Tax

¹ 27 F.R. 2010.

Regulations (26 CFR Part 1) under section 163 of the Internal Revenue Code of 1954 was published in the Federal Register (26 F.R. 8526). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the proposed amendment of the regulations as revised and hereinafter set forth is hereby adopted. Except as otherwise specifically provided therein, such paragraph is effective for taxable years beginning after December 31, 1953, and ending after August 16, 1954. Such amended provision reads as follows:

§ 1.163-1 INTEREST DEDUCTION IN GENERAL.

* * * * *

(b) Interest paid by the taxpayer on a mortgage upon real estate of which he is the legal or equitable owner, even though the taxpayer is not directly liable upon the bond or note secured by such mortgage, may be deducted as interest on his indebtedness. Payment of Pennsylvania ground rent is deductible as interest if the ground rent is redeemable, but is treated as rent if the ground rent is irredeemable and in such case is deductible only to the extent such rent constitutes a proper business expense. Maryland ground rent paid or accrued prior to January 1, 1962, is deductible as interest if the ground rent is redeemable, but is treated as rent if the ground rent is irredeemable and in such case is deductible only to the extent such rent constitutes a proper business expense. Maryland ground rent paid or accrued on or after January 1, 1962, is deductible as interest only if such ground rent must be redeemed by a fixed date, but otherwise is treated as rent and deductible only to the extent such rent constitutes a proper business expense.

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

MORTIMER M. CAPLIN,
Commissioner of Internal Revenue.

Approved February 26, 1962.

STANLEY S. SURREY,
Assistant Secretary of the Treasury.

(Filed by the Division of the Federal Register on February 28, 1962, 8:47 a.m., and published in the issue of the Federal Register for March 1, 1962, 27 F.R. 2010)

Alimony award partially allocated to payment of interest on debt secured by lien on residence owned as tenants in common. See Rev. Rul. 62-39, page 17.

SECTION 164.—TAXES

26 CFR 1.164-1: Deduction for taxes.

Rev. Rul. 62-40

The tax imposed by the State of California on cigarettes under the California Cigarette Tax Law of 1959, as amended, is, on and after September 15, 1961, deductible under section 164(a) of the Internal Revenue Code of 1954, in computing taxable income, by the purchaser or consumer who pays the tax to the retailer and who does not elect to use the standard deduction or the optional tax table.

Revenue Ruling 60-239, C.B. 1960-2, 61, insofar as it holds that the California cigarette tax is deductible by the distributor or retailer making payment to the State Board of Equalization, is not applicable to the tax on cigarettes imposed by the State of California on or after September 15, 1961.

Advice has been requested as to the deductibility, for Federal income tax purposes, of the tax imposed by the State of California on cigarettes under the California Cigarette Tax Law as amended in 1961.

The California Cigarette Tax Law is found in Part 13 of Division 2 of West's Annotated California Revenue and Taxation Code, Enacted Statutes 1959, Chapter 1040, effective July 1, 1959.

Revenue Ruling 60-239, C.B. 1960-2, 61, holds, in part, that the cigarette tax imposed by the California Cigarette Tax Law of 1959 is deductible under section 164(a) of the Internal Revenue Code of 1954 by the distributor who affixes the stamps, or imprints such stamps by means of a meter stamping device, or otherwise makes payment to the State Board of Equalization, and that since the tax is not a retail sales tax, it is not deductible by the purchaser of the cigarettes under the provisions of section 164(c) of the Code.

Section 4 of Assembly Bill No. 818, Enacted Statutes 1961, Chapter 2193, effective September 15, 1961, added section 30016 to Chapter 1 of Part 13 of the California Revenue and Taxation Code. Section 30016 provides as follows:

All taxes paid pursuant to the provisions of this part shall be conclusively presumed to be direct taxes on the retail consumer precollected for the purpose of convenience and facility only. When the tax is paid by any other person, such payment shall be considered as an advance payment and shall be added to the price of the cigarettes and recovered from the ultimate consumer or user. Any person selling cigarettes at retail shall state or separately display in the licensed premises a notice of the amount of the tax included in the selling price and charged or payable pursuant to this part. The provisions of this section shall in no way affect the method of collection of such tax as provided by this part.

Section 5 of Assembly Bill No. 818, *supra*, reads as follows:

The Legislature hereby declares that its intent in enacting Section 4 of this chapter is to enable those who are subject to the taxes imposed by the federal tax laws to avail themselves of the deductions respecting state and local taxes specified in section 164 of the Federal Internal Revenue Code of 1954 in computing their taxable income.

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

Section 1.164-1 of the Income Tax Regulations provides that, in general, taxes are deductible only by the person upon whom they are imposed.

In view of the intent of the California Legislature to impose the State cigarette tax upon the consumer, it is held that such tax on cigarettes is, on and after September 15, 1961, the effective date of the amendment, deductible under section 164(a) of the Code in computing taxable income by the purchaser or consumer who pays the tax to the retailer. In the case of an individual who elects to use the standard deduction or the optional tax table, no deduction is allowable unless the tax is attributable to a trade or business carried on by him. If the tax is attributable to a trade or business carried on by the individual, the amount of the tax is deductible from gross income in computing adjusted gross income. See section 62 of the Code.

On and after September 15, 1961, no deduction is allowable to the

distributor or retailer paying the cigarette tax to the State Board of Equalization and no portion of the price paid by the consumer to the distributor or retailer for cigarettes which represents the California State tax is includible in the gross income of such distributor or retailer.

Revenue Ruling 60-239, C.B. 1960-2, 61, insofar as it holds that the California cigarette tax is deductible by the distributor or retailer making payment to the State Board of Equalization, is not applicable to the tax on cigarettes imposed by the State of California on or after September 15, 1961.

Rev. Rul. 62-65

The tax imposed by the State of Missouri on the sale of cigarettes under Title X, Chapter 149, section 149.020 of the Revised Statutes of Missouri, Laws of 1955, as amended, is, on and after May 1, 1961, deductible under section 164(a) of the Internal Revenue Code of 1954 in computing taxable income by the consumer or user of the cigarettes, except that, in the case of an individual who elects to use the standard deduction or optional tax table, the taxes are not deductible unless attributable to a trade or business carried on by him which does not consist of the performance of services by the taxpayer as an employee. If the tax is attributable to a trade or business carried on by the individual, the amount of tax is deductible from gross income in computing adjusted gross income under section 62 of the Code.

Rev. Rul. 62-76

The tax imposed by the State of Georgia under the Georgia Retailers' and Consumers' Sales and Use Tax Act, as amended by the Acts of 1960, effective March 1, 1960, is a tax imposed upon the purchaser or consumer and is deductible under section 164(a) of the Internal Revenue Code of 1954.

Revenue Ruling 59-65, C.B. 1959-1, 51 and I.T. 4058, C.B. 1951-2, 22, distinguished.

Advice has been requested regarding the effect of the Acts of 1960 amending the Georgia Retailers' and Consumers' Sales and Use Tax Act, Georgia Laws, 1951, 360, approved on February 20, 1951, on the deductibility, under section 164(a) of the Internal Revenue Code of 1954, of taxes imposed under that Act.

The Georgia Retailers' and Consumers' Sales and Use Tax Act, as amended by the Acts of 1960, is found in Title 92, sections 92-3401a through 92-3451a of the Code of Georgia Annotated (1961 revision). The express purpose of the Georgia General Assembly in amending the Act was to make it clear that the tax imposed by the Act is a tax imposed upon the purchaser. See Georgia Laws, 1960, 153, 154, effective March 1, 1960. The Act, as amended, provides, in part, that the tax is levied and imposed on the retail purchase, retail sale, rental, storage, use or consumption of tangible personal property and certain services described in the Act.

Prior to the 1960 amendments, the Act levied and imposed a privilege or license tax on every person who engaged in the business of selling tangible personal property in the State or who rented or furnished any of the things or services taxable under the Act. Com-

pare section 92-3402a of Title 92, as revised, with section 2 of the Act as approved on February 20, 1951, Georgia Laws 1951, 360.

The Act, as amended, also provides that a retailer or dealer who neglects, fails, or refuses to collect the tax is made liable for the tax himself. See section 92-3415a of Title 92, as revised.

Section 164(a) of the Internal Revenue Code provides, in general, that, except as otherwise provided, there shall be allowed as a deduction taxes paid or accrued within the taxable year.

Section 1.164-1 of the Income Tax Regulations provides, in part, that taxes are generally deductible only by the person upon whom they are imposed.

Revenue Ruling 59-65, C.B. 1959-1, 51, holds that the tax imposed by the State of Georgia by section 2 of the Georgia Retailers' and Consumers' Sales and Use Tax Act, Georgia Laws, 1951, 360, effective April 1, 1951, is a tax imposed upon the dealers who engage in the business of selling tangible personal property at retail in the State of Georgia. Such tax is deductible by the dealer under section 23(c) of the Internal Revenue Code of 1939, or section 164(a) of the Internal Revenue Code of 1954, whichever is applicable. The ruling further holds that, where the dealers collect the tax from the vendees, the total amounts so collected are includible in their gross income for Federal income tax purposes. See also I.T. 4058, C.B. 1951-2, 22, which expresses a position consistent with that expressed in Revenue Ruling 59-65.

Revenue Ruling 59-65 was published in view of the decision of the Supreme Court of the State of Georgia in the case of *T. V. Williams, State Revenue Commissioner v. Bear's Den, Inc.*, 104 S.E. (2d) 230 (1958), which held under the Georgia Retailers' and Consumers' Sales and Use Tax Act, before the 1960 amendments, that the tax was imposed upon the retailer or dealer. Thus, Revenue Ruling 59-65 is distinguishable from the instant Revenue Ruling, since that ruling provides the Federal income tax treatment to be accorded to the tax imposed under the Act before the 1960 amendments whereas the instant ruling applies only to taxes imposed under the Act on and after March 1, 1960, the effective date of the amending Acts of 1960. I.T. 4058 is distinguishable from the instant ruling for the same reason.

It is clear, particularly in the light of the construction placed on the Act by the *Bear's Den* case before its amendment, that it was the intention of the Georgia General Assembly in amending the statute to impose the tax upon the purchaser or consumer on and after March 1, 1960, rather than upon the retailer or dealer. The mere fact that the Act, as amended, requires the retailer or dealer to collect the tax for the State or, in lieu of collecting the tax, to pay the uncollected tax to the State does not impose such tax upon the retailer or dealer when it is the clear intent of the statute that the tax is to be imposed upon the purchaser or consumer.

Accordingly, it is held that the tax imposed by the State of Georgia under the Georgia Retailers' and Consumers' Sales and Use Tax Act, as amended by the Acts of 1960, is a tax imposed upon the purchaser or consumer and is, therefore, deductible by the purchaser or consumer under section 164(a) of the Code.

However, in the case of an individual who elects the standard deduction or the optional tax table, no deduction is allowable unless the

tax is attributable to a trade or business carried on by him. If the tax is attributable to a trade or business carried on by an individual, the amount thereof is deductible from gross income in computing adjusted gross income.

Since the retailers or dealers are merely agents of the State under the Act, as amended, for collection purposes, amounts collected by them as tax paid to the State are not includible in their gross income for Federal income tax purposes. However, amounts of the tax collected which are retained by such agents as fees, or otherwise, for collecting the tax are includible in their gross income.

Amounts paid to the State by retailers and dealers in lieu of collecting the tax are not deductible by them under section 164(a) of the Code, since such payments are not made as a result of a tax imposed upon such retailers and dealers, but may be deductible by them as business expenses if otherwise qualified for such treatment under section 162 of the Code.

Alimony award partially allocated to payment of real estate taxes on residence owned by divorced parties as tenants by the entirety. See Rev. Rul. 62-38, page 15.

Alimony award partially allocated to payment of real estate taxes on residence owned as tenants in common. See Rev. Rul. 62-39, page 17.

26 CFR 1.164-6: Apportionment of taxes on real property between seller and purchaser. Rev. Rul. 62-45
(Also Section 482.)

Section 164(d) of the Internal Revenue Code of 1954, which provides for the allocation of real estate taxes between the seller and the buyer of real estate, does not apply to a transfer resulting from the dissolution of a corporation. However, where inclusion of more than a pro rata amount of real estate taxes in the final return of a dissolving corporation will not clearly reflect income, section 164(d) will not prevent the Commissioner's allocation of such taxes under section 482 of the Code between the corporation and the distributee of the real estate.

Advice has been requested concerning the application of section 164(d) of the Internal Revenue Code of 1954, which requires the apportionment of real property taxes between the buyer and the seller, to the transfer of real property under a corporate dissolution.

The taxpayer corporation used the accrual method of accounting, had not elected to accrue its real property taxes ratably under section 461(c) of the Code, and in the past accrued its real property taxes on its books and for tax purposes on April 1. It was dissolved at the end of its short period January 1-June 30, 1960. Its assets at the date of dissolution, consisting principally of real estate, were distributed to a trust, the beneficiaries of which were the stockholders of the corporation as of the date of dissolution. On the corporation's Federal income tax return for the short period ended June 30, 1960, it deducted the amount of 26x dollars representing an estimate of real property taxes accrued as of April 1, 1960, for the real property tax year ending December 31, 1960.

Section 164(d) of the Code provides, in part, as follows:

(1) GENERAL RULE.—* * * if real property is sold during any real property tax year, then—

(A) so much of the real property tax as is properly allocable to that part of such year which ends on the day before the date of the sale shall be treated as a tax imposed on the seller, and

(B) so much of such tax as is properly allocable to that part of such year which begins on the date of the sale shall be treated as a tax imposed on the purchaser.

Section 1.164-6(a) of the Income Tax Regulations provides, with certain exceptions not here material, that when real property is sold, section 164(d)(1) of the Code governs the deduction by the seller and the purchaser of current real property taxes.

Since section 164(d) of the Code and section 1.164-6 of the regulations mention only purchase and sale transactions, that section of the Code has no application to a transfer of real property in liquidation or dissolution of a corporation. However, even though section 164(d) of the Code does not apply to corporate dissolution situations, it will not prevent the allocation of real property taxes in such situations where some other section of the Code permits the allocation.

Section 482 of the Code provides, in part, that, in the case of two or more organizations, trades, or businesses owned or controlled directly or indirectly by the same interests, the Secretary of the Treasury or his delegate may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to clearly reflect the income of such organizations, trades, or businesses.

The power conferred upon the Secretary or his delegate by section 482 of the Code is a discretionary power and once exercised it can be set aside only when clearly shown to be arbitrary. *National Securities Corp. v. Commissioner*, 137 Fed. (2d) 600 (1943), certiorari denied, 320 U.S. 794 (1943).

In *Tennessee Life Insurance Co. v. R. L. Phinney*, 280 Fed. (2d) 38, certiorari denied, 364 U.S. 914, the distributor corporation, which used the accrual method of accounting, deducted, on its tax return for the short year ending with its dissolution on January 23, 1953, a full year's real property taxes accrued on property owned by the distributor on January 1, 1953. The Commissioner of Internal Revenue prorated the taxes between the distributor and the distributee of the real property for the period of ownership of each of them in the year 1953. The United States Court of Appeals for the Fifth Circuit sustained the Commissioner's proration of the tax on the ground that to do otherwise would not clearly reflect income. The United States Court of Appeals for the Sixth Circuit, however, in an earlier decision reversing the Tax Court's decision (reviewed without dissent), held under similar circumstances that proration was not proper and that the taxpayer correctly deducted an entire year's real property taxes in its short return covering an 11-day period. See *Simon J. Murphy Company v. Commissioner*, 231 Fed. (2d) 639 (1956), reversing 22 T.C. 1341 (1956). The Service adheres to the decision rendered in *Tennessee Life Insurance Company*, and does not follow the decision in the *Simon J. Murphy Company* case.

Accordingly, based upon the foregoing, it is held that section 164(d) of the Code, which provides for the allocation of real property taxes

between the seller and the buyer of real estate, does not apply to a transfer resulting from the dissolution of a corporation. However, where the inclusion of more than a pro rata amount of real estate taxes in the final return of a dissolving corporation will not clearly reflect income, section 164(d) will not prevent the Commissioner's allocation of such taxes under section 482 of the Code between the corporation and the distributee of the real estate.

Therefore, in the instant case, since the taxpayer's accrual method of accounting does not clearly reflect his income, the Commissioner will require, under the provisions of section 482 of the Code, an allocation of the property taxes between the taxpayer-corporation and the trust based upon the number of days that each of them owned the property in the real property tax year.

SECTION 165.—LOSSES

26 CFR 1.165-1: Losses.

Repayment of regular Army retirement pay in order to receive non-taxable disability compensation from the Veterans' Administration. See Rev. Rul. 62-14, page 11.

SECTION 167.—DEPRECIATION

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

Rev. Rul. 62-92

The depreciation deduction for the taxable year of disposition of an asset used in the trade or business or in the production of income, otherwise properly allowable under the taxpayer's method of accounting for depreciation, is limited to the amount, if any, by which the adjusted basis of the asset at the beginning of the year exceeds the amount realized from sale or exchange.

Advice has been requested whether the Internal Revenue Service will apply the decision of the United States Court of Appeals in the case of *Bertrand W. Cohn, et al., v. United States*, 259 Fed. (2d) 371, (1958), to the extent that the deduction for depreciation of an asset used in a trade or business will be adjusted in the year of disposition of the asset if the amount received from disposition exceeds the adjusted basis of the asset as of the beginning of the taxable year.

In the *Cohn* case, which arose under the Internal Revenue Code of 1939, it was held that it is proper for the Commissioner of Internal Revenue, in computing the deduction for depreciation of an asset, to adjust salvage value at or near the end of the useful life of an asset where there is a difference between what was estimated and what salvage value as shown by actual sale proves to be.

The Service policy with respect to depreciation adjustments is set forth in Revenue Ruling 90, C.B. 1953-1, 43, wherein it is provided that depreciation deductions taken by taxpayers generally will not be disturbed and Service personnel will not propose adjustments to such deductions unless there is a clear and convincing basis for a change. Revenue Ruling 91, C.B. 1953-1, 44, furnished guidance in the application of Revenue Ruling 90.

In Revenue Procedure 57-18, C.B. 1957-1, 748, the Service, in clarifying Revenue Rulings 90 and 91, stated that if the facts in a case currently under examination furnish a clear and convincing basis for a depreciation adjustment, such adjustment will be made even though a depreciation deduction claimed in a previous return has been accepted without change upon examination.

Sections 1.167(a)-1(a), 1.167(a)-1(c), and 1.167(b)-0(a) of the Income Tax Regulations under the Internal Revenue Code of 1954 provide, in pertinent part, as follows:

1.167(a)-1(a). Section 167(a) provides that a reasonable allowance for the exhaustion, wear and tear, and obsolescence of property used in the trade or business or of property held by the taxpayer for the production of income shall be allowed as a depreciation deduction. The allowance is that amount which should be set aside for the taxable year in accordance with a reasonably consistent plan (not necessarily at a uniform rate), so that the aggregate of the amounts set aside, plus the salvage value, will, at the end of the estimated useful life of the depreciable property, equal the cost or other basis of the property as provided in section 167(f) and section 1.167(f)-1. An asset shall not be depreciated below a reasonable salvage value under any method of computing depreciation.

1.167(a)-1(c). Salvage value is the amount (determined at the time of acquisition) which is estimated will be realizable upon sale or other disposition of an asset when it is no longer useful in the taxpayer's trade or business or in the production of his income and is to be retired from service by the taxpayer. Salvage value shall not be changed at any time after the determination made at the time of acquisition merely because of changes in price levels. However, if there is a redetermination of useful life under the rules of paragraph (b) of this section, salvage value may be redetermined based upon facts known at the time of such redetermination of useful life. * * * Salvage value must be taken into account in determining the depreciation deduction either by a reduction of the amount subject to depreciation or by a reduction in the rate of depreciation, but in no event shall an asset (or an account) be depreciated below a reasonable salvage value.

1.167(b)-0(a). * * * Regardless of the method used in computing depreciation, deductions for depreciation shall not exceed such amounts as may be necessary to recover the unrecovered cost or other basis less salvage during the remaining useful life of the property. The reasonableness of any claim for depreciation shall be determined upon the basis of conditions known to exist at the end of the period for which the return is made.

The provision in section 1.167(a)-1(c) of the regulations to the effect that salvage value shall not be changed at any time after the determination made at the time of acquisition merely because of changes in price levels applies to assets still on hand. The provision does not preclude adjustment of salvage value where there is a clear and convincing basis therefor even though no adjustment of useful life is required. The purpose of the provision is to eliminate needless and endless controversies over depreciation allowances which at best are merely informed estimates of the cost of using the property in the taxpayer's business. That purpose has been served when the asset is disposed of and when a final transaction has occurred over which there can be no dispute or difference of opinion or judgment. These rules are and have always been applicable to the allowance of the deduction for depreciation. See *Massey Motors, Inc. v. United States and Commissioner v. Robley H. Evans et ux.*, 364 U.S. 92 (1960), Ct. D. 1847, C.B. 1960-2, 445; and *Hertz Corporation v. United States*, 364 U.S. 122 (1960), Ct. D. 1848, C.B. 1960-2, 70.

Accordingly, it is the position of the Service that the *Cohn* case applies equally to the 1939 Code and the 1954 Code and that it is not

only reasonable but proper to take the ultimate facts into consideration in determining the depreciation deduction for the year of disposition of the asset. Therefore, the deduction for depreciation of an asset used in the trade or business or in the production of income shall be adjusted in the year of disposition so that the deduction, otherwise properly allowable for such year under the taxpayer's method of accounting for depreciation, is limited to the amount, if any, by which the adjusted basis of the property at the beginning of such year exceeds the amount realized from sale or exchange. See also section 1.167(a)-10 of the regulations for rules with respect to when depreciation is allowable.

Revenue Rulings 90 and 91, as clarified by Revenue Procedure 57-18, are, of course, applicable for taxable years prior to the year of disposition where there is a clear and convincing basis existing at the end of such prior taxable year for an adjustment in the depreciation deduction. See also section 1.167(b)-0(a) of the regulations.

Revised average useful lives for selected major items of textile machinery and equipment and effect on the remaining useful lives of textile machinery and equipment now in use. See Rev. Proc. 62-1, page 415.

Amplification of Revenue Procedure 62-1, page 415, by the revision of the average useful lives of certain items of machinery and equipment used largely in the apparel segment of the textile industry and the effect on the remaining useful lives of such machinery and equipment now in use. See Rev. Proc. 62-2, page 420.

The study of average useful lives of items of textile machinery and equipment has been completed. See Rev. Proc. 62-7, page 428.

26 CFR 1.167(a)-4: Leased property.

Rev. Rul. 62-8

A lessor may, upon proper showing, be entitled to some allowance for depreciation (including any obsolescence) of leased depreciable property in a taxable year or years during the term of a lease for several years, even though the lessee has agreed to so preserve, replace, renew, and maintain such property, and all additions, amendments, and improvements thereof, that, at the termination of the lease, the property shall be in at least as good condition as at its beginning.

G.C.M. 11933, C.B. XII-2, 52 (1933), distinguished.

Advice has been requested whether the holding in G.C.M. 11933, C.B. XII-2, 52 (1933), should be reconsidered in view of the decision in *North Carolina Midland Railway Co. v. United States*, 163 Fed. Supp. 610 (1958).

G.C.M. 11933 holds that a lessor should not be allowed depreciation deductions in respect of buildings or other depreciable property during the continuance of a lease thereof which provides that the property is to be maintained by the lessee and the same property or its equiva-

lent in value returned to the lessor at the expiration of the lease in as good condition and value as when leased (holding (2) of the G.C.M.).

In support of its aforesaid holding, G.C.M. 11933 cited the decisions in *Appeal of A. Wilhelm Co.*, 6 B.T.A. 1 (1927), and *Terre Haute, Indianapolis & Eastern Traction Co., et al. v. Commissioner*, 24 B.T.A. 197 (1931).

In the *Wilhelm Co.* case, the taxpayer leased its plant for five years, the lessee agreeing to maintain it and return it upon expiration of the lease in the same condition as when leased and with assets so that the aggregate thereof would be of at least as great book value and actual value as the plant assets had when leased. The United States Board of Tax Appeals (now The Tax Court of the United States) held that the Commissioner properly disallowed depreciation deductions taken by the taxpayer-lessor in respect of the property involved for a taxable period during the lease term.

The decision in the *Wilhelm Co.* case was followed in the *Terre Haute, Indianapolis and Eastern Traction Co.* case, where depreciable properties were leased for 999 years and the lessee agreed that it would "during said term, 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 are now" and, upon expiration of the term, deliver to the lessors property equivalent in value to the property existing at the date of execution of the leases. In holding that the lessors, during the terms of the leases, were not entitled to any deductions for depreciation of the leased properties, the Board stated, in part:

* * * When property is leased with a provision in the lease that it is to be maintained by the lessee and the same property or its equivalent in value returned to the lessor at the expiration of the lease in as good a condition and value as when leased, we believe that it would be contrary to the meaning of section 234(a)(7) of the Revenue Act of 1921 to find that the lessor had actually suffered any loss deductible under that section, for, as said in *Weiss v. Wiener, supra*, he must show "a present loss to him to make the statute apply."

The decision was affirmed in *Terre Haute Electric Co., Inc.* (previously *Terre Haute Traction & Light Co.*) v. *Commissioner*, 67 Fed. (2d) 697 (1933), certiorari denied 292 U.S. 624, Ct. D. 838, C.B. XIII-1, 295 (1934). The same position has been adopted in many similar cases. See *Atlantic Coast Line Railroad Co., et al. v. Commissioner*, 31 B.T.A. 730 (1934), affirmed 81 Fed. (2d) 309 (1936), certiorari denied, 298 U.S. 656, Ct. D. 1125, C.B. XV-1, 167 (1936); *Cincinnati Gas & Electric Co. v. Commissioner*, 36 B.T.A. 1122 (1937), taxpayer's appeal dismissed on its motion, 105 Fed. (2d) 1016; and *Mississippi River and Bonne Terre Railway Co. v. Commissioner*, 39 B.T.A. 995 (1939).

In *Terre Haute Electric Company, Inc. v. Commissioner*, 96 Fed. (2d) 383 (1938), affirming 33 B.T.A. 975, the lessor-taxpayer's claim for a deduction on account of obsolescence, as distinguished from physical depreciation, of the same leased properties as were involved in the *Terre Haute, Indianapolis and Eastern Traction Co.* case, was denied, the court saying, in part:

* * * The question as to whether petitioner, under such a lease, suffered a loss from obsolescence, is so similar to the question as to whether it suffered a loss from depreciation of the leased property, that a negative answer to the latter precludes an affirmative answer to the former. In either case, the loss does not fall upon petitioner. By the terms of the lease it is afforded protection from both losses.

In *Georgia Railway & Electric Co. et al. v. Commissioner*, 77 Fed. (2d) 897 (1935), certiorari denied 296 U.S. 601, Ct. D. 1095, C.B. XV-1, 304 (1936), affirming a B.T.A. Memorandum Opinion, entered April 12, 1934, it was held that, where a lessee, under a 999-year lease entered into in 1912, agreed to renew, repair, and replace the leased properties 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 provisions of the lease were strictly carried out, the lessor was not entitled in 1927, upon termination of the lease by cancellation, to any deduction for depreciation on account of exhaustion, wear, and tear in respect of the leased properties; and that, in the absence of proof of the cost, or fair market value as of March 1, 1913, of leased property allegedly abandoned or sold on account of obsolescence, or of any amount allocable to obsolescence, the lessor was not entitled to any deduction for loss sustained upon abandonment or sale, or for depreciation, on account of obsolescence, of leased property.

In *North Carolina Midland Railway Co. v. United States*, *supra*, the taxpayer on February 5, 1916, leased its railroad properties for six years, subject to termination by the taxpayer-lessor in the event of breach by the lessee, and on March 15, 1921, the term was extended to continue indefinitely subject to termination by either party on thirty days' notice. The lessee agreed to pay specified rental and also "That it, at its own cost, charge and expense, shall and will so preserve, replace, renew and maintain the railroad and property hereby demised, and all additions, amendments and improvements thereof, that if and when in any manner or for any cause the said railroad property shall revert to the possession of the Midland Company, its successors or assigns, the said railroad property and its appurtenances, when it shall so revert, shall be in at least as good condition as at the beginning of the term hereunder."

Under other provisions in the lease, title to improvements, betterments, replacements, and additions, which might be put upon or made to the demised premises by the lessee, shall pass to the lessor, but the lessor shall repay and reimburse the lessee for expenditures by it that are chargeable to capital account for additions and betterments to the leased property.

In its Federal income tax return filed for the calendar year 1947, the lessor made no deduction for depreciation of the leased properties, but it subsequently filed a claim, for refund of \$1,732.77 tax (plus interest), based upon contentions that it sustained certain depreciation in respect thereof in that taxable year. The claim was rejected and the taxpayer instituted suit for recovery in the United States Court of Claims, which held that the taxpayer-lessor was entitled to some depreciation deduction for that taxable year in respect of leased properties, and pursuant thereto entered judgment for recovery of \$1,132.53 tax (with interest as provided by law). In its opinion, the Court stated, in part:

Property by its very nature has a limited span of life. Gradual deterioration in the condition of property that is inherent in its very nature progressively diminishes its value. Of necessity, depreciation comprehends not only physical impairment, but also obsolescence. At the end of the period of its useful life, the property * * * must be replaced.

* * * * *

In the instant case, much of the property consists of various buildings, such as depots, stations, water tanks and the like. All are subject to depreciation and

obsolescence, even if they remain in as good condition at the end of the term as they were at the beginning. Improvements in design, and development of more desirable types of equipment may detract from their value. It may well be that the roadbed does not suffer any depreciation if it is properly maintained, as the lease requires. To some extent this may be true of the tracks, since it is reasonable to assume that in fulfilling its obligations, the lessee will periodically replace the rails. On the other hand, new and perhaps heavier types of rails may be devised during the intervening period, that are more suitable to changes in rolling stock, thereby rendering the track as originally constructed of less value than it had been. These matters of necessity involve questions of fact.

It follows, hence, that insofar as obsolescence is concerned, there is nothing in the covenant that saves the plaintiff from suffering depreciation in that aspect. This is likewise true of depreciation on buildings. To be sure the life of the buildings may be longer than the average, by reason of the covenant, but manifestly they cannot endure permanently. The extent to which depreciation is suffered in respect to the track is a question of proof.

The court also expressed the view that "it is an immaterial difference that in some cases the lessee covenanted to maintain the property in good condition, whereas in the instant case he undertook to return it in as good condition as it was in the beginning of the term". However, in regard to the *Terre Haute Electric Co.* case, the court stated that "the lease required the tenants not only to keep the demised premises in as good condition as they were at the beginning of the term, but also to restore the value of the property at the expiration of the term" and that, "Because of this provision, the lessor did not sustain any depreciation". Thus, the court distinguished that case from the *North Carolina Midland Railway Co.* case.

Since, as indicated in G.C.M. 11933, the lease provisions considered therein were identical to those involved in the *Terre Haute, Indianapolis and Eastern Traction Co.* case, holding (2) of that G.C.M. is likewise distinguishable from the *North Carolina Midland Railway Co.* decision.

Under the principle of G.C.M. 11933, it is recognized that a taxpayer may deduct depreciation actually sustained by him, which would necessarily include obsolescence since the statutory allowance as a deduction for "depreciation" expressly includes allowance for "obsolescence." But, it must appear that the taxpayer suffers obsolescence in order that an allowance may be made to him therefor, the same as he must suffer other exhaustion and wear and tear to entitle him to allowance on account thereof. Compare *Forrester Box Co. v. Commissioner*, 43 B.T.A. 657 (1941), acquiescence C.B. 1941-1, 4, affirmed and remanded, 123 Fed. (2d) 225; and *Swoby Corporation v. Commissioner*, 9 T.C. 887 (1947).

In view of the foregoing, it is held that a lessor may, upon proper showing, be entitled to some allowance for depreciation (including any obsolescence) of leased depreciable property in a taxable year or years during the term of a lease for several years, even though the lessee has agreed to so preserve, replace, renew and maintain such property, and all additions, amendments, and improvements thereof, that, at the termination of the lease, the property shall be in at least as good condition as at its beginning.

G.C.M. 11933, as to its holding that a lessor should not be allowed depreciation deductions in respect of buildings or other depreciable property during the continuance of a lease thereof which provides that the property is to be maintained by the lessee and the same property or its equivalent in value returned to the lessor at the expiration

of the lease in as good condition and value as when leased, is distinguished. In such cases, the lessor suffers no loss, during the term of the lease, on account of wear and tear or exhaustion (including obsolescence) of the leased property.

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

26 CFR 1.170-1: Charitable, etc., contributions
and gifts; allowance of deduction.

Contributions to or for the use of a State activity for exclusively public purposes. See Rev. Rul. 62-66, page 83.

SECTION 171.—AMORTIZABLE BOND PREMIUM

26 CFR 1.171-2: Determination of
bond premium.

The extent to which a premium may be deducted through amortization. See Ct. D. 1870, page 321.

SECTION 172.—NET OPERATING LOSS DEDUCTION

26 CFR 1.172-1: Net operating loss deduction.

The conversion of a net operating loss carryover of an insurance company into an "operations loss deduction" disallowed. See Rev. Rul. 62-43, page 90.

PART VII.—ADDITIONAL ITEMIZED DEDUCTIONS FOR INDIVIDUALS

SECTION 212.—EXPENSES FOR PRODUCTION OF INCOME

26 CFR 1.212-1: Nontrade or nonbusiness expenses. Rev. Rul. 62-9
(Also Section 871; 1.871-7.)

Treatment, for Federal income tax purposes, of legal fees paid by a nonresident alien individual to contest a foreign tax assessed upon his income from sources within the United States.

The Internal Revenue Service has been requested to specify whether, in view of section 1.212-1(1) of the Income Tax Regulations, a nonresident alien individual is entitled to a deduction for legal fees paid to contest a foreign tax assessed upon the taxpayer's income from sources within the United States.

Section 212(3) of the Internal Revenue Code of 1954 provides that in the case of an individual, there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in connection with the determination, collection, or refund of

any tax. Section 1.212-1(1) of the regulations, in interpreting this statutory provision states, in part, as follows:

Expenses paid or incurred by an individual in connection with the determination, collection, or refund of any tax, *whether the taxing authority be Federal, State, or municipal*, and whether the tax be income, estate, gift, property, or any other tax, are deductible. Thus, expenses paid or incurred by a taxpayer for tax counsel or expenses paid or incurred in connection with the preparation of his tax returns or in connection with any proceedings involved in determining the extent of tax liability or in contesting his tax liability are deductible. [Emphasis added.]

The question has been raised whether the italicized words in the preceding paragraph restrict the deduction to those expenses which pertain to Federal, State, or municipal taxes, and, therefore, by implication, deny a deduction for expenses relating to the determination, collection, or refund of taxes levied by foreign jurisdictions.

In view of the legislative history of section 212(3) of the Code, which indicates that Congress intended to allow the deduction of "any expenses incurred in contesting any liability collected as a tax or as part of the tax," in view of the plain language of the statute, and indeed in view of the last sentence of the regulation quoted above, it is held that for purposes of applying section 212(3) of the Code, it is immaterial whether the expenses sought to be deducted thereunder relate to a foreign or domestic tax liability. See House Report No. 1337 at A59, and Senate Report No. 1622, at 218, Eighty-third Congress, Second Session. Therefore, the words, "Federal, State, or municipal," as they appear in section 1.212(1) of the regulations, are not all inclusive but merely illustrative of the types of taxes which can bring about the deduction contemplated in section 212(3) of the Code.

The taxpayer's right to a deduction for the legal expenses otherwise allowable under section 212(3) of the Code is limited, however, by the operation of sections 265 and 871 through 873 of the Code. Section 265 provides, in general, that no amount shall be allowed as a deduction under any provision of the Code for an expense which is allocable to a class or classes of tax-exempt income. Section 871 of the Code groups nonresident aliens into three different categories and prescribes the basis for taxing each group. Irrespective of the category within which they belong, however, nonresident aliens are taxed only upon income from sources within the United States and, to the extent they are entitled to any deductions at all, such deductions (with certain exceptions not here pertinent) are allowable only if and to the extent they are connected with income from sources within the United States. See sections 872 and 873 of the Code.

If the taxpayer computes his tax liability under section 871(a) of the Code, he will not, under any circumstances, be entitled to a deduction for legal fees otherwise allowable under section 212(3) of the Code, since nonresident alien individuals falling within that category are taxed on their gross income without the benefit of any deductions.

If the taxpayer computes his tax under section 871(b) or 871(c) of the Code, the effect of sections 265 and 873 of the Code is to insure that the expenses otherwise allowable under section 212(3) of the Code will qualify for deduction only if the income with respect to which the foreign tax liability arose was income from sources within the United States, which he was required to report on a Federal income tax return, in accordance with section 871 of the Code. Thus, if the

foreign income tax in question was levied upon the taxpayer's income from sources without the United States, no deduction may be allowed for any of the expenses paid or incurred by him in connection with the determination, collection, or refund of such foreign tax. Furthermore, even where the foreign income tax is based upon the alien's income from United States sources, the legal fees are not deductible to the extent that they are allocable to that portion of the foreign tax which is attributable to a class or classes of income exempt by virtue of a tax convention. See sections 265 and 894 of the Code and section 1.873-1(a)(5) of the regulations.

(Also Sections 61, 111; 1.61-1, 1.111-1.)

Rev. Rul. 62-21

A premium paid by an individual to purchase a bond of indemnity, required prior to the issuance of new stock certificates to replace missing original certificates of the individual which were mislaid, lost, stolen, or destroyed, and expenses incident to such purchase are expenses for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income within the meaning of section 212 of the Internal Revenue Code of 1954.

Advice has been requested as to the deductibility for Federal income tax purposes of a premium paid to purchase a bond of indemnity required prior to the issuance of new stock certificates to replace missing original certificates which were mislaid, lost, stolen, or destroyed, and of expenses incident to such purchase under the circumstances described below.

A taxpayer, as the owner of common stock in a company, became entitled to receive an additional number of common shares of that company. The additional stock certificates were sent to the home of the taxpayer by registered mail by the company's transfer agent, but, although signed for by an employee in the taxpayer's home, were never received by the taxpayer.

Subsequently, the taxpayer purchased a bond of indemnity (sometimes also referred to as a surety bond or lost securities bond) which was required by the company prior to its issuance of new stock certificates to the taxpayer. The premium, plus incidental expenses, paid by the taxpayer with respect to this bond was reasonable under the circumstances.

The taxpayer can recover a small portion of his expenditures in connection with the issuance of the new stock certificates under a so-called blanket insurance policy, if and when a claim is filed and allowed. Further, under the terms of the bond of indemnity, if the missing certificates are recovered within one year after the bond was posted, one half of the premium paid will be refunded.

Section 212 of the Internal Revenue Code of 1954 provides, in part, that in the case of an individual there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income or for the management, conservation, or maintenance of property held for the production of income.

Section 1.212-1(g) of the Income Tax Regulations provides, in effect, that expenses incurred by a taxpayer in connection with invest-

ments held by him are deductible where the requirements of section 212 are met.

Section 1.212-1(k) of the regulations provides, in part, that expenses paid or incurred in defending or perfecting title to property or in recovering property (other than investment property and amounts of income which, if and when recovered, must be included in gross income) constitute a part of the cost of the property and are not deductible expenses.

In the instant case, the missing certificates clearly represented ownership of stock held by the taxpayer as an investment for the production of income. The premiums for the indemnity bond and other incidental expenses were not paid or incurred in defending or perfecting title to property, since the taxpayer always had clear and complete title to the missing certificates and there was no question of establishing ownership of them.

Accordingly, it is held that the premiums paid for the purchase of the bond of indemnity in the instant case, plus the miscellaneous expenses incident thereto, are ordinary and necessary expenses for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income within the meaning of section 212 of the Code and are, to the extent not reimbursed by insurance or otherwise during the taxable year, deductible by the taxpayer under that section of the Code in computing his taxable income.

Amounts recovered in a subsequent taxable year with respect to the missing certificates through reimbursement by insurance or a refund of a portion of the premium paid for the purchase of the bond are includible in the taxpayer's gross income as ordinary income to the extent that a tax benefit was received in a prior taxable year. See section 1.111-1(a) of the regulations.

Federal income tax treatment of amounts equal to cash dividends paid or incurred by an investor in securities with respect to stock borrowed to cover short sales. See Rev. Rul. 62-42, page 133.

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

26 CFR 1.213-1: Medical, dental, etc., expenses.

Ct. D. 1871

INCOME TAX—INTERNAL REVENUE CODE OF 1954—DECISION OF COURT

1. DEDUCTIONS FROM GROSS INCOME—MEDICAL EXPENSES—APARTMENT RENTAL PAYMENTS FOR FLORIDA SOJOURN.

A taxpayer, who suffered from a severe heart ailment, on advice of his physician, spent the winter months in Florida, may not deduct as a medical expense apartment rent paid by him in Florida. It was the purpose of Congress in enacting section 213(e)(1) of the 1954 Code to deny deduction for all personal or living expenses incident to medical treatment other than the cost of transportation for the patient. Although section 23(x) of the 1939 Code has been construed to allow deduction for cost of meals and lodging during travel for medical reasons and section

213(e)(1)(A) of the 1954 Code was enacted in language identical to that used in section 23(x), in adding subsection (B) to 213(e)(1) expressly allowing deduction for transportation expenses of the patient, Congress intended to deny deduction for personal and living expenses. A construction of section 213 must be based on its legislative history. The Committee Reports, anticipating the instant situation, foreclose any deduction of rental payments for taxpayer's Florida apartment as "medical care."

2. DECISION REVERSED.

Decision of the United States Court of Appeals for the Third Circuit, 289 Fed. (2d) 291, (1961), reversed.

SUPREME COURT OF THE UNITED STATES

No. 384.—October Term, 1961

Commissioner of Internal Revenue, petitioner, v. Sally L. Bilder, etc.

On writ of certiorari to the United States Court of Appeals for the Third Circuit

[April 30, 1962]

MR. JUSTICE HARLAN delivered the opinion of the Court.

This case concerns the deductibility as an expense for "medical care," under section 213 of the Internal Revenue Code of 1954, 26 U.S.C. section 213, of rent paid by a taxpayer for an apartment in Florida, where he was ordered by his physician, as part of a regimen of medical treatment, to spend the winter months.¹

The taxpayer, now deceased, was an attorney practicing law in Newark, New Jersey. In December 1953, when he was 43 years of age and had suffered four heart attacks during the previous eight years, he was advised by a heart specialist to spend the winter season in a warm climate. The taxpayer, his wife, and his three-year-old daughter proceeded immediately to Fort Lauderdale, Florida, where they resided for the ensuing three months in an apartment rented for \$1,500. Two months of the succeeding winter were also spent in Fort Lauderdale in an apartment rented for \$829.

The taxpayer claimed the two rental payments as deductible medical expenses in his 1954 and 1955 income tax returns. These deductions were disallowed in their entirety by the Commissioner.² The Tax Court reversed the Commissioner's determination to the extent of one-third of the deductions, finding that proportion of the total claimed attributable to the taxpayer's own living accommodations. The remaining two-thirds it attributed to the accommodations of his wife and child, whose presence, the Tax Court concluded, had not been shown to be necessary to the medical treatment of the taxpayer's illness. 33 T.C. 155.

On cross-appeals from the decision of the Tax Court, the Court of Appeals held, by a divided vote, that the full rental payments were deductible as expenses for "medical care" within the meaning of section 213. 289 F.2d 291. Because of a subsequent contrary holding by the Court of Appeals for the Second Circuit, *Carasso v. Commissioner*, 292 F.2d 367, and the need for a uniform rule on the point, we granted certiorari to resolve the conflict. 368 U.S. 912.

The Commissioner concedes that prior to the enactment of the Internal Revenue Code of 1954 rental payments of the sort made by the taxpayer were recognized as deductible medical expenses. This was because section 23(x) of

¹ Section 213 of the 1954 Code allows as deductions in computing net income "the expenses paid during the taxable year, not compensated for by insurance or otherwise, for medical care of the taxpayer, his spouse, or a dependent * * *." Subdivision (e)(1) defines such expenses as "amounts paid"—

"(A) for the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body (including amounts paid for accident or health insurance), or

"(B) for transportation primarily for and essential to medical care referred to in subparagraph (A)."

² The Commissioner concedes that the taxpayer's sojourn in Florida was not for vacation purposes but was "a medical necessity and * * * a primary part of necessary medical treatment of a disease" from which the taxpayer was suffering, i.e., atherosclerosis. The taxpayer also claimed in each of his tax returns a \$250 deduction for his transportation between Newark and Fort Lauderdale. Although the Commissioner initially disallowed this deduction, he thereafter acquiesced in its allowance by the Tax Court.

the Internal Revenue Code of 1939, though expressly authorizing deductions only for "amounts paid for the diagnosis, cure, mitigation, treatment, or prevention of disease,"³ had been construed to include "travel primarily for and essential to * * * the prevention or alleviation of a physical or mental defect or illness," Regulations 111, section 29.23(x)-1, and the cost of meals and lodging during such travel, I. T. 3786, 1946-1 Cum. Bull. 76. See, e. g., *L. Keever Stringham*, 12 T.C. 580, aff'd, 183 F. 2d 579; Rev. Rule 55-261, 1955-1 Cum. Bull. 307.

The Commissioner maintains, however, that it was the purpose of Congress, in enacting section 213(e)(1)(A) of the 1954 Code, albeit in language identical to that used in section 23(x) of the 1939 Code (compare notes 1 and 3, *supra*), to deny deductions for all personal or living expenses incidental to medical treatment other than the cost of transportation of the patient alone, that exception having been expressly added by subdivision (B) to the definition of "medical care" in section 213(e)(1). Note 1, *supra*.

We consider the Commissioner's position unassailable in light of the congressional purpose explicitly revealed in the House and Senate Committee Reports on the bill. These reports, anticipating the precise situation now before us, state:

"Subsection (e) defines medical care to mean amounts paid for the diagnosis, cure, mitigation, treatment, or prevention of diseases or for the purpose of effecting any structure or function of the body (including amounts paid for accident or health insurance), or for transportation primarily for and essential to medical care. The deduction permitted for 'transportation primarily for and essential to medical care' *clarifies existing law* in that it specifically *excludes deduction of any meals and lodging while away from home receiving medical treatment*. For example, if a doctor prescribes that a patient must go to Florida in order to alleviate specific chronic ailments and to escape unfavorable climatic conditions which have proven injurious to the health of the taxpayer, and the travel is prescribed for reasons other than the general improvement of a patient's health, the cost of the patient's transportation to Florida would be deductible *but not his living expenses while there*. However, if a doctor prescribed an appendectomy and the taxpayer chose to go to Florida for the operation not even his transportation costs would be deductible. The subsection is not intended otherwise to *change* the existing definitions of medical care, to deny the cost of ordinary ambulance transportation nor to deny the cost of food or lodging provided as part of a hospital bill." H.R. Rep. No. 1337, 83d Cong., 2d Sess. A60 (1954); S. Rep. No. 1622, 83d Cong., 2d Sess. 219-220 (1954).⁴ (Emphasis supplied.)

Since under the predecessor statute, as it had been construed, expenses for meals and lodging *were* deductible as expenses for "medical care," it may well be true that the Committee Reports spoke in part inartistically when they referred to subsection (e) as a mere clarification of "existing law," although it will be noted that the report also referred to what was being done as a *pro tanto* "change" in "the existing definition of medical care." Yet Congress' purpose to exclude such expenses as medical deductions under the new bill is unmistakable in these authoritative pronouncements, *ibid.*; cf. Budget Message of the President

³ Section 23(x) was added to the Internal Revenue Code of 1939 by sec. 127(a) of the Revenue Act of 1942, 56 Stat. 825. It provided, in pertinent part: "[In computing net income there shall be allowed as deductions] * * * expenses paid during the taxable year, not compensated for by insurance or otherwise, for medical care of the taxpayer, his spouse, or a dependent * * * of the taxpayer. The term 'medical care' as used in this subsection, shall include amounts paid for the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body (including amounts paid for accident or health insurance)."

⁴ The substance of the rule set forth in both Reports has been embodied in the Treasury Regulations interpreting sec. 213:

"(iv) Expenses paid for transportation primarily for and essential to the rendition of the medical care are expenses paid for medical care. However, an amount allowable as a deduction for "transportation primarily for and essential to medical care" shall not include the cost of any meals and lodging while away from home receiving medical treatment. For example, if a doctor prescribes that a taxpayer go to a warm climate in order to alleviate a specific chronic ailment, the cost of meals and lodging while there would not be deductible. On the other hand, if the travel is undertaken merely for the general improvement of a taxpayer's health, neither the cost of transportation nor the cost of meals and lodging would be deductible. If a doctor prescribes an operation or other medical care, and the taxpayer chooses for purely personal considerations to travel to another locality (such as a resort area) for the operation or the other medical care, neither the cost of transportation nor the cost of meals and lodging (except where paid as part of a hospital bill) is deductible." Treasury Regulations on Income Tax (1954 Code) sec. 1.213-1(e)(1)(iv).

for the Fiscal Year 1955, H.R. Doc. No. 264, 83d Cong., 2d Sess. M17 (1954); Memorandum of Joint Committee on Internal Revenue Taxation, 1 Senate Hearings on the Internal Revenue Code of 1954, 83d Cong., 2d Sess. 24 (1954); Memorandum of the Undersecretary of the Treasury, *id.*, at 103. It is that factor which is of controlling importance here.⁶

We need not consider whether we would be warranted in disregarding these unequivocal expressions of legislative intent if the statute were so written as to permit no reasonable construction other than that urged on behalf of the taxpayer. Compare *Boston Sand & Gravel Co. v. United States*, 278 U.S. 41, 48; *United States v. Dickerson*, 310 U.S. 554, 561-562; *Harrison v. Northern Trust Co.*, 317 U.S. 476, 479; See also *Association of Westinghouse Salaried Employees v. Westinghouse Elec. Corp.*, 348 U.S. 437, 444. Even the initial decision of the Tax Court under the 1939 Code respecting the deductibility of similar expenses under section 23(x) recognized that the language of that statute was "susceptible to a variety of conflicting interpretations," *L. Keever Stringham*, 12 T.C. 580, 583. The Tax Court's conclusion as to the meaning of section 23(x) of the earlier statute which was affirmed by the Court of Appeals, 183 F. 2d 579, and acquiesced in by the Commissioner, necessarily rested on what emerged from a study of the legislative history of that enactment. So too the conclusion in this case, which turns on the construction of the identical words re-enacted as part of section 213, must be based on an examination of the legislative history of this provision of the 1954 Code. The Committee Reports foreclose any reading of that provision which would permit this taxpayer to take the rental payments for his Florida apartment as "medical care" deductions.

Reversed.

MR. JUSTICE DOUGLAS would affirm the judgment below for the reasons given by Judge Kalodner, 289 F. 2d 291.

MR. JUSTICE FRANKFURTER took no part in the decision of this case.

MR. JUSTICE WHITE took no part in the consideration or decision of this case.

SECTION 215.—ALIMONY, ETC., PAYMENTS

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

Rev. Rul. 62-53

(Also Section 71; 1.71-1.)

Periodic payments for support made by a husband and received by a wife under a divorce decree, or an instrument or agreement described in section 71(a) of the Internal Revenue Code of 1954, are includible in the gross income of the wife and deductible by the husband except to the extent that the terms of the decree, instrument, or agreement specifically designate or "fix" such payments, or a portion of such payments, as child support.

Revenue Ruling 59-93, C.B. 1959-1, 22, revoked.

Reconsideration has been given to Revenue Ruling 59-93, C.B. 1959-1, 22, in the light of the decision of the Supreme Court of the United States in *Commissioner v. Jerry Lester*, 366 U.S. 299 (1961), Ct. D. 1862, C.B. 1961-2, 241.

Revenue Ruling 59-93 holds that the decision in *Charles S. Weil et al. v. Commissioner*, 240 Fed. (2d) 584 (1957), certiorari denied, 353

⁶The explicitness of the Committee Reports renders it unnecessary to consider the Commissioner's alternative argument that the statute on its face precludes these deductions because (1) sec. 262 of the 1954 Code, 26 U.S.C. sec. 262, allows no deductions for "personal, living, or family expenses * * * except as otherwise expressly provided in this chapter," and (2) apart from the medical "transportation" expense provided in sec. 213(c)(1)(B), no other express exception can be found in the statute. And the equitable considerations which the respondent brings to bear in support of her construction of sec. 213 are of course beside the point in this Court, since we must give the statute effect in accordance with the purpose so clearly manifested by Congress.

U.S. 958 (1957), relating to the treatment of certain periodic payments made to a wife for the support of herself and minor children, will be followed by the Internal Revenue Service only in cases involving similar facts and circumstances. In determining whether payments made to a wife for the support of herself and minor children, treated as alimony or a portion is for the support of minor children, the ruling states that the Service will continue to follow the rationale of the decision in *Jo Eisinger, et ux v. Commissioner*, 250 Fed. (2d) 303 (1957), Ct. D. 1834, C.B. 1959-1, 661, certiorari denied, 356 U.S. 913 (1958), which held that the agreement in that case allocated the payments between alimony and support for the children with sufficient certainty, even though such payments were not specifically designated.

In the *Lester* case, the Supreme Court concluded that the Congress intended that, to come within the exception portion of section 22(k) of the Internal Revenue Code of 1939 allowing a portion of the payment which is payable for the support of minor children to be excluded from the wife's income, the agreement providing for the periodic payments must specifically state the amounts or parts thereof allocable to the support of the children. Thus, the agreement in the case providing for payment of certain monies to the wife for support of herself and the children which did not "fix" an amount for child support, but merely provided for a specific percentage reduction in payment to the wife upon the marriage, emancipation or death of any child, failed to meet the requirements of the statute and the payments were, therefore, fully deductible by the husband under section 23(u) of the 1939 Code.

While the *Lester* case was decided under sections 22(k) and 23(u) of the 1939 Code, the decision is equally applicable to sections 71 and 215 of the Internal Revenue Code of 1954.

In view of the foregoing, it is held that where periodic payments for support are made by a husband and received by a wife under a divorce decree, or an instrument or agreement described in section 71(a), such payments are includible in the gross income of the wife under section 71 of the 1954 Code and are deductible by the husband under section 215, except to the extent that the terms of the decree, instrument, or agreement specifically designate or "fix" such payments, or a portion of such payments, as support for minor children of the husband.

Revenue Ruling 59-93, C.B. 1959-1, 22 is hereby revoked.

Alimony award partially allocated to payment of insurance and taxes on residence owned by divorced parties as tenants by the entirety. See Rev. Rul. 62-38, page 15.

Alimony award partially allocated to payments of principal, interest, taxes, insurance and utilities on residence owned as tenants in common. See Rev. Rul. 62-39, page 17.

PART IX.—ITEMS NOT DEDUCTIBLE

SECTION 262.—PERSONAL, LIVING, AND FAMILY EXPENSES

26 CFR 1.262-1: Personal, living, and family expenses.

Expenses paid for a taxpayer's family in connection with his traveling in a foreign country to lecture. See Rev. Rul. 62-2, page 9.

SECTION 269.—ACQUISITIONS MADE TO EVADE OR AVOID INCOME TAX

26 CFR 1.269: Statutory provisions; acquisitions made to evade or avoid income tax. T.D. 6595¹
(Also Section 482; 1.482.)

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

Regulations under sections 269 and 482 of the Internal Revenue Code of 1954.

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

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

On December 10, 1960, notice of proposed rulemaking with respect to regulations under sections 269 and 482 of the Internal Revenue Code of 1954 (relating, respectively, to acquisitions made to evade or avoid income tax and allocation of income and deductions among taxpayers) was published in the Federal Register (25 F.R. 12703). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the following regulations are hereby adopted.

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AUTHORITY: §§ 1.269 through 1.269-6, incl., 1.482 and 1.482-1, issued under sec. 7805, I.R.C. 1954; 68A Stat. 917; 26 U.S.C. 7805.

¹ The publication of this Treasury Decision in 27 F.R. 3595, dated April 14, 1962, contains (1) instructions for modifying the notice of proposed rulemaking in 25 F.R. 12703, dated December 10, 1960, and (2) the full context of the regulations with such modifications. As here published, the Treasury Decision reflects the full context of such regulations, with modifications. The individual instructions have been omitted.

§ 1.269 STATUTORY PROVISIONS; ACQUISITIONS MADE TO EVADE OR AVOID INCOME TAX.

SEC. 269. ACQUISITIONS MADE TO EVADE OR AVOID INCOME TAX.

(a) IN GENERAL.—If—

(1) Any person or persons acquire, or acquired on or after October 8, 1940, directly or indirectly, control of a corporation, or

(2) Any corporation acquires, or acquired on or after October 8, 1940, directly or indirectly, property of another corporation, not controlled, directly or indirectly, immediately before such acquisition, by such acquiring corporation or its stockholders, the basis of which property, in the hands of the acquiring corporation, is determined by reference to the basis in the hands of the transferor corporation,

and the principal purpose for which such acquisition was made is evasion or avoidance of Federal income tax by securing the benefit of a deduction, credit, or other allowance which such person or corporation would not otherwise enjoy, then such deduction, credit, or other allowance shall not be allowed. For purposes of paragraphs (1) and (2), control means the ownership of stock possessing at least 50 percent of the total combined voting power of all classes of stock entitled to vote or at least 50 percent of the total value of shares of all classes of stock of the corporation.

(b) POWER OF SECRETARY OR HIS DELEGATE TO ALLOW DEDUCTION, ETC., IN PART.—In any case to which subsection (a) applies the Secretary or his delegate is authorized—

(1) To allow as a deduction, credit, or allowance any part of any amount disallowed by such subsection, if he determines that such allowance will not result in the evasion or avoidance of Federal income tax for which the acquisition was made; or

(2) To distribute, apportion, or allocate gross incomes, and distribute, apportion, or allocate the deductions, credits, or allowances the benefit of which was sought to be secured, between or among the corporations, or properties, or parts thereof, involved, and to allow such deductions, credits, or allowances so distributed, apportioned, or allocated, but to give effect to such allowance only to such extent as he determines will not result in the evasion or avoidance of Federal income tax for which the acquisition was made; or

(3) To exercise his powers in part under paragraph (1) and in part under paragraph (2).

(c) PRESUMPTION IN CASE OF DISPROPORTIONATE PURCHASE PRICE.—The fact that the consideration paid upon an acquisition by any person or corporation described in subsection (a) is substantially disproportionate to the aggregate—

(1) Of the adjusted basis of the property of the corporation (to the extent attributable to the interest acquired specified in paragraph (1) of subsection (a)), or of the property acquired specified in paragraph (2) of subsection (a); and

(2) Of the tax benefits (to the extent not reflected in the adjusted basis of the property) not available to such person or corporation otherwise than as a result of such acquisition, shall be prima facie evidence of the principal purpose of evasion or avoidance of Federal income tax. This subsection shall apply only with respect to acquisitions after March 1, 1954.

§ 1.269-1 MEANING AND USE OF TERMS.—As used in section 269 and §§ 1.269-2 through 1.269-6—

(a) *Allowance*.—The term “allowance” refers to anything in the internal revenue laws which has the effect of diminishing tax liability. The term includes, among other things, a deduction, a credit, an adjustment, an exemption, or an exclusion.

(b) *Evasion or avoidance*.—The phrase “evasion or avoidance” is not limited to cases involving criminal penalties, or civil penalties for fraud.

(c) *Control*.—The term “control” means the ownership of stock possessing at least 50 percent of the total combined voting power of all classes of stock entitled to vote, or at least 50 percent of the total value of shares of all classes of stock of the corporation. For control to be “acquired on or after October 8, 1940”, it is not necessary that all of such stock be acquired on or after October 8, 1940. Thus, if A, on October 7, 1940, and at all times thereafter, owns 40 percent of the stock of X Corporation and acquires on October 8, 1940, an additional 10 percent of such stock, an acquisition within the meaning of such phrase is made by A on October 8, 1940. Similarly, if B, on October 7, 1940, owns certain assets and transfers on October 8, 1940, such assets to a newly organized Y Corporation in exchange for all the stock of Y Corporation, an acquisition within the meaning of such phrase is made by B on October 8, 1940. If, under the facts stated in the preceding sentence, B is a corporation, all of whose stock is owned by Z Corporation, then an acquisition within the meaning of such phrase is also made by Z Corporation on October 8, 1940, as well as by the shareholders of Z Corporation taken as a group on such date, and by any of such shareholders if such shareholders as a group own 50 percent of the stock of Z on such date.

(d) *Person*.—The term “person” includes an individual, a trust, an estate, a partnership, an association, a company, or a corporation.

§ 1.269-2 PURPOSE AND SCOPE OF SECTION 269.—(a) *General*.—Section 269 is designed to prevent in the instances specified therein the use of the sections of the Internal Revenue Code providing deductions, credits, or allowances in evading or avoiding Federal income tax. See § 1.269-3.

(b) *Disallowance of deduction, credit, or other allowance*.—Under the Code, an amount otherwise constituting a deduction, credit, or other allowance becomes unavailable as such under certain circumstances. Characteristic of such circumstances are those in which the effect of the deduction, credit, or other allowance would be to distort the liability of the particular taxpayer when the essential nature of the transaction or situation is examined in the light of the basic purpose or plan which the deduction, credit, or other allowance was designed by the Congress to effectuate. The distortion may be evidenced, for example, by the fact that the transaction was not undertaken for reasons germane to the conduct of the business of the taxpayer, by the unreal nature of the transaction such as its sham character, or by the unreal or unreasonable relation which the deduction, credit, or other allowance bears to the transaction. The principle of law making an amount unavailable as a deduction, credit, or other allowance in cases in which the effect of making an amount so available would be to distort the liability of the taxpayer, has been judicially recognized and applied in several cases. Included in these cases are *Gregory v. Helvering* (1935) (293 U.S. 465; Ct. D. 911, C.B. XIV-1, 193); *Griffiths v. Helvering* (1939) (308 U.S. 355; Ct. D. 1431, C.B. 1940-1, 136); *Higgins v. Smith* (1940) (308 U.S. 473; Ct. D. 1434, C.B. 1940-1, 127); and *J. D. & A. B. Spreckles Co. v.*

Commissioner (1940) (41 B.T.A. 370). In order to give effect to such principle, but not in limitation thereof, several provisions of the Code, for example, section 267 and section 270, specify with some particularity instances in which disallowance of the deduction, credit, or other allowance is required. Section 269 is also included in such provisions of the Code. The principle of law and the particular sections of the Code are not mutually exclusive and in appropriate circumstances they may operate together or they may operate separately. See, for example, § 1.269-6.

§ 1.269-3 INSTANCES IN WHICH SECTION 269(a) DISALLOWS A DEDUCTION, CREDIT, OR OTHER ALLOWANCE.—(a) *Instances of disallowance*.—Section 269 specifies two instances in which a deduction, credit, or other allowance is to be disallowed. These instances, described in paragraphs (1) and (2) of section 269(a), are those in which—

(1) Any person or persons acquire, or acquired on or after October 8, 1940, directly or indirectly, control of a corporation, or

(2) Any corporation acquires, or acquired on or after October 8, 1940, directly or indirectly, property of another corporation (not controlled, directly or indirectly, immediately before such acquisition by such acquiring corporation or its stockholders), the basis of which property in the hands of the acquiring corporation is determined by reference to the basis in the hands of the transferor corporation.

In either instance the principal purpose for which the acquisition was made must have been the evasion or avoidance of Federal income tax by securing the benefit of a deduction, credit, or other allowance which such person or persons, or corporation, would not otherwise enjoy. If this requirement is satisfied, it is immaterial by what method or by what conjunction of events the benefit was sought. Thus, an acquiring person or corporation can secure the benefit of a deduction, credit, or other allowance within the meaning of section 269 even though it is the acquired corporation that is entitled to such deduction, credit, or other allowance in the determination of its tax. If the purpose to evade or avoid Federal income tax exceeds in importance any other purpose, it is the principal purpose. This does not mean that only those acquisitions fall within the provisions of section 269 which would not have been made if the evasion or avoidance purpose was not present. The determination of the purpose for which an acquisition was made requires a scrutiny of the entire circumstances in which the transaction or course of conduct occurred, in connection with the tax result claimed to arise therefrom. For the presumption of a principal purpose of tax evasion or avoidance, see section 269(c) and § 1.269-5.

(b) *Acquisition of control; transactions indicative of purpose to evade or avoid tax*.—If the requisite acquisition of control within the meaning of paragraph (1) of section 269(a) exists, the transactions set forth in the following subparagraphs are among those which, in the absence of additional evidence to the contrary, ordinarily are indicative that the principal purpose for acquiring control was evasion or avoidance of Federal income tax:

(1) A corporation or other business enterprise (or the interest controlling such corporation or enterprise) with large profits acquires control of a corporation with current, past, or prospective credits, deductions, net operating losses, or other allowances and the acquisition is followed by such transfers or other action as is necessary to bring the deduction, credit, or other allowance into conjunction with the income (see further § 1.269-6). This subparagraph may be illustrated by the following example:

Example. Individual A acquires all of the stock of L Corporation which has been engaged in the business of operating retail drug stores. At the time of the acquisition, L Corporation has net operating loss carryovers aggregating \$100,000 and its net worth is \$100,000. After the acquisition, L Corporation continues to engage in the business of operating retail drug stores but the profits attributable to such business after the acquisition are not sufficient to absorb any substantial portion of the net operating loss carryovers. Shortly after the acquisition, individual A causes to be transferred to L Corporation the assets of a hardware business previously controlled by A which business produces profits sufficient to absorb a substantial portion of L Corporation's net operating loss carryovers. The transfer of the profitable business, which has the effect of using net operating loss carryovers to offset gains of a business unrelated to that which produced the losses, indicates that the principal purpose for which the acquisition of control was made is evasion or avoidance of Federal income tax.

(2) A person or persons organize two or more corporations instead of a single corporation in order to secure the benefit of multiple surtax exemptions (see section 11(c)) or multiple minimum accumulated earnings credits (see section 535(c) (2) and (3)).

(3) A person or persons with high earning assets transfer them to a newly organized controlled corporation retaining assets producing net operating losses which are utilized in an attempt to secure refunds.

(c) *Acquisition of property; transactions indicative of purpose to evade or avoid tax.*—If the requisite acquisition of property within the meaning of paragraph (2) of section 269(a) exists, the transactions set forth in the following subparagraphs are among those which, in the absence of additional evidence to the contrary, ordinarily are indicative that the principal purpose for acquiring such property was evasion or avoidance of Federal income tax:

(1) A corporation acquires property having in its hands an aggregate carryover basis which is materially greater than its aggregate fair market value at the time of such acquisition and utilizes the property to create tax-reducing losses or deductions.

(2) A subsidiary corporation, which has sustained large net operating losses in the operation of business X and which has filed separate returns for the taxable years in which the losses were sustained, acquires high earning assets, comprising business Y, from its parent corporation. The acquisition occurs at a time when the parent would not succeed to the net operating loss carryovers of the subsidiary if the subsidiary were liquidated, and the profits of business Y are sufficient to offset a substantial portion of the net operating loss carryovers attributable to business X (see further example (3) of § 1.269-6).

§ 1.269-4 POWER OF DISTRICT DIRECTOR TO ALLOCATE DEDUCTION, CREDIT, OR ALLOWANCE IN PART.—The district director is authorized

by section 269(b) to allow a part of the amount disallowed by section 269(a), but he may allow such part only if and to the extent that he determines that the amount allowed will not result in the evasion or avoidance of Federal income tax for which the acquisition was made. The district director is also authorized to use other methods to give effect to part of the amount disallowed under section 269(a), but only to such extent as he determines will not result in the evasion or avoidance of Federal income tax for which the acquisition was made. Whenever appropriate to give proper effect to the deduction, credit, or other allowance, or such part of it which may be allowed, this authority includes the distribution, apportionment, or allocation of both the gross income and the deductions, credits, or other allowances the benefit of which was sought between or among the corporations, or properties, or parts thereof, involved, and includes the disallowance of any such deduction, credit, or other allowance to any of the taxpayers involved.

§ 1.269-5 PRESUMPTION IN CASE OF DISPROPORTIONATE PURCHASE PRICE.—Section 269(c) provides that the fact that the consideration paid upon an acquisition by any person or corporation described in section 269(a) is substantially less than the aggregate—

(a) Of the adjusted basis of the property of the corporation (to the extent attributable to the interest acquired specified in paragraph (1) of section 269(a)), or of the property acquired specified in paragraph (2) of section 269(a); and

(b) Of the tax benefits (to the extent not reflected in the adjusted basis of the property) not available to such person or corporation otherwise than as a result of such acquisition,

shall be prima facie evidence of the principal purpose of evasion or avoidance of Federal income tax. Under principles applicable to income tax litigation generally, the Commissioner's determination that an acquisition was made for the principal purpose of evasion or avoidance of Federal income tax is presumptively correct, and the burden of proving such determination wrong by a preponderance of the evidence, together with the corresponding burden of first going forward with the evidence, is on the taxpayer. The effect of section 269(c), if applicable, is to give further weight to the presumption of correctness already arising from the Commissioner's determination, by expressly providing an additional presumption of the existence of a principal purpose of evasion or avoidance of Federal income tax. Section 269(c) shall apply only with respect to acquisitions occurring after March 1, 1954.

§ 1.269-6 RELATIONSHIP OF SECTION 269 TO SECTION 382.—Section 269 and §§ 1.269-1 through 1.269-5 may be applied to disallow a net operating loss carryover even though such carryover is not disallowed (in whole or in part) under section 382 and the regulations thereunder. This section may be illustrated by the following examples:

Example (1). L Corporation has computed its taxable income on a calendar year basis and has sustained heavy net operating losses for a number of years. Assume that A purchases all of the stock of L Corporation on December 31, 1955, for the principal purpose of utilizing its net operating loss carryovers by changing its business to a profitable new business. Assume further that A makes no attempt to revitalize

the business of L Corporation during the calendar year 1956 and that during January 1957 the business is changed to an entirely new and profitable business. The carryovers will be disallowed under the provisions of section 269(a) without regard to the application of section 382.

Example (2). L Corporation has sustained heavy net operating losses for a number of years. In a merger under State law, P Corporation acquires all of the assets of L Corporation for the principal purpose of utilizing the net operating loss carryovers of L Corporation against the profits of P Corporation's business. As a result of the merger, the former stockholders of L Corporation own, immediately after the merger, 12 percent of the fair market value of the outstanding stock of P Corporation. If the merger qualifies as a reorganization to which section 381(a) applies, the entire net operating loss carryovers will be disallowed under the provisions of section 269(a) without regard to the application of section 382.

Example (3). L Corporation has been sustaining net operating losses for a number of years. P Corporation, a profitable corporation, on December 31, 1955, acquires all the stock of L Corporation for the purpose of continuing and improving the operation of L Corporation's business. Under the provisions of sections 334(b)(2) and 381(a)(1), P Corporation would not succeed to L Corporation's net operating loss carryovers if L Corporation were liquidated pursuant to a plan of liquidation adopted within two years after the date of the acquisition. During 1956, P Corporation transfers a profitable business to L Corporation for the principal purpose of using the profits of such business to absorb the net operating loss carryovers of L Corporation. The transfer is such as to cause the basis of the transferred assets in the hands of L Corporation to be determined by reference to their basis in the hands of P Corporation. L Corporation's net operating loss carryovers will be disallowed under the provisions of section 269(a) without regard to the application of section 382.

§ 1.482 STATUTORY PROVISIONS; ALLOCATION OF INCOME AND DEDUCTIONS AMONG TAXPAYERS.

SEC. 482. ALLOCATION OF INCOME AND DEDUCTIONS AMONG TAXPAYERS.

In any case of two or more organizations, 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 Secretary or his delegate may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, 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 organizations, trades, or businesses.

§ 1.482-1 DETERMINATION OF THE TAXABLE INCOME OF A CONTROLLED TAXPAYER.—(a) *Definitions.*—When used in this section—

(1) The term "organization" includes any organization of any kind, whether it be a sole proprietorship, a partnership, a trust, an estate, an association, or a corporation (as each is defined or understood in the Internal Revenue Code or the regulations thereunder), irrespective of the place where organized, where operated, or where its trade or business is conducted, and regardless of whether domestic

or foreign, whether exempt, whether affiliated, or whether a party to a consolidated return.

(2) The term "trade" or "business" includes any trade or business activity of any kind, regardless of whether or where organized, whether owned individually or otherwise, and regardless of the place where carried on.

(3) The term "controlled" includes any kind of control, direct or indirect, whether legally enforceable, and however exercisable or exercised. It is the reality of the control which is decisive, not its form or the mode of its exercise. A presumption of control arises if income or deductions have been arbitrarily shifted.

(4) The term "controlled taxpayer" means any one of two or more organizations, trades, or businesses owned or controlled directly or indirectly by the same interests.

(5) The terms "group" and "group of controlled taxpayers" mean the organizations, trades, or businesses owned or controlled by the same interests.

(6) The term "true taxable income" means, in the case of a controlled taxpayer, the taxable income (or, as the case may be, any item or element affecting taxable income) which would have resulted to the controlled taxpayer, had it in the conduct of its affairs (or, as the case may be, in the particular contract, transaction, arrangement, or other act) dealt with the other member or members of the group at arm's length. It does not mean the income, the deductions, the credits, the allowances, or the item or element of income, deductions, credits, or allowances, resulting to the controlled taxpayer by reason of the particular contract, transaction, or arrangement, the controlled taxpayer, or the interests controlling it, chose to make (even though such contract, transaction, or arrangement be legally binding upon the parties thereto).

(b) *Scope and purpose.*—(1) The purpose of section 482 is to place a controlled taxpayer on a tax parity with an uncontrolled taxpayer, by determining, according to the standard of an uncontrolled taxpayer, the true taxable income from the property and business of a controlled taxpayer. The interests controlling a group of controlled taxpayers are assumed to have complete power to cause each controlled taxpayer so to conduct its affairs that its transactions and accounting records truly reflect the taxable income from the property and business of each of the controlled taxpayers. If, however, this has not been done, and the taxable incomes are thereby understated, the district director shall intervene, and, by making such distributions, apportionments, or allocations as he may deem necessary of gross income, deductions, credits, or allowances, or of any item or element affecting taxable income, between or among the controlled taxpayers constituting the group, shall determine the true taxable income of each controlled taxpayer. The standard to be applied in every case is that of an uncontrolled taxpayer dealing at arm's length with another uncontrolled taxpayer.

(2) Section 482 and this section apply to the case of any controlled taxpayer, whether such taxpayer makes a separate or a consolidated return. If a controlled taxpayer makes a separate return, the determination is of its true separate taxable income. If a controlled taxpayer is a party to a consolidated return, the true consolidated taxable

income of the affiliated group and the true separate taxable income of the controlled taxpayer are determined consistently with the principles of a consolidated return.

(3) Section 482 grants no right to a controlled taxpayer to apply its provisions at will, nor does it grant any right to compel the district director to apply such provisions. It is not intended (except in the case of the computation of consolidated taxable income under a consolidated return) to effect in any case such a distribution, apportionment, or allocation of gross income, deductions, credits, or allowances, or any item of gross income, deductions, credits, or allowances, as would produce a result equivalent to a computation of consolidated taxable income under subchapter A, chapter 6 of the Code.

(c) *Application.*—Transactions between one controlled taxpayer and another will be subjected to special scrutiny to ascertain whether the common control is being used to reduce, avoid, or escape taxes. In determining the true taxable income of a controlled taxpayer, the district director is not restricted to the case of improper accounting, to the case of a fraudulent, colorable, or sham transaction, or to the case of a device designed to reduce or avoid tax by shifting or distorting income, deductions, credits, or allowances. The authority to determine true taxable income extends to any case in which either by inadvertence or design the taxable income, in whole or in part, of a controlled taxpayer, is other than it would have been had the taxpayer in the conduct of his affairs been an uncontrolled taxpayer dealing at arm's length with another uncontrolled taxpayer.

BERTRAND M. HARDING,

Acting Commissioner of Internal Revenue.

Approved April 9, 1962.

STANLEY S. SURREY,

Assistant Secretary of the Treasury.

(Filed by the Division of the Federal Register on April 13, 1962, 8:48 a.m., and published in the issue of the Federal Register for April 14, 1962, 27 F.R. 3595)

SUBCHAPTER C.—CORPORATE DISTRIBUTIONS AND ADJUSTMENTS

PART II.—CORPORATE LIQUIDATIONS

Subpart C.—Collapsible Corporations; Foreign Personal Holding Companies

SECTION 341.—COLLAPSIBLE CORPORATIONS

26 CFR 1.341-2: Definitions.

Determination of "substantial part" of net income to be derived from property of a collapsible corporation. See Rev. Rul. 62-12, page 321.

PART III.—CORPORATE ORGANIZATIONS AND REORGANIZATIONS

Subpart B.—Effects on Shareholders and Security Holders

SECTION 356.—RECEIPT OF ADDITIONAL CONSIDERATION

26 CFR 1.356-1: Receipt of additional consideration in connection with an exchange.

Recognition of gain on the exchange of stock for stock plus cash in the absence of a statutory reorganization. See Ct. D. 1868, page 317.

PART V.—CARRYOVERS

SECTION 381.—CARRYOVERS IN CERTAIN CORPORATE ACQUISITIONS

26 CFR 1.381(c)(2): Statutory provisions; carryovers in certain corporate acquisitions; items of the distributor or transferor corporation; earnings and profits. T. D. 6586¹

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

Income Tax Regulations under section 381(c)(2) of the Internal Revenue Code of 1954, relating to the carryover of earnings and profits in certain corporate acquisitions.

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

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

On December 31, 1960, notice of proposed rulemaking with respect to regulations under section 381(c)(2) and (16) of the Internal Revenue Code of 1954, relating to the carryover of earnings and profits and certain obligations of the distributor or transferor corporation in certain corporate acquisitions, was published in the Federal Register (25 F.R. 14039). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the regulations under section 381(c)(2) are hereby adopted, subject to the reservation of paragraph (c) of § 1.381(c)(2)-1, which remains outstanding as a notice of proposed rule making, and the addition of

¹ The publication of this Treasury Decision in 26 F.R. 12550, dated December 28, 1961, contains (1) instructions for modifying the notice of proposed rulemaking in 25 F.R. 14039, dated December 31, 1960, and (2) the full context of the regulations with such modifications. As here published, the Treasury Decision reflects the full context of such regulations, with modifications. The individual instructions have been omitted.

a new paragraph (d) as set forth below. The proposed regulations under section 381(c)(16) are also reserved and remain outstanding as a notice of proposed rule making.

The following regulations are hereby prescribed under section 381(c)(2) (carryover of earnings and profits) of the Internal Revenue Code of 1954. Except as otherwise provided therein, such regulations shall apply to liquidations and reorganizations, the tax treatment of which is determined under such Code.

1.381(c)(2) Statutory provisions; carryovers in certain corporate acquisitions; items of the distributor or transferor corporation; earnings and profits.

1.381(c)(2)-1 Earnings and profits.

§ 1.381(c)(2) STATUTORY PROVISIONS; CARRYOVERS IN CERTAIN CORPORATE ACQUISITIONS; ITEMS OF THE DISTRIBUTOR OR TRANSFEROR CORPORATION; EARNINGS AND PROFITS.

SEC. 381. CARRYOVERS IN CERTAIN CORPORATE ACQUISITIONS. * * *

(c) ITEMS OF THE DISTRIBUTOR OR TRANSFEROR CORPORATION.—The items referred to in subsection (a) are:

* * * * *

(2) EARNINGS AND PROFITS.—In the case of a distribution or transfer described in subsection (a)—

(A) The earnings and profits or deficit in earnings and profits, as the case may be, of the distributor or transferor corporation shall, subject to subparagraph (B), be deemed to have been received or incurred by the acquiring corporation as of the close of the date of the distribution or transfer; and

(B) A deficit in earnings and profits of the distributor, transferor, or acquiring corporation shall be used only to offset earnings and profits accumulated after the date of transfer. For this purpose, the earnings and profits for the taxable year of the acquiring corporation in which the distribution or transfer occurs shall be deemed to have been accumulated after such distribution or transfer in an amount which bears the same ratio to the undistributed earnings and profits of the acquiring corporation for such taxable year (computed without regard to any earnings and profits received from the distributor or transferor corporation, as described in subparagraph (A) of this paragraph) as the number of days in the taxable year after the date of distribution or transfer bears to the total number of days in the taxable year.

§ 1.381(c)(2)-1 EARNINGS AND PROFITS.—(a) *In general.*—(1) Section 381(c)(2) requires the acquiring corporation in a transaction to which section 381(a) applies to succeed to, and take into account, the earnings and profits, or deficit in earnings and profits, of the distributor or transferor corporation as of the close of the date of distribution or transfer. In determining the amount of such earnings and profits, or deficit, to be carried over, and the manner in which they are to be used by the acquiring corporation after such date, the provisions of section 381(c)(2) and this section shall apply. For purposes of section 381(c)(2) and this section, if the distributor or transferor corporation accumulates earnings and profits, or incurs a deficit in earnings and profits, after the date of distribution or transfer and before the completion of the reorganization or liquidation, such earnings and profits, or deficit, shall be deemed to have been accumulated or incurred as of the close of the date of distribution or transfer.

(2) If the distributor or transferor corporation has accumulated earnings and profits as of the close of the date of distribution or transfer, such earnings and profits shall (except as hereinafter provided in this section) be deemed to be received by, and to become a part of the accumulated earnings and profits of, the acquiring corporation as of such time. Similarly, if the distributor or transferor corporation has a deficit in accumulated earnings and profits as of the close of the date of distribution or transfer, such deficit shall (except as hereinafter provided in this section) be deemed to be incurred by the acquiring corporation as of such time. In no event, however, shall the accumulated earnings and profits, or deficit, of the distributor or transferor corporation be taken into account in determining earnings and profits of the acquiring corporation for the taxable year during which occurs the date of distribution or transfer.

(3) Any part of the accumulated earnings and profits, or deficit in accumulated earnings and profits, of the distributor or transferor corporation which consists of earnings and profits, or deficits, accumulated before March 1, 1913, shall be deemed to become earnings and profits, or deficits, of the acquiring corporation accumulated before March 1, 1913, and any part of the accumulated earnings and profits of the distributor or transferor corporation which consists of increase in value of property accrued before March 1, 1913, shall be deemed to become earnings and profits of the acquiring corporation consisting of increase in value of property accrued before March 1, 1913.

(4) If the acquiring corporation and each distributor or transferor corporation has accumulated earnings and profits as of the close of the date of distribution or transfer, or if each of such corporations has a deficit in accumulated earnings and profits as of such time, then the accumulated earnings and profits (or deficit) of each such corporation shall be consolidated as of the close of the date of distribution or transfer in the accumulated earnings and profits account of the acquiring corporation. See subparagraph (6) of this paragraph for determination of the accumulated earnings and profits (or deficit) of the acquiring corporation as of the close of the date of distribution or transfer.

(5) If (i) one or more corporations a party to a distribution or transfer has accumulated earnings and profits as of the close of the date of distribution or transfer, and (ii) one or more of such corporations has a deficit in accumulated earnings and profits as of such time, the total of any such deficits shall be used only to offset earnings and profits accumulated, or deemed to have been accumulated under subparagraph (6) of this paragraph, by the acquiring corporation after the date of distribution or transfer. In such instance, the acquiring corporation will be considered as maintaining two separate earnings and profits accounts after the date of distribution or transfer. The first such account shall contain the total of the accumulated earnings and profits as of the close of the date of distribution or transfer of each corporation which has accumulated earnings and profits as of such time, and the second such account shall contain the total of the deficits in accumulated earnings and profits of each corporation which has a deficit as of such time. The total deficit in the second account

may not be used to reduce the accumulated earnings and profits in the first account (although such earnings and profits may be offset by deficits incurred, or deemed to have been incurred, after the date of distribution or transfer) but shall be used only to offset earnings and profits accumulated, or deemed to have been accumulated under subparagraph (6) of this paragraph, by the acquiring corporation after the date of distribution or transfer.

(6) In any case in which it is necessary to compute the accumulated earnings and profits, or the deficit in accumulated earnings and profits, of the acquiring corporation as of the close of the date of distribution or transfer and such date is a day other than the last day of a taxable year of the acquiring corporation—

(i) If the acquiring corporation has earnings and profits for its taxable year during which occurs the date of distribution or transfer, such earnings and profits (a) shall be deemed to have accumulated as of the close of such date in an amount which bears the same ratio to the undistributed earnings and profits of such corporation for such year as the number of days in the taxable year preceding the date following the date of distribution or transfer bears to the total number of days in the taxable year, and (b) shall be deemed to have accumulated after the date of distribution or transfer in an amount which bears the same ratio to the undistributed earnings and profits of such corporation for such year as the number of days in the taxable year following such date bears to the total number of days in such taxable year. For purposes of the preceding sentence, the undistributed earnings and profits of the acquiring corporation for such taxable year shall be the earnings and profits for such taxable year reduced by any distribution made therefrom during such taxable year.

(ii) If the acquiring corporation has an operating deficit for its taxable year during which occurs the date of distribution or transfer, then, unless the actual accumulated earnings and profits, or deficit, as of such date can be shown, such operating deficit shall be deemed to have accumulated in a manner similar to that described in subdivision (i) of this subparagraph.

(7) This paragraph may be illustrated by the following examples, in which it is assumed that none of the accumulated earnings and profits, or deficits, consist of earnings and profits or deficits accumulated, or increase in value of property accrued, before March 1, 1913.

Example (1). (i) M and N Corporations make their returns on the basis of the calendar year. On June 30, 1959, M Corporation transfers all its assets to N Corporation in a statutory merger to which section 361 applies. The books of the two corporations reveal the following information:

Description	M Corporation (transferor)	N Corporation (acquirer)
Accumulated earnings and profits at close of calendar year 1958.....	\$100, 000	\$150, 000
Earnings and profits of taxable year ending June 30, 1959.....	15, 000	-----
Earnings and profits of calendar year 1959.....	-----	36, 500
Distributions during calendar year 1959.....	0	0

(ii) As of the close of June 30, 1959, N acquires from M accumulated earnings and profits of \$115,000. Since M and N each has accumulated earnings and profits as of the close of the date of transfer, M's accumulated earnings and profits are added to N's accumulated earnings and profits as of such time. However, no part of M's accumulated earnings and profits is taken into account in determining N's earnings and profits for the calendar year 1959. Therefore, N's earnings and profits for the calendar year 1959 are \$36,500.

Example (2). (i) X and Y Corporations make their returns on the basis of the calendar year. On June 30, 1959, X Corporation transfers all its assets to Y Corporation in a statutory merger to which section 361 applies. The books of the two corporations reveal the following information:

Description	X Corporation (transferor)	Y Corporation (acquirer)
Accumulated earnings and profits at close of calendar year 1958-----	\$20, 000	\$100, 000
Deficit in earnings and profits for taxable year ending June 30, 1959-----	(80, 000)	-----
Earnings and profits of calendar year 1959-----	-----	36, 500
Distributions during calendar year 1959-----	0	0

(ii) As of the close of June 30, 1959, Y acquires from X a deficit in accumulated earnings and profits in the amount of \$60,000. This deficit may be used only to reduce those earnings and profits of Y which are accumulated, or deemed to have accumulated, after June 30, 1959. Accordingly, as of December 31, 1959, the accumulated earnings and profits of Y amount to \$118,100; at such time Y also has a separate deficit in accumulated earnings and profits in the amount of \$41,600. These amounts are determined as follows:

Accumulated earnings and profits of Y as of the close of 1958-----	\$100, 000
Add:	
Portion of undistributed earnings and profits of Y for 1959 deemed to have accumulated as of close of June 30, 1959 ($\$36,500 \times 181/365$)-----	18, 100
Accumulated earnings and profits of Y as of close of June 30, 1959, and also as of December 31, 1959-----	118, 100
Portion of undistributed earnings and profits of Y for 1959 deemed to have accumulated after June 30, 1959 ($\$36,500 \times 184/365$)-----	18, 400
Less:	
Deficit in accumulated earnings and profits acquired by Y from X Corporation as of close of June 30, 1959-----	(\$60, 000)
Separate deficit in accumulated earnings and profits of Y as of December 31, 1959-----	(41, 600)

Example (3). Assume the same facts as in example (2), except that on September 15, 1959, Y Corporation makes a cash distribution of \$96,500. The entire distribution is a dividend: \$36,500 from earnings and profits for the taxable year 1959 and \$60,000 from earnings and profits accumulated as of December 31, 1958. Accordingly, as of December 31, 1959, Y has accumulated earnings and profits of \$40,000, and also has a separate deficit in accumulated earnings and profits of \$60,000. These amounts are determined as follows:

Earnings and profits of Y for calendar year 1959.....	\$36,500
Accumulated earnings and profits of Y as of close of 1958.....	100,000
Total.....	136,500
Less:	
Distributions during 1959.....	96,500
Accumulated earnings and profits of Y as of December 31, 1959.....	40,000
Deficit in accumulated earnings and profits acquired from X as of close of June 30, 1959.....	(60,000)
Less:	
Portion of Y's undistributed earnings and profits for 1959 deemed to have accumulated after June 30, 1959.....	0
Separate deficit in accumulated earnings and profits of Y as of December 31, 1959.....	(60,000)

Example (4). (i) M and N Corporations make their returns on the basis of the calendar year. On June 30, 1959, M Corporation transfers all its assets to N Corporation in a statutory merger to which section 361 applies. The books of the two corporations reveal the following information:

Description	M Corporation (transferor)	N Corporation (acquirer)
Accumulated earnings and profits at close of calendar year 1958.....	\$100,000	\$50,000
Earnings and profits for taxable year ending June 30, 1959.....	10,000	
Deficit in earnings and profits for calendar year 1959.....		(146,000)
Distributions during calendar year 1959.....	0	0

(ii) Assuming that N has not shown its actual accumulated earnings and profits, or deficit, as of the close of June 30, 1959, N has a deficit in accumulated earnings and profits at such time which amounts to \$22,400, determined as follows:

Accumulated earnings and profits of N as of close of 1958.....	\$50,000
Less:	
Portion of deficit in earnings and profits of N for 1959 deemed to have accumulated as of close of June 30, 1959 ($\$146,000 \times 181/365$)	(72,400)
Deficit in accumulated earnings and profits of N as of close of June 30, 1959, and also as of December 31, 1959.....	(22,400)

As of the close of June 30, 1959, N acquires from M accumulated earnings and profits in the amount of \$110,000, no part of which may be offset by N's own deficit of \$22,400; however, such earnings and profits may be offset by deficits incurred, or deemed incurred, by N after June 30, 1959. Thus, as of December 31, 1959, N has the above-mentioned deficit of \$22,400; at such time N also has accumulated earnings and profits in the amount of \$36,400, determined as follows:

Accumulated earnings and profits acquired from M as of close of June 30, 1959.....	\$110,000
Less:	
Portion of deficit in earnings and profits of N for 1959 deemed to have accumulated after June 30, 1959 ($\$146,000 \times 184/365$)	(73,500)
Accumulated earnings and profits of N as of December 31, 1959.....	36,400

Example (5). Assume the same facts as in example (4), except that on September 9, 1959, N Corporation makes a cash distribution of \$100,000. The amount of \$82,000 is a dividend from accumulated earnings and profits, computed as follows:

Accumulated earnings and profits acquired from M as of close of June 30, 1959-----	\$110,000
Less:	
Deficit in earnings and profits of N for 1959 deemed to have accumulated from June 30 through September 8, 1959 ($\$146,000 \times 70/365$) -----	(28,000)
Accumulated earnings and profits as of close of September 8, 1959----	82,000
As of December 31, 1959, N Corporation has a deficit in accumulated earnings and profits of \$68,000, computed as follows:	
Deficit in accumulated earnings and profits of N as of close of June 30, 1959-----	(\$22,400)
Add:	
Portion of N's deficit in earnings and profits for 1959 deemed to have accumulated after September 8, 1959 ($\$146,000 \times 11\frac{1}{2}/365$) --	(45,600)
Deficit in accumulated earnings and profits of N as of December 31, 1959-----	(68,000)

Example (6). (i) X, Y, and Z Corporations make their returns on the basis of the calendar year. On June 30, 1959, X Corporation and Y Corporation transfer all their assets to Z Corporation in a statutory merger to which section 361 applies. The books of the three corporations reveal the following information:

Description	X Corporation (transferor)	Y Corporation (transferor)	Z Corporation (acquirer)
Accumulated earnings and profits (or deficit) at close of calendar year 1958-----	\$35,000	(\$25,000)	(\$20,000)
Earnings and profits (or deficit) for taxable year ended June 30, 1959----	5,000	(5,000)	-----
Earnings and profits for calendar year 1959-----			36,500
Distributions during 1959-----	0	0	0

(ii) As of the close of June 30, 1959, Z acquires from Y a deficit in accumulated earnings and profits of \$30,000. As of such time, Z's own deficit in accumulated earnings and profits amounts to \$1,900, determined as follows:

Deficit in accumulated earnings and profits of Z as of close of 1958----	(\$20,000)
Less:	
Portion of undistributed earnings and profits of Z for 1959 deemed to have accumulated as of close of June 30, 1959 ($\$36,500 \times 181/365$)-----	18,100
Deficit in accumulated earnings and profits as of close of June 30, 1959--	(1,900)

The total deficit of \$31,900 may be used only to offset earnings and profits of Z accumulated, or deemed to have accumulated, after June 30, 1959; such deficit may not be used to reduce the accumulated earnings and profits of \$40,000 acquired from X as of the close of June 30, 1959. Thus, as of December 31, 1959, the accumulated earnings and

profits of Z amount to \$40,000; at such time Z Corporation also has a separate deficit in accumulated earnings and profits in the amount of \$13,500, determined as follows:

Deficit in accumulated earnings and profits as of close of June 30, 1959_ (\$31, 900)
Less:

Portion of undistributed earnings and profits of Z for 1959 deemed
to have accumulated after June 30, 1959 ($\$36,500 \times 184/365$)_--- 18, 400

Separate deficit in accumulated earnings and profits as of December 31,
1959_----- (13, 500)

Example (7). X and Y Corporations make their returns on the basis of the calendar year. On December 31, 1954, X transfers all its assets to Y in a statutory merger to which section 361 applies. The books of the two corporations reveal the following information:

Description	X Corporation (transferor)	Y Corporation (acquirer)
Accumulated earnings and profits (or deficit) at close of calendar year 1954_-----	(\$50, 000)	\$210, 000
Earnings and profits (or deficit) for calendar year—		
1955_-----		5, 000
1956_-----		(20, 000)
1957_-----		70, 000
1958_-----		60, 000
1959_-----		55, 000
Cash distributions on—		
September 1, 1957_-----		80, 000
September 1, 1958_-----		40, 000
September 1, 1959_-----		30, 000

The balances in the accumulated earnings and profits account and the separate deficit account of Y Corporation at the close of the taxable year involved are as follows:

Year	Deficit acquired from X Corpo- ration	Accumulated earnings and profits of Y Corporation
1954_-----	(\$50, 000)	\$210, 000
1955_-----	(45, 000)	210, 000
1956_-----	(45, 000)	190, 000
1957_-----	(45, 000)	180, 000
1958_-----	(25, 000)	180, 000
1959_-----	None	180, 000

(b) SUCCESSIVE ACQUISITIONS.—(1) If, as of the date of distribution or transfer, either the acquiring corporation, or the distributor or transferor corporation, or both, is considered under paragraph (a) of this section to be maintaining separate earnings and profits accounts as the result of a prior transaction or transactions to which section 381(a) applied, the accumulated earnings and profits, or deficit in accumulated earnings and profits, of each such corporation shall be combined with the appropriate earnings and profits account of the other such corporation. For example, if, as of the date of transfer, the

acquiring corporation and the transferor corporation are each maintaining separate accounts, one containing accumulated earnings and profits and the other containing a deficit in accumulated earnings and profits, the amounts in the two accumulated earnings and profits accounts shall be combined into one account, and the amounts in the two deficit accounts shall be combined into a second account, and the amount in one combined account may not be used to offset the amount in the other combined account.

(2) This paragraph may be illustrated by the following examples, in which it is assumed that none of the accumulated earnings and profits, or deficits, consist of earnings and profits or deficits accumulated, or increase in value of property accrued, before March 1, 1913.

Example (1). (i) X, Y, and Z Corporations make their returns on the basis of the calendar year. On June 30, 1958, X Corporation transfers all its assets to Z Corporation in a statutory merger to which section 361 applies, and on August 31, 1958, Y Corporation transfers all its assets to Z Corporation in another statutory merger to which section 361 applies. The books of the three corporations reveal the following information:

Description	X Corporation (transferor)	Y Corporation (transferor)	Z Corporation (acquirer)
Accumulated earnings and profits (deficit) at close of calendar year 1957-----	(\$40, 000)	\$10, 000	\$60, 000
Deficit in earnings and profits for taxable year ending June 30, 1958-----	(5, 000)	-----	-----
Earnings and profits for taxable year ending August 31, 1958-----	-----	2, 000	-----
Earnings and profits of calendar year 1958-----	-----	-----	36, 500
Distributions during calendar year 1958-----	0	0	0

(ii) As of the close of June 30, 1958, Z acquires from X a deficit in accumulated earnings and profits in the amount of \$45,000, which deficit may be used only to reduce those earnings and profits of Z which are accumulated, or deemed to have been accumulated, after June 30, 1958. As of the close of August 31, 1958, Z acquires from Y earnings and profits of \$12,000, no portion of which may be reduced by the deficit acquired by Z from X. Accordingly, as of December 31, 1958, Z has accumulated earnings and profits of \$90,100, and also has a separate deficit in accumulated earnings and profits of \$26,600. These amounts are determined as follows:

Accumulated earnings and profits of Z as of December 31, 1957-----	\$60, 000
Add:	
Portion of undistributed earnings and profits of Z for 1958 deemed to have accumulated as of close of June 30, 1958 ($\$36,500 \times \frac{18\frac{1}{2}}{365}$)-----	18, 100
Accumulated earnings and profits of Z as of June 30, 1958-----	78, 100
Add:	
Accumulated earnings and profits acquired by Z from Y as of close of August 31, 1958-----	12, 000

Accumulated earnings and profits of Z as of close of August 31, 1958, and also as of December 31, 1958-----	90, 100
Deficit in accumulated earnings and profits acquired by Z from X as of close of June 30, 1958-----	(45, 000)
Less: Portion of undistributed earnings and profits of Z for 1958 deemed to have accumulated from June 30 through August 31, 1958 (\$36,500 × $\frac{62}{365}$) -----	6, 200
Separate deficit in accumulated earnings and profits of Z as of Au- gust 31, 1958-----	(38, 800)
Less: Portion of undistributed earnings and profits of Z for 1958 deemed to have accumulated after August 31, 1958 (\$36,500 × $\frac{122}{365}$) ---	12, 200
Separate deficit in accumulated earnings and profits of Z as of Decem- ber 31, 1958-----	(26, 600)

Example (2). (i) Assume the same facts as in example (1), plus the additional fact that on June 30, 1959, Z Corporation transfers all its assets to M Corporation (which makes its return on the basis of the calendar year) in a statutory merger to which section 361 applies, and that as of such time M Corporation is considered to be maintaining separate earnings and profits accounts as the result of a previous transaction to which section 381 (a) applied. The books of the two corporations reveal the following information:

Description	Z Corporation (transferor)	M Corporation (acquirer)
Accumulated earnings and profits as of December 31, 1958-----	\$90, 100	\$50, 000
Separate deficit in accumulated earnings and profits as of December 31, 1958-----	(26, 600)	(30, 000)
Earnings and profits for taxable year ending June 30, 1959-----	5, 000	36, 500
Earnings and profits of calendar year 1959-----	0	0
Distributions during 1959-----		

(ii) As of June 30, 1959, M acquires from Z accumulated earnings and profits of \$90,100, which amount is combined with M's own accumulated earnings and profits of \$50,000; M also acquires from Z a deficit in accumulated earnings and profits of \$21,600 (\$26,600 minus \$5,000), which amount is combined with M's own deficit of \$11,900. The total deficit of \$33,500 may be used only to reduce earnings and profits of M which are accumulated, or deemed to have accumulated, after June 30, 1959. Accordingly, as of December 31, 1959, M has accumulated earnings and profits of \$140,100, and also has a separate deficit in accumulated earnings and profits in the amount of \$15,100. These amounts are determined as follows:

Deficit of M as of December 31, 1958-----	(\$30,000)
Less:	
Portion of M's undistributed earnings and profits for 1959 deemed to have accumulated as of close of June 30, 1959 (\$36,500 × 181/365) -----	18,100
Deficit of M as of June 30, 1959-----	(11,900)
Plus:	
Deficit of Z as of June 30, 1959-----	(21,600)
Combined deficit of M as of close of June 30, 1959-----	(33,500)
Less:	
Portion of M's undistributed earnings and profits for 1959 deemed to have accumulated after June 30, 1959 (\$36,500 × 184/365) --	18,400
Separate deficit of M as of December 31, 1959-----	(15,100)
Accumulated earnings and profits of Z as of December 31, 1958, and also as of June 30, 1959-----	50,000
also as of June 30, 1959-----	90,100
Combined accumulated earnings and profits of M as of close of June 30, 1959, and also as of December 31, 1959-----	140,100

(c) *Distribution of earnings and profits pursuant to reorganization or liquidation.* [Reserved]

(d) *Treatment of earnings and profits where assets are transferred to a corporation controlled by the acquiring corporation.* If, pursuant to the provisions of paragraph (b) (2) of § 1.381(a)-1, a corporation is considered to be the acquiring corporation even though a part of the acquired assets is transferred to one or more corporations controlled by the acquiring corporation, or all the acquired assets are transferred to two or more corporations controlled by the acquiring corporation, then whether any portion of the earnings and profits received by the acquiring corporation under section 381(c)(2) is allocable to such controlled corporation or corporations shall be determined without regard to section 381. See paragraph (a) of § 1.312-11.

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

MORTIMER M. CAPLIN,
Commissioner of Internal Revenue.

Approved December 21, 1961.

STANLEY S. SURREY,
Assistant Secretary of the Treasury.

(Filed by the Division of the Federal Register on December 27, 1961, 8:50 a.m., and published in the issue of the Federal Register for December 28, 1961, 26 F.R. 12550)

SUBCHAPTER D.—DEFERRED COMPENSATION, ETC.

PART I.—PENSION, PROFIT-SHARING, STOCK BONUS PLANS, ETC.

SECTION 404.—DEDUCTION FOR CONTRIBUTIONS OF AN EMPLOYER TO AN EMPLOYEES' TRUST OR ANNUITY PLAN AND COMPENSATION UNDER A DEFERRED-PAYMENT PLAN

26 CFR 1.404(a)-2: Information to be furnished T. D. 6599¹
by employer claiming deductions.

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

Amendment of the Income Tax Regulations under section 404
of the Internal Revenue Code of 1954, relating to the filing of certain
information.

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

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

On January 5, 1962, notice of proposed rulemaking with respect to the amendment of paragraphs (a) (7), (8), and (9), (b), (c) (d), and (e) of § 1.404(a)-2 of the Income Tax Regulations (26 CFR Part 1) under section 404 of the Internal Revenue Code of 1954 was published in the Federal Register (27 F.R. 106). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the following amendment of the regulations is hereby adopted for taxable years beginning after December 31, 1953, and ending after August 16, 1954, as follows.

§ 1.404(a)-2 INFORMATION TO BE FURNISHED BY EMPLOYER CLAIMING DEDUCTIONS.—(a) * * *

(7) If a pension or annuity plan, a detailed description of all the methods, factors, and assumptions used in determining costs and in adjusting the costs for actual experience under the plan (including any loadings, contingency reserves, or special factors and the basis of any insured costs or liabilities involved therein) explaining their source and application in sufficient detail to permit ready analysis and verification thereof, and, in the case of a trust, a detailed description of the basis used in valuing the investments held.

(8) A statement of the applicable limitations under section 404(a) (1), (2), (3), or (7) and an explanation of the method of determining such limitations, a summary of the data, and a statement of computations necessary to determine the allowable deductions for the taxable year. Also, in the case of a pension or annuity plan, a summary of the costs or liabilities and adjustments for the year under the plan based on the application of the methods, factors, and assumptions used under the plan, in sufficient detail to permit ready verification of the reasonableness thereof.

(9) A statement of the contributions paid under the plan for the taxable year showing the date and amount of each payment. Also, a summary of the deductions claimed for the taxable year for the plan with a breakdown of the deductions claimed into the following components:

¹ The publication of this Treasury Decision in 27 F.R. 4474, dated May 10, 1962, contains (1) instructions for modifying the notice of proposed rulemaking published in 27 F.R. 106, dated January 5, 1962, and (2) the full context of the regulations with such modifications. As here published, the Treasury Decision reflects the full context of such regulations, with modifications. The individual instructions have been omitted.

(i) For contributions paid in the taxable year before giving effect to the provisions of paragraph (7) of section 404(a).

(ii) For contributions paid in prior taxable years beginning after December 31, 1941, in accordance with the carryover provisions of paragraphs (1) and (3) of section 404(a), before giving effect to the provisions of paragraph (7) thereof, and in accordance with the carryover provisions of section 404(d).

(iii) Any reductions or increases in the deductions in accordance with the provisions of paragraph (7) of section 404(a). However, if the information in this subdivision is filed prior to the filing of the information required by subparagraph (8) of this paragraph, then, in determining the limit of deduction under paragraph (7) of section 404(a), the applicable percentage of the compensation otherwise paid or accrued during the year may be used.

(b) For taxable years subsequent to the year for which all of the applicable information under paragraph (a) of this section (or corresponding provisions of prior regulations) has been filed, information is to be filed only to the following extent:

(1) If there is any change in the plan, instruments, methods, factors, or assumptions upon which the data and information specified in paragraph (a) (1), (2), or (7) of this section are based, a detailed statement explaining the change and its effect is to be filed only for the taxable year in which the change is put into effect. However, if there is no such change, unless otherwise requested by the district director, merely a statement that there is no such change is to be filed.

(2) The information specified in paragraph (a) (3) of this section which has been filed for a taxable year, unless otherwise requested by the district director and so long as the plan and the method and basis of allocations are not changed, is to be filed for subsequent years only to the extent of showing in the tabulation such information with respect to employees who, at any time in the taxable year, own, directly or indirectly, more than 5 percent of the voting stock, considering stock so owned by an individual's spouse or minor lineal descendant as owned by the individual for this purpose.

(3) The information specified in paragraph (a) (4), (5), (6), (8), and (9) of this section.

In the case of corporate employers, the information required to be submitted by this paragraph shall, except as otherwise provided by the Commissioner, be filed on Form 2950 for taxable years ending on or after December 31, 1961. In the case of other employers, the information required to be submitted by this paragraph shall, except as otherwise provided by the Commissioner, be filed on Form 2950 for taxable years ending on or after December 31, 1962.

(c) If a deduction is claimed under section 404(a) (5) for the taxable year, the taxpayer shall furnish such information as is necessary to show that the deduction is not allowable under the other paragraphs of section 404(a), that the amount paid is an ordinary and necessary expense or an expense for the production of income, and that the employees' rights to, or derived from, such employer's contribution or such compensation were nonforfeitable at the time the contribution or compensation was paid. In the case of corporate employers, the information required to be submitted by this paragraph shall, except as otherwise provided by the Commissioner, be filed on Form 2950 for taxable years ending on or after December 31, 1961. In the case of other employers, the information required to be submitted by this paragraph shall, except as otherwise provided by the Commissioner, be filed on Form 2950 for taxable years ending on or after December 31, 1962.

(d) For the purpose of the information required by this section, contributions paid in a taxable year shall include those deemed to be so paid in accordance with the provisions of section 404(a) (6) and shall exclude those deemed to be paid in the prior taxable year in accordance with such provisions. As used in this section, "taxable year" refers to the taxable year of the employer and, unless otherwise requested by the district director, a "year" which is not specified as a "taxable year" may be taken as the taxable year of the employer or as the plan, trust, valuation, or group contract year with respect to which deductions are being claimed provided the same rule is followed consistently so that there is no gap or overlap in the information furnished for each item. In any case the date or period to which each item of information furnished relates should be clearly shown. All the information required by this section should be filed with the tax return for the taxable year in which the deduction is claimed,

except that, unless sooner requested by the district director, such information, other than that specified in paragraph (a) (4) (i) and (9) of this section, may be filed within 12 months after the close of the taxable year provided there is filed with the tax return a statement that the information cannot reasonably be filed therewith, setting forth the reasons therefor.

(e) In any case all the information and data required by this section must be filed in the office of the district director in which the employer files his tax returns and must be filed independently of any information and data otherwise submitted in connection with a determination of the qualification of the trust or plan under section 401(a). The district director may, in addition, require any further information that he considers necessary to determine allowable deductions under section 404 or qualification under section 401. For taxable years ending on or before December 31, 1961, the district director may waive the filing of such information required by this section which he finds unnecessary in a particular case. For taxable years ending after December 31, 1961, the Commissioner may waive the filing of such information.

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

BERTRAND M. HARDING,
Acting Commissioner of Internal Revenue.

Approved May 7, 1962.

STANLEY S. SURREY,
Assistant Secretary of the Treasury.

(Filed by the Division of the Federal Register on May 9, 1962, 8:48 a.m., and published in the issue of the Federal Register for May 10, 1962, 27 F.R. 4474)

PART II.—MISCELLANEOUS PROVISIONS

SECTION 421.—EMPLOYEE STOCK OPTIONS

26 CFR 1.421-4: Modification, extension, or renewal. Rev. Rul. 62-86

For purposes of section 421(e) (1) of the Internal Revenue Code of 1954, relating to modification, extension, or renewal of employee stock options, the monthly average fair market values of a corporation's capital stock may be determined by (1) computing averages based on the mean between the high and the low daily prices of the stock on a stock exchange, or (2) by computing averages based on the daily closing price of such stock on a stock exchange. However, secondary distributions of stock shall be taken into account.

Advice has been requested whether the monthly average fair market value of a corporation's stock may be determined by either, or both, of the valuation methods described below for purposes of section 421(e) (1) of the Internal Revenue Code of 1954, relating to modification, extension, or renewal of employee stock options.

A corporation granted stock options to certain of its employees on various dates during prior taxable years to permit them to purchase shares of the corporate capital stock. At the time granted, all of the options qualified as restricted stock options as defined by section 421(d) (1) of the Code.

The corporation now proposes to grant new options in substitution for the old options since the value of the corporation's stock on a

stock exchange is substantially below the option price under the original options and the original options thus are without value as a means of creating an incentive for the corporation's employees.

Section 421(d)(1)(A) of the Code provides, in part, that in order to constitute a "restricted stock option" (other than a variable price option), the option price at the time the option is granted must be at least 85 percent of the fair market value at such time of the stock subject to the option.

Section 421(e)(1)(A) provides that the modification, extension, or renewal of an existing stock option shall be considered a granting of a new option. Section 421(e)(1)(B) provides that the fair market value of the stock subject to the new option at the time of granting such option shall be (1) the fair market value of such stock on the date of the original granting of the option, (2) the fair market value of such stock on the day of the making of the modification, extension, or renewal, or (3) the fair market value of such stock at the time of the making of any intervening modification, extension, or renewal, whichever is the highest.

However, section 421(e)(1)(B) does not apply if the aggregate of the monthly average fair market values of the stock subject to the option for the 12 consecutive calendar months before the date of the modification, extension, or renewal, divided by 12, is an amount less than 80 percent of the fair market value of such stock on the date of the original granting of the option or the date of the making of any intervening modification, extension, or renewal, whichever is the highest.

For the purposes of qualification under the above provisions, the corporation proposes the possible use of two methods of computing the monthly average fair market value of its stock. The two valuation methods are (1) multiplying the mean between the high and low prices for such stock on a stock exchange for each trading day during the month by the number of shares sold during such day, adding the daily amounts so determined and dividing the sum thereof by the total number of shares of such stock sold on the exchange during the month; or (2) multiplying the closing price for such stock on a stock exchange for each trading day during the month by the number of shares sold during such day, adding the daily amounts so determined and dividing the sum thereof by the total number of shares of such stock sold on the exchange during the month.

Section 1.421-4(b)(3)(i) of the Income Tax Regulations provides, in part, that in the case of stock listed on a stock exchange, the average fair market value of the stock for any month may be determined by adding the highest and lowest quoted selling prices during such month and dividing the sum by two.

Section 1.421-2(a)(5) of the regulations provides that any reasonable valuation method may be used in determining whether at the time the option is granted the option price is at least 85 percent of the fair market value at such time of the stock subject to the option, and that such methods include the valuation methods described in section 20.2031-2 of the Estate Tax Regulations.

The purpose of the above-cited regulations is to allow flexibility in determining the fair market value of stock subject to options. It is recognized that the method described in section 1.421-4(b)(3) of the

regulations may not reflect most accurately the value of stock during a particular month but, since the monthly average must be determined for a period of 12 months, as required by section 421(e) (1) of the Code, such method is considered sufficiently reliable in the case of a stock which is listed on a stock exchange. However, it does not follow that a taxpayer is required to use only the valuation methods described or referred to in sections 1.421-4(b) (3) and 1.421-2(a) (5) of the regulations.

Based on the facts of the instant case, it is held that the monthly average fair market values of the stock subject to the new options may be determined under either of the above described valuation methods for purposes of section 421(e) (1) of the Code, but the taxpayer should maintain his records in sufficient detail to permit substantiation of his computations.

Whichever method the taxpayer uses for any one month must be used for all 12 months, except where it is shown that such method cannot be used for any month, or does not clearly reflect the average fair market value of the stock for any such month. See section 1.421-4(b) (3) (i) of the regulations.

For the purpose of the foregoing rules, secondary distributions of stock shall be taken into account.

SUBCHAPTER E.—ACCOUNTING PERIODS AND METHODS OF ACCOUNTING

PART II.—METHODS OF ACCOUNTING

Subpart A.—Methods of Accounting in General

SECTION 446.—GENERAL RULE FOR METHODS OF ACCOUNTING

26 CFR 1.446-1: General rule for methods of accounting. T.D. 6584¹

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

Amendment of the regulations under section 446 of the Internal Revenue Code of 1954.

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

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

In order to amend the Income Tax Regulations (26 CFR Part 1) to require the use of Form 3115 by taxpayers requesting permission to change their method of accounting under section 446(e) of the Internal Revenue Code of 1954, paragraph (e) (3) of § 1.446-1 of such regulations is hereby amended to read as follows:

¹ 26 F.R. 12216.

§ 1.446-1 GENERAL RULE FOR METHODS OF ACCOUNTING.

* * * * *

(e) *Requirement respecting the adoption or change of accounting method.* * * *

(3) In order to secure the Commissioner's consent to a change of a taxpayer's method of accounting, the taxpayer must file an application on Form 3115 with the Commissioner of Internal Revenue, Washington 25, D.C., within 90 days after the beginning of the taxable year in which it is desired to make the change. The taxpayer shall, to the extent applicable, furnish all information requested on such form, disclosing in detail all classes of items which would be treated differently under the new method of accounting and showing all amounts which would be duplicated or omitted as a result of the proposed change. The Commissioner may require such other information as may be necessary in order to determine whether the proposed change will be permitted. Permission to change a taxpayer's method of accounting will not be granted unless the taxpayer and the Commissioner agree to the terms, conditions, and adjustments under which the change will be effected. See section 481 and the regulations thereunder, relating to certain adjustments required by such changes, section 472 and the regulations thereunder, relating to changes to and from the last-in, first-out method of inventorying goods, and section 453 and the regulations thereunder, relating to certain adjustments required by a change from an accrual method to the installment method.

Because this Treasury Decision merely changes the procedure for the submission of certain information, it is found that it is unnecessary to issue this Treasury Decision with notice and public procedure thereon under section 4(a) of the Administrative Procedure Act, approved June 11, 1946, or subject to the effective date limitation of section 4(c) of said Act.

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

MORTIMER M. CAPLIN,
Commissioner of Internal Revenue.

Approved December 15, 1961.

STANLEY S. SURREY,
Assistant Secretary of the Treasury.

(Filed by the Division of the Federal Register on December 20, 1961, 8:49 a.m., and published in the issue of the Federal Register for December 21, 1961, 26 F.R. 12216)

Subpart B.—Taxable Year for Which Items of Gross Income Included

SECTION 451.—GENERAL RULE FOR TAXABLE YEAR OF INCLUSION

26 CFR 1.451-1: General rule for taxable year of inclusion.
(Also Section 74; 1.74-1.)

Rev. Rul. 62-74

A taxpayer was awarded a prize in the amount of $12x$ dollars. Pursuant to terms of the contest, established prior to time the winner was chosen, the contest sponsor placed $12x$ dollars in a noninterest-bearing escrow account to be paid to the winner as follows: $2.5x$ dollars immediately, $5x$ dollars four months later, and $4.5x$ dollars one year after the payment of the second installment. The taxpayer uses the cash receipts and disbursements method of accounting. *Held*, the discounted value of the right to receive future

payments from the escrow account is includible in the taxpayer's gross income for the taxable year in which the prize was awarded. The excess of future payments received over the discounted value is includible in the taxpayer's gross income for the taxable years in which received.

Advice has been requested with respect to the treatment for Federal income tax purposes of a cash prize won and to be paid under the circumstances described below.

The taxpayer was awarded a prize in the amount of $12x$ dollars. Pursuant to the terms of the contest, which were issued before the winner was chosen, the contest sponsor placed the $12x$ dollars in a noninterest-bearing escrow account to be paid to the winner as follows: $2.5x$ dollars immediately, $5x$ dollars four months later, and $4.5x$ dollars one year after payment of the second installment. The taxpayer uses the cash receipts and disbursements method of accounting.

Section 74 of the Internal Revenue Code of 1954 provides, in part, that gross income includes amounts received as prizes and awards, with certain exceptions not pertinent here.

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

In *E. T. Sproull v. Commissioner*, 16 T.C. 244, affirmed, 194 Fed. (2d) 541, the court held, in determining the taxable year of inclusion of an amount placed in a trust established in 1945 but to be paid to the taxpayer in later years, that though the doctrine of constructive receipt was not applicable, still the entire amount was the measure of the economic benefit conferred on the taxpayer in 1945. The court stated, in part, as follows:

The question then becomes * * * was "any economic or financial benefit conferred on the employee as compensation" in the taxable year. If so, it was taxable to him in that year. This question we must answer in the affirmative. The employer's part of the transaction terminated in 1945. It was then that the amount of the compensation was fixed * * * and irrevocably paid out for the petitioner's sole benefit * * *.

The only substantial difference between the *Sproull* case and the instant situation is that in the former interest was to be paid to the taxpayer with the last installment of trust principal. In this case, no interest is to accrue to the benefit of the taxpayer. Therefore, unlike the *Sproull* case, the present value of the fund to the taxpayer is not equivalent to the amount paid over for his benefit, but, rather, is equivalent to the $2.5x$ dollars paid to him immediately plus the discounted value of the future payments to be received.

The interest factor to be used in arriving at the present discounted value of the right to receive payments in the future may be determined by reference to section 20.2031-7 of the Estate Tax Regulations. The difference between this discounted value and the full amount of future payments is includible in the taxpayer's gross income for the taxable years the payments are received in the proportion dictated by the projected interest. Thus, the aggregate of the amounts attributable to the prize which are presently and ultimately includible in the taxpayer's gross income should be exactly $12x$ dollars.

Based upon the specific facts of this case, it is held that the discounted value of the right to receive future payments from the escrow account is includible in the taxpayer's gross income for the taxable year in which the prize was awarded. The excess of future payments received over the discounted value is includible in the taxpayer's gross income for the taxable years in which received.

SECTION 453.—INSTALLMENT METHOD

26 CFR 1.453: Statutory provisions;
installment method.

T. D. 6590 ¹

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

Amendment of the Income Tax Regulations under section 453 of the Internal Revenue Code of 1954 to conform to section 27 of the Technical Amendments Act of 1958.

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

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

On November 4, 1961, notice of proposed rule making with respect to the amendments of the Income Tax Regulations (26 CFR Part 1) under section 453 of the Internal Revenue Code of 1954 to conform the regulations to the change made by section 27 of the Technical Amendments Act of 1958 (72 Stat. 1624) [C.B. 1958-3, 254] was published in the Federal Register (26 F.R. 10450). No comments on the rules proposed having been received during the thirty-day period prescribed by the notice, the amendments of the regulations as proposed are hereby adopted.

PARAGRAPH 1.—Section 1.453 is amended by adding a new paragraph (5) to section 453(d), and by adding a historical note. These added provisions read as follows:

§ 1.453 STATUTORY PROVISIONS; INSTALLMENT METHOD.

SEC. 453. INSTALLMENT METHOD.— * * *

(d) GAIN OR LOSS ON DISPOSITION OF INSTALLMENT OBLIGATIONS.— * * *

(5) LIFE INSURANCE COMPANIES.—In the case of a disposition of an installment obligation by any person other than a life insurance company (as defined in section 801(a)) to such an insurance company or to a partnership of which such an insurance company is a partner, no provision of this subtitle providing for the nonrecognition of gain shall apply with respect to any gain resulting under paragraph (1). If a corporation which is a life insurance company for the taxable year was (for the preceding taxable year) a corporation which was not a life insurance company, such corporation shall, for purposes of this paragraph and paragraph (1), be treated as having transferred to a life insurance company, on the last day of the preceding taxable year, all installment obligations which it held on such last day. A partnership of which a life insurance company becomes a partner shall, for purposes of this paragraph and paragraph (1), be treated as having transferred to a life in-

¹ 27 F.R. 1319.

surance company, on the last day of the preceding taxable year of such partnership, all installment obligations which it holds at the time such insurance company becomes a partner.

[Sec. 453 as amended by sec. 27, Technical Amendments Act 1958 (72 Stat. 1624) [C.B. 1958-3, 254]]

PAR. 2. Section 1.453-9 is amended by adding at the end thereof the following new paragraph:

§ 1.453-9 GAIN OR LOSS ON DISPOSITION OF INSTALLMENT OBLIGATIONS.

* * * * *

(g) *Disposition of installment obligations to life insurance companies.*—(1) Notwithstanding the provisions of section 453(d)(4) and paragraph (c) of this section or any provision of subtitle A relating to the nonrecognition of gain, the entire amount of any gain realized on the disposition of an installment obligation by any person, other than a life insurance company (as defined in section 801(a) and paragraph (b) of § 1.801-3), to a life insurance company or to a partnership of which a life insurance company is a partner shall be recognized and treated in accordance with section 453(d)(1) and paragraphs (a) and (b) of this section. If a corporation which is a life insurance company for the taxable year was a corporation which was not a life insurance company for the preceding taxable year, such corporation shall be treated, for purposes of section 453(d)(1) and this paragraph, as having transferred to a life insurance company, on the last day of the preceding taxable year, all installment obligations which it held on such last day. The gain, if any, realized by reason of the installment obligations being so transferred shall be recognized and treated in accordance with section 453(d)(1) and paragraphs (a) and (b) of this section. Similarly, a partnership of which a life insurance company becomes a partner shall be treated, for purposes of section 453(d)(1) and this paragraph as having transferred to a life insurance company, on the last day of the preceding taxable year of such partnership, all installment obligations which it holds at the time such life insurance company becomes a partner. The gain, if any, realized by reason of the installment obligations being so transferred shall be recognized and treated in accordance with section 453(d)(1) and paragraphs (a) and (b) of this section.

(2) The provisions of section 453(d)(5) and subparagraph (1) of this paragraph shall not apply to losses sustained in connection with the disposition of installment obligations to a life insurance company.

(3) For the effective date of the provisions of section 453(d)(5) and this paragraph, see paragraph (f) of § 1.453-10.

(4) Application of the provisions of this paragraph may be illustrated by the following examples:

Example (1). A, an individual, in a transaction to which section 351 applies, transfers in 1961 certain assets, including installment obligations, to a new corporation, X, which qualifies as a life insurance company (as defined in section 801(a)) for the year 1961. A makes his return on the calendar year basis. Section 453(d)(5) provides that the nonrecognition provisions of section 351 will not apply to the installment obligations transferred by A to X Corporation. Therefore, the entire amount of any gain realized by A on the transfer of the installment obligations shall be recognized in 1961, with the amount of any such gain computed in accordance with the provisions of section 453(d)(1) and paragraph (b) of this section.

Example (2). The M Corporation did not qualify as a life insurance company (as defined in section 801(a)) for the taxable year 1958. On December 31, 1958, it held \$60,000 of installment obligations. The M Corporation qualified as a life insurance company for the taxable year 1959. Accordingly, the M Corporation is treated as having transferred to a life insurance company, on December 31, 1958, the \$60,000 of installment obligations it held on such date. The gain, if any, realized by M by reason of such installment obligations being so transferred shall be recognized in the taxable year 1958, with the amount of any such gain computed in accordance with the provisions of section 453(d)(1) and paragraph (b) of this section.

Example (3). During its taxable year 1958, none of the partners of the N partnership qualified as a life insurance company (as defined in section 801(a)). The N partnership held \$30,000 of installment obligations on December 31, 1958. On July 30, 1959, the O Corporation, a life insurance company (as defined in

section 801(a)), became a partner in the partnership. The N partnership held \$50,000 of installment obligations on July 30, 1959. Pursuant to section 453(d) (5), the N partnership is treated as having transferred to a life insurance company, on December 31, 1958, the \$50,000 of installment obligations it held on July 30, 1959. The gain, if any, realized by the N partnership by reason of such installment obligations being so transferred shall be recognized in the taxable year 1958, with the amount of any such gain computed in accordance with the provisions of section 453(d) (1) and paragraph (b) of this section.

Example (4). In 1960, the P Corporation, in a reorganization qualifying under section 368(a), transferred certain assets (including installment obligations) to the R Corporation, a life insurance company as defined in section 801(a). P realized a loss upon the transfer of the installment obligations, which was not recognized under section 361. Pursuant to subparagraph (2) of paragraph (c) of this section, no loss with respect to the transfer of these obligations will be recognized to P under section 453(d) (1).

PAR. 3. Section 1.453-10 is amended by adding at the end thereof the following new paragraph:

§ 1.453-10 EFFECTIVE DATE.

* * * * *

(f) The provisions of section 453(d) (5) and paragraph (g) of § 1.453-9 shall apply to taxable years ending after December 31, 1957, but only as to transfers or other dispositions of installment obligations occurring after such date.

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

MORTIMER M. CAPLIN,
Commissioner of Internal Revenue.

Approved February 7, 1962.

STANLEY S. SURREY,
Assistant Secretary of the Treasury.

(Filed by the Division of the Federal Register on February 12, 1962, 8:48 a.m., and published in the issue of the Federal Register for February 13, 1962, 27 F.R. 1319)

SECTION 455.—PREPAID SUBSCRIPTION INCOME

26 CFR 1.455: Statutory provisions; T.D. 6591¹
prepaid subscription income.

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

Regulations prescribed under section 455 of the Internal Revenue
Code of 1954, relating to prepaid subscription income.

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

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

On December 14, 1960, a notice of proposed rulemaking regarding the regulations under section 455 of the Internal Revenue Code of

¹ The publication of this Treasury Decision in 27 F.R. 1797, dated February 27, 1962, contains (1) instructions for modifying the notice of proposed rulemaking published in 25 F.R. 12833, dated December 14, 1960, and (2) the full context of the regulations with such modifications. As here published, the Treasury Decision reflects the context of such regulations with modifications. The individual instructions have been omitted.

1954, relating to prepaid subscription income, effective for taxable years beginning after December 31, 1957, was published in the Federal Register (25 F.R. 12833). After consideration of all such relevant matter as was presented by interested parties regarding the rules proposed, the following regulations are hereby adopted. Such regulations supersede § 18.1-6 of Treasury Decision 6335 (26 CFR Part 18) [C.B. 1958-2, 1112], approved November 19, 1958 (23 F.R. 8981).

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AUTHORITY: §§ 1.455 to 1.455-6, incl., issued under sec. 7805, I.R.C. 1954; 68A Stat. 917; 26 U.S.C. 7805.

§ 1.455 STATUTORY PROVISIONS; PREPAID SUBSCRIPTION INCOME.

SEC. 455. PREPAID SUBSCRIPTION INCOME.

(a) YEAR IN WHICH INCLUDED.—Prepaid subscription income to which this section applies shall be included in gross income for the taxable years during which the liability described in subsection (d) (2) exists.

(b) WHERE TAXPAYER'S LIABILITY CEASES.—In the case of any prepaid subscription income to which this section applies—

(1) If the liability described in subsection (d) (2) ends, then so much of such income as was not includible in gross income under subsection (a) for preceding taxable years shall be included in gross income for the taxable year in which the liability ends.

(2) If the taxpayer dies or ceases to exist, then so much of such income as was not includible in gross income under subsection (a) for preceding taxable years shall be included in gross income for the taxable year in which such death, or such cessation of existence, occurs.

(c) PREPAID SUBSCRIPTION INCOME TO WHICH THIS SECTION APPLIES.

(1) ELECTION OF BENEFITS.—This section shall apply to prepaid subscription income if and only if the taxpayer makes an election under this section with respect to the trade or business in connection with which such income is received. The election shall be made in such manner as the Secretary or his delegate may by regulations prescribe. No election may be made with respect to a trade or business if in computing taxable income the cash receipts and disbursements method of accounting is used with respect to such trade or business.

(2) SCOPE OF ELECTION.—An election made under this section shall apply to all prepaid subscription income received in connection with the trade or business with respect to which the taxpayer has made the election; except that the taxpayer may, to the extent permitted under regulations prescribed by the Secretary or his delegate, include in gross income for the taxable year of receipt the entire amount of any prepaid subscription income if the liability from which it arose is to end within 12 months after the date of receipt. An election made under this section shall not apply to any prepaid subscription income received before the first taxable year for which the election is made.

(3) WHEN ELECTION MAY BE MADE.—

(A) WITH CONSENT.—A taxpayer may, with the consent of the Secretary or his delegate, make an election under this section at any time.

(B) WITHOUT CONSENT.—A taxpayer may, without the consent of the Secretary or his delegate, make an election under this section for his first taxable year (i) which begins after December 31, 1957, and (ii) in which he receives prepaid subscription income in the trade or business. Such election shall be made not later than the time prescribed by law for filing the return for the taxable year (including extensions thereof) with respect to which such election is made.

(4) PERIOD TO WHICH ELECTION APPLIES.—An election under this section shall be effective for the taxable year with respect to which it is first made and for all subsequent taxable years, unless the taxpayer secures the consent of the Secretary or his delegate to the revocation of such election. For purposes of this title, the computation of taxable income under an election made under this section shall be treated as a method of accounting.

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

(1) PREPAID SUBSCRIPTION INCOME.—The term "prepaid subscription income" means any amount (includible in gross income) which is received in connection with, and is directly attributable to, a liability which extends beyond the close of the taxable year in which such amount is received, and which is income from a subscription to a newspaper, magazine, or other periodical.

(2) LIABILITY.—The term "liability" means a liability to furnish or deliver a newspaper, magazine, or other periodical.

(3) RECEIPT OF PREPAID SUBSCRIPTION INCOME.—Prepaid subscription income shall be treated as received during the taxable year for which it is includible in gross income under section 451 (without regard to this section).

(e) DEFERRAL OF INCOME UNDER ESTABLISHED ACCOUNTING PROCEDURES.—Notwithstanding the provisions of this section, any taxpayer who has, for taxable years prior to the first taxable year to which this section applies, reported his income under an established and consistent method or practice of accounting for prepaid subscription income (to which this section would apply if an election were made) may continue to report his income for taxable years to which this title applies in accordance with such method or practice.

[Sec. 455 as added by sec. 28, Technical Amendments Act 1958 (72 Stat. 1625) [Public Law 85-866, C.B. 1958-3, 254]]

§ 1.455-1 TREATMENT OF PREPAID SUBSCRIPTION INCOME.—Effective with respect to taxable years beginning after December 31, 1957, section 455 permits certain taxpayers to elect with respect to a trade or business in connection with which prepaid subscription income is received, to include such income in gross income for the taxable years during which a liability exists to furnish or deliver a newspaper, magazine, or other periodical. If a taxpayer does not elect to treat prepaid subscription income under the provisions of section 455, such income is includible in gross income for the taxable year in which received by the taxpayer, unless under the method or practice of accounting used in computing taxable income such amount is to be properly accounted for as of a different period.

§ 1.455-2 SCOPE OF ELECTION UNDER SECTION 455.—(a) If a taxpayer makes an election under section 455 and § 1.455-6 with respect to a trade or business, all prepaid subscription income from such trade or business shall be included in gross income for the taxable years during which the liability exists to furnish or deliver a newspaper, magazine, or other periodical. Such election shall be applicable to all prepaid subscription income received in connection with the trade or business for which the election is made; except that the taxpayer may

further elect to include in gross income for the taxable year of receipt (as described in section 455(d)(3) and paragraph (c) of § 1.455-5) the entire amount of any prepaid subscription income if the liability from which it arose is to end within 12 months after the date of receipt, hereinafter sometimes referred to as "within 12 months" election.

(b) If the taxpayer is engaged in more than one trade or business in which a liability is incurred to furnish or deliver a newspaper, magazine, or other periodical, a separate election may be made under section 455 with respect to each such trade or business. In addition, a taxpayer may make a separate "within 12 months" election for each separate trade or business for which it has made an election under section 455.

(c) An election made under section 455 shall be binding for the first taxable year for which the election is made and for all subsequent taxable years, unless the taxpayer secures the consent of the Commissioner to the revocation of such election. Thus, in any case where the taxpayer has elected a method prescribed by section 455 for the inclusion of prepaid subscription income in gross income, such method of reporting income may not be changed without the prior approval of the Commissioner. In order to secure the Commissioner's consent to the revocation of such election, an application must be filed with the Commissioner in accordance with section 446(e) and the regulations thereunder. For purposes of subtitle A of the Code, the computation of taxable income under an election made under section 455 shall be treated as a method of accounting. For adjustments required by changes in method of accounting, see section 481 and the regulations thereunder.

(d) An election made under section 455 shall not apply to any prepaid subscription income received before the first taxable year to which the election applies. For example, Corporation M, which computes its taxable income under an accrual method of accounting and files its income tax returns on the calendar year basis, publishes a monthly magazine and customarily sells subscriptions on a 3-year basis. In 1958 it received \$135,000 of 3-year prepaid subscription income for subscriptions beginning during 1958, and in 1959 it received \$142,000 of prepaid subscription income for subscriptions beginning after December 31, 1958. In February, 1959 it elected, with the consent of the Commissioner, to report its prepaid subscription income under the provisions of section 455 for the year 1959 and subsequent taxable years. The \$135,000 received in 1958 from prepaid subscriptions must be included in gross income in full in that year, and no part of such 1958 income shall be allocated to the years 1959, 1960, and 1961 during which M was under a liability to deliver its magazine. The \$142,000 received in 1959 from prepaid subscriptions shall be allocated to the years 1959, 1960, 1961, and 1962.

(e) No election may be made under section 455 with respect to a trade or business if, in computing taxable income, the cash receipts and disbursements method of accounting is used with respect to such trade or business. However, if the taxpayer is on a "combination" method of accounting under section 446(c)(4) and the regulations thereunder, it may elect the benefits of section 455 if it uses an accrual method of accounting for subscription income.

§ 1.455-3 METHOD OF ALLOCATION.—(a) Prepaid subscription income to which section 455 applies shall be included in gross income for the taxable years during which the liability to which the income relates is discharged or is deemed to be discharged on the basis of the taxpayer's experience.

(b) For purposes of determining the period or periods over which the liability of the taxpayer extends, and for purposes of allocating prepaid subscription income to such periods, the taxpayer may aggregate similar transactions during the taxable year in any reasonable manner, provided the method of aggregation and allocation is consistently followed.

§ 1.455-4 CESSATION OF TAXPAYER'S LIABILITY.—(a) If a taxpayer has elected to apply the provisions of section 455 to a trade or business in connection with which prepaid subscription income is received, and if its liability to furnish or deliver a newspaper, magazine, or other periodical ends for any reason, then so much of the prepaid subscription income attributable to such liability as was not includible in its gross income under section 455 for preceding taxable years shall be included in its gross income for the taxable year in which such liability ends. A taxpayer's liability may end, for example, because of the cancellation of a subscription. See section 381(c)(4) and the regulations thereunder for the treatment of prepaid subscription income in a transaction to which section 381(a) applies.

(b) If a taxpayer who has elected to apply the provisions of section 455 to a trade or business dies or ceases to exist, then so much of the prepaid subscription income attributable to such trade or business which was not includible in its gross income under section 455 for preceding taxable years shall be included in its gross income for the taxable year in which such death or cessation of existence occurs. See section 381(c)(4) and the regulations thereunder for the treatment of prepaid subscription income in a transaction to which section 381(a) applies.

§ 1.455-5 DEFINITIONS AND OTHER RULES.—(a) *Prepaid subscription income*.—(1) The term "prepaid subscription income" means any amount includible in gross income which is received in connection with, and is directly attributable to, a liability of the taxpayer which extends beyond the close of the taxable year in which such amount is received and which is income from a newspaper, magazine, or other periodical. For example where Corporation X, a publisher of newspapers, magazines, and other periodicals makes sales on a subscription basis and the purchaser pays the subscription price in advance, prepaid subscription income would include the amounts actually received by X in connection with its liability to furnish or deliver the newspaper, magazine, or other periodical.

(2) For purposes of section 455, prepaid subscription income does not include amounts received by a taxpayer in connection with sales of subscriptions on a prepaid basis where such taxpayer does not have the liability to furnish or deliver a newspaper, magazine, or other periodical. The provisions of this subparagraph may be illustrated by the following example. Corporation D has a contract with each of several large publishers which grants it the right to sell subscriptions to their periodicals. Corporation D collects the subscription

price from the subscribers, retains a portion thereof as its commission and remits the balance to the publishers. The amount retained by Corporation D represents commissions on the sale of subscriptions, and is not prepaid subscription income for purposes of section 455 since the commissions represent compensation for services rendered and are not directly attributable to a liability of Corporation D to furnish or deliver a newspaper, magazine, or other periodical.

(b) *Liability*.—The term “liability” means a liability of the taxpayer to furnish or deliver a newspaper, magazine, or other periodical.

(c) *Receipt of prepaid subscription income*.—For purposes of section 455, prepaid subscription income shall be treated as received during the taxable year for which it is includible in gross income under section 451, relating to general rule for taxable year of inclusion, without regard to section 455.

(d) *Treatment of prepaid subscription income under an established accounting method*.—Notwithstanding the provisions of section 455 and § 1.455-1, any taxpayer who, for taxable years beginning before January 1, 1958, has reported prepaid subscription income for income tax purposes under an established and consistent method or practice of deferring such income may continue to report such income in accordance with such method or practice for all subsequent taxable years to which section 455 applies without making an election under section 455.

§ 1.455-6 TIME AND MANNER OF MAKING ELECTION.—(a) *Election without consent*.—(1) A taxpayer may, without consent, elect to treat prepaid subscription income of a trade or business under section 455 for the first taxable year—

(i) Which begins after December 31, 1957, and

(ii) In which there is received prepaid subscription income from the trade or business for which the election is made.

Such an election shall be made not later than the time prescribed by law for filing the income tax return for such year (including extensions thereof), and shall be made by means of a statement attached to such return.

(2) The statement shall indicate that the taxpayer is electing to apply the provisions of section 455 to his trade or business, and shall contain the following information:

(i) The name and a description of the taxpayer's trade or business to which the election is to apply;

(ii) The method of accounting used in such trade or business;

(iii) The total amount of prepaid subscription income from such trade or business for the taxable year;

(iv) The period or periods over which the liability of the taxpayer to furnish or deliver a newspaper, magazine, or other periodical extends;

(v) The amount of prepaid subscription income applicable to each such period; and

(vi) A description of the method used in allocating the prepaid subscription income to each such period.

In any case in which prepaid subscription income is received from more than one trade or business, the statement shall set forth the

required information with respect to each trade or business subject to the election.

(3) See paragraph (c) of this section for additional information required to be submitted with the statement if the taxpayer also elects to include in gross income for the taxable year of receipt the entire amount of prepaid subscription income attributable to a liability which is to end within 12 months after the date of receipt.

(b) *Election with consent.*—A taxpayer may, with the consent of the Commissioner, elect at any time to apply the provisions of section 455 to any trade or business in which it receives prepaid subscription income. The request for such consent shall be in writing, signed by the taxpayer or its authorized representative, and shall be addressed to the Commissioner of Internal Revenue, Attention: T: R: C, Washington 25, D.C. The request must be filed on or before the later of the following dates: (1) 90 days after the beginning of the first taxable year to which the election is to apply, or (2) May 28, 1962, and must contain the information described in paragraph (a) (2) of this section. See paragraph (c) of this section for additional information required to be submitted with the request if the taxpayer also elects to include in gross income for the taxable year of receipt the entire amount of prepaid subscription income attributable to a liability which is to end within 12 months after the date of receipt.

(c) *“Within 12 months” election.*—(1) A taxpayer who elects to apply the provisions of section 455 to any trade or business may also elect to include in gross income for the taxable year of receipt (as described in section 455(d)(3) and paragraph (c) of § 1.455-5) the entire amount of any prepaid subscription income from such trade or business if the liability from which it arose is to end within 12 months after the date of receipt. Any such election is binding for the first taxable year for which it is effective and for all subsequent taxable years, unless the taxpayer secures permission from the Commissioner to treat such income differently. Application to revoke or change a “within 12 months” election shall be made in accordance with the provisions of section 446(e) and the regulations thereunder.

(2) The “within 12 months” election shall be made by including in the statement required by paragraph (a) of this section or the request described in paragraph (b) of this section, whichever is applicable, a declaration that the taxpayer elects to include such income in gross income in the taxable year of receipt, and the amount of such income. If the taxpayer is engaged in more than one trade or business for which the election under section 455 is made, it must include, in such statement or request, a declaration for each trade or business for which it makes the “within 12 months” election. See also paragraph (e) of § 1.455-2.

(3) If the taxpayer does not make the “within 12 months” election for its trade or business at the time prescribed for making the election to include prepaid subscription income in gross income for the taxable years during which its liability to furnish or deliver a newspaper, magazine, or other periodical exists for such trade or business, but later wishes to make such election, it must apply for permission from the

Commissioner. Such application shall be made in accordance with the provisions of section 446(e) and the regulations thereunder.

MORTIMER M. CAPLIN,
Commissioner of Internal Revenue.

Approved February 21, 1962.

STANLEY S. SURREY,
Assistant Secretary of the Treasury.

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SECTION 456.—PREPAID DUES INCOME OF CERTAIN MEMBERSHIP ORGANIZATIONS

Temporary regulations relating to elections permitted certain membership organizations to defer the reporting of prepaid dues income. See T.D. 6596, page 408.

Subpart C.—Taxable Year for Which Deductions Taken

SECTION 461.—GENERAL RULE FOR TAXABLE YEAR OF DEDUCTION

26 CFR 1.461-1: General rule for taxable year of deduction.

Amounts paid by a television station as rental costs of films. See Rev. Rul. 62-20, page 21.

Subpart D.—Inventories

SECTION 472.—LAST-IN, FIRST-OUT INVENTORIES

26 CFR 1.472-1: Last-in, first-out inventories. Rev. Rul. 62-70

Price indexes for January 1962, published by the Bureau of Labor Statistics on March 6, 1962, for use by department stores employing the retail inventory and last-in, first-out inventory methods.

The following price indexes for January 1962, published by the Bureau of Labor Statistics on March 6, 1962, for use by department stores employing the retail inventory and last-in, first-out inventory methods, are accepted by the Internal Revenue Service pursuant to section 1.472-1(k) of the Income Tax Regulations and Mimeograph 6244, C.B. 1948-1, 21, for appropriate application to inventories for taxable years of 12 months ended December 31, 1961, and January 31, 1962.

Indexes are given on a national basis for store total, for 20 major groups of departments, and for two special group combinations—soft and durable goods. The store total index includes all departments,

including some not listed separately, with the following exceptions: candy, foods, liquor, tobacco, paints, and wallpaper, as well as contract departments.

Bureau of Labor Statistics, Department Store Inventory Price Indexes, by Department Groups

[January 1941=100]

Department group		January 1962	January 1961	Percent change* from January 1961 to January 1962
I	Piece goods.....	204. 7	202. 4	1. 1
II	Domestics and draperies.....	199. 4	198. 1	. 7
III	Women's and children's shoes.....	269. 4	264. 0	2. 0
IV	Men's and boys' shoes.....	257. 5	253. 2	1. 7
V	Infants' wear.....	177. 2	177. 3	— . 1
VI	Women's underwear.....	178. 9	178. 9	0
VII	Women's and girls' hosiery.....	156. 8	157. 9	— . 7
VIII	Women's and girls' accessories.....	193. 2	187. 1	3. 3
IX	Women's outerwear and girls' wear.....	183. 4	184. 7	— . 7
X	Men's clothing.....	227. 8	226. 4	. 6
XI	Men's furnishings.....	198. 6	201. 2	— 1. 3
XII	Boys' clothing and furnishings.....	211. 0	209. 6	. 7
XIII	Jewelry.....	180. 4	179. 7	. 4
XIV	Notions.....	170. 0	164. 9	3. 1
XV	Toilet articles and drugs.....	200. 5	195. 7	2. 5
XVI	Furniture and bedding.....	229. 8	226. 2	1. 6
XVII	Floor covering.....	193. 4	194. 0	— . 3
XVIII	Housewares.....	228. 0	229. 0	— . 4
XIX	Major appliances.....	131. 7	130. 5	. 9
XX	Radios and television sets.....	126. 5	130. 4	— 3. 0
Groups I—XV: Soft goods.....		201. 4	200. 4	. 5
Groups XVI—XX: Durable goods.....		197. 1	196. 9	. 1
Store Total.....		200. 6	199. 7	. 5

*Absence of a minus sign before percent change in this column signifies price increase.

26 CFR 1.472-8: Dollar-value method of pricing
LIFO inventories.

Rev. Rul. 62-77

Wholesalers, retailers, jobbers and distributors using a method of valuing their inventories other than the last-in, first-out (LIFO) method, who desire to change to the dollar-value LIFO method and wish to adopt the natural business unit method of pooling in connection therewith must obtain, for any taxable year, the Commissioner's prior permission to adopt such method of pooling. Such taxpayers already valuing their inventories by the dollar-value LIFO method and using a method of pooling authorized by section 1.472-8 of the Income Tax Regulations must likewise obtain, for any taxable year, the Commissioner's prior permission to change their method of pooling to the natural business unit method of pooling.

A change by such wholesalers, retailers, etc., from the unit or specific goods LIFO method, using separate LIFO pools, to the dollar-value LIFO method, using the same LIFO pools as used under

the unit method, may be made by such a taxpayer under section 1.472-8(f)(1) of the regulations without securing the Commissioner's prior approval.

A change from the unit or specific goods LIFO method to the dollar-value LIFO method using a natural business unit pool or pools by any taxpayer regardless of the nature of his business, requires the permission of the Commissioner.

Advice has been requested as to the various circumstances under which taxpayers, particularly wholesalers, retailers, jobbers and distributors, are required to obtain the permission of the Commissioner of Internal Revenue to change to the dollar-value last-in, first-out (LIFO) inventory method, using a natural business unit pool or pools, of valuing inventories, particularly in view of the respective provisions of sections 1.472-8(c), 1.472-8(f)(1), and 1.472-8(h)(1) of the Income Tax Regulations.

Section 1.472-8(a) of the regulations provides, in part, that any taxpayer may elect to determine the cost of his LIFO inventories under the so-called "dollar-value" LIFO method, provided such method is used consistently and clearly reflects the income of the taxpayer in accordance with the rules of that section. The dollar-value method of valuing LIFO inventories is a method of determining cost by using "base-year" cost expressed in terms of total dollars rather than the quantity and price of specific goods as the unit of measurement. Under such method the goods contained in the inventory are grouped in a pool or pools as described in paragraphs (b) and (c) of section 1.472-8 of the regulations with reference to manufacturers or processors and in paragraph (c) of that section with reference to wholesalers, retailers, etc.

Under section 1.472-8(c) of the regulations, items of inventory in the hands of wholesalers, retailers, jobbers, and distributors, shall be placed into pools by major lines, types, or classes of goods. In determining such groupings, it is provided that customary business classifications of the particular trade in which the taxpayer is engaged is an important consideration. An example of such customary business classification is the department in the department store. In such cases, practices are relatively uniform throughout the trade, and departmental grouping is peculiarly adapted to the customs and needs of the business. However, in appropriate cases, the principles set forth in paragraphs (b) (1) and (2) of section 1.472-8 of the regulations, relating to pooling by natural business units, may be used by wholesalers, retailers, jobbers, or distributors with the permission of the Commissioner.

Section 1.472-8(f)(1) of the regulations provides that, except as provided in section 1.472-3 of the regulations, in the case of a taxpayer electing to use a LIFO inventory method for the first time, or in the case of a taxpayer changing to the dollar-value method and continuing to use the same pools as were used under another LIFO method, a taxpayer using another LIFO method of pricing inventories may not change to the dollar-value method of pricing such inventories unless he first secures the consent of the Commissioner in accordance with paragraph (e) of section 1.446-1 of the regulations.

Section 1.472-8(g)(1) of the regulations provides that any method of pooling authorized by section 1.472-8 and used by the taxpayer in computing his LIFO inventories under the dollar-value method shall

be treated as a method of accounting. Any method of pooling which is authorized by that section shall be used for the year of adoption and for all subsequent taxable years unless a change is required by the Commissioner in order to clearly reflect income, or unless permission to change is granted by the Commissioner as provided in paragraph (e) of section 1.446-1 of the regulations. Where the taxpayer changes from one method of pooling to another method of pooling permitted by that section, the ending LIFO inventory for the taxable year preceding the year of change shall be restated under the new method of pooling.

Under section 1.472-8(h) (1) of the regulations, it is provided, in part, that notwithstanding the provisions of paragraph (g) of section 1.472-8, a taxpayer, for his first taxable year ending after April 15, 1961, may change from one method of pooling authorized by section 1.472-8 to any other method of pooling authorized by that section, provided the requirements of subparagraph (2) of paragraph (h) are met. Also, it is provided that, for such year if a taxpayer is currently using only a method of pooling which would be authorized by that section if additional items were included in the pool, and could change to the natural business unit method except for the fact that he has not inventoried all items entering into the inventory investment for such natural business unit on the LIFO method, he may change to the natural business unit method if he elects, under the provisions of section 1.472-3, to extend the LIFO election to all items entering into the entire inventory investment for such natural business unit, provided the requirements of subparagraph (2) of that paragraph are met.

Since the natural business unit method of pooling is not an authorized method for wholesalers, retailers, jobbers and distributors without the Commissioner's prior permission under section 1.472-8(c) of the regulations, and since section 1.472-8(h) is applicable only to taxpayers changing from one authorized method of pooling to another authorized method of pooling under section 1.472-8, it is held that wholesalers, retailers, jobbers and distributors may not change from any other method of pooling to the natural business unit method without the Commissioner's prior permission.

A change from the unit or specific goods LIFO method using separate LIFO pools, to the dollar-value LIFO method, using the same LIFO pools as used under the unit or specific goods LIFO method, may be made by such a taxpayer without the Commissioner's permission under the exception provided in section 1.472-8(f) (1) of the regulations.

With respect to all taxpayers using the unit or specific goods LIFO method, nothing in sections 1.472-8(f) (1) and 1.472-8(h) (1) of the regulations permits the change from such unit or specific goods LIFO method to the dollar-value LIFO method, using a natural business pool or pools, without the Commissioner's permission for the first taxable year ending after April 15, 1961.

However, wholesalers, retailers, jobbers and distributors electing to use the dollar-value LIFO method for the first time, utilizing a method of pooling by major lines, types or classes of goods, shall do so by filing an application, Form 970, Application for the Adoption and Use of the Elective Inventory Method, and by otherwise complying

with the provisions of sections 1.472-3 of the regulations. In such case the appropriateness of the method of pooling used, as well as the propriety of all computations incidental to the use of such pools, will be determined by the Commissioner through the appropriate District Director in connection with the examination of the returns of such taxpayers. See sections 1.472-3(d) and 1.472-8(d) of the regulations.

Where wholesalers, retailers, jobbers and distributors wish to use the natural business unit method of pooling in connection with a change to the dollar-value LIFO method from a method of valuation other than the LIFO method, the prior permission of the Commissioner to do so is required for any taxable year. See section 1.472-8(c) of the regulations. Such permission must be secured in accordance with section 1.446-1(e) of the regulations.

In each case where a wholesaler, retailer, jobber or distributor applies to the Commissioner for permission to change to the dollar-value LIFO method, using a natural business unit pool or pools, for valuing his inventories, he must clearly demonstrate that such natural business unit method of pooling is appropriate and clearly reflects income.

PART III.—ADJUSTMENTS

SECTION 482.—ALLOCATION OF INCOME AND DEDUCTIONS AMONG TAXPAYERS

Allocation of taxes between a dissolved corporation and the continuing entity. See Rev. Rul. 62-45, page 27.

26 CFR 1.482: Statutory provisions; allocation of income and deductions among taxpayers.

Regulations relating to the allocation of income and deductions in the case of two or more organizations, trades, or businesses owned or controlled directly or indirectly by the same interests. See T.D. 6595, page 43.

SUBCHAPTER F.—EXEMPT ORGANIZATIONS

PART I.—GENERAL RULE

SECTION 501.—EXEMPTION FROM TAX ON CORPORATIONS, CERTAIN TRUSTS, ETC.

26 CFR 1.501(c)(3)-1: Organizations organized and operated for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals.

Rev. Rul. 62-66

(Also Sections 170, 2055, 2106, 2522; 1.170-1, 20.2055-1, 20.2106, 25.2522(a)-1.)

A committee created by executive order of the governor of a state as an official agency thereof to commemorate "United Nations Day" and to conduct a continuing program through the state university and the state public school system for the education of the public, with respect to the purposes and activities of the United Nations, is not entitled to exemption under section 501(c)(3) of the Code of 1954.

As an official agency of the state, the committee is not required to file Federal income tax returns.

Contributions made to or for the use of the committee for exclusively public purposes are deductible by the donors as provided in section 170 of the Code. Bequests, legacies, devises, transfers or gifts to or for the use of the committee for exclusively public purposes are deductible for Federal estate and gift tax purposes under the provisions of sections 2055, 2106 and 2522 of the Code.

Advice has been requested whether a committee created by executive order of the governor of a state as an official agency thereof for the purpose of educating the public with respect to the purposes and activities of the United Nations as an instrument of world peace is entitled to exemption under section 501(a) of the Internal Revenue Code of 1954 as an educational organization described in section 501(c)(3) of the Code.

It is stated that the instant committee was created by executive order of the governor of a state to commemorate "United Nations Day" and to conduct a continuing program through the state university and the state public school system for the education of the public with respect to the purposes and activities of the United Nations as an instrument of world peace. The activities of the committee are supported by public contributions.

Section 501(c)(3) of the Code reads, in part, as follows:

Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, * * * or educational purposes, * * *, no part of the net earnings of which inures to the benefit of any private shareholder or individual. * * *.

Section 1.501(c)(3)-1 of the Income Tax Regulations provides that in order to qualify for exemption under the section of law quoted above, an organization must be both organized and operated exclusively for one or more of the purposes specified therein.

A state or municipality itself does not qualify as an organization of the type described in section 501(c)(3) of the Code since its purposes are clearly not exclusively those described in that section. Similarly, an activity constituting an integral part of a state or municipal government cannot so qualify inasmuch as the organization engaged therein would still be the state or municipal government, which cannot qualify as an organization described in section 501(c)(3) of the Code. Revenue Ruling 60-384, C.B. 1960-2, 172.

Since the instant committee is an official agency of the State, it is a part of the state government and, therefore, not an organization described in section 501(c)(3) of the Code. Accordingly, it is held that the committee does not qualify for exemption under section 501(c)(3) of the Code.

As a part of the state government, the committee is not required to file Federal income tax returns.

Contributions made to or for the use of the committee for exclusively public purposes are deductible by the donors as provided in

section 170 of the Code. Bequests, legacies, devises, transfers or gifts to or for the use of the committee for exclusively public purposes are deductible for Federal estate and gift tax purposes under the provisions of sections 2055, 2106 and 2522 of the Code.

Rev. Rul. 62-71

An organization which, as its primary objective, advocates the adoption of a doctrine or theory which can become effective only by the enactment of legislation is not entitled to exemption from Federal income tax under section 501(a) of the Internal Revenue Code of 1954, since it is an "action" organization and thus is not operated exclusively for educational purposes within the meaning of section 501(c) (3) of the Code.

Advice has been requested whether an organization whose primary activities consist of advocating a particular doctrine or theory may qualify for exemption as an organization described in section 501(c) (3) of the Internal Revenue Code of 1954.

The instant organization is a nonprofit corporation formed for the purpose of supporting an educational program for the stimulation of interest in the study of the science of economics or political economy, particularly with reference to a specified doctrine or theory.

It conducts research, makes surveys of economic conditions, moderates discussion groups, and publishes books, pamphlets, etc. These publications as well as publications obtained from other sources are distributed by the organization at nominal prices. It maintains a lecture service for the benefit of schools, colleges, civic clubs and other organizations of various kinds which are interested in the study of civic, social and economic problems. The research activities are primarily concerned with securing information for determining the effect of the various methods of real estate taxation on the rise and fall of land values with particular reference to the single tax theory of taxation.

It is the announced policy of the organization to promote its philosophy by educational methods as well as by the encouragement of political action. Most of the publications disseminated by the organization, together with a substantial part of its other activities, deal with the theory advocated. This theory or doctrine can be put into effect only by legislative action.

The corporation is organized without capital stock and is governed by a board of trustees elected by the membership. All the trustees and voting members are required to be avowed adherents of the theory advocated. In the event of dissolution all the remaining assets of the corporation, after debts and other obligations are satisfied, are to be devoted to a charitable or educational use.

Section 501(c) of the Code reads, in part, as follows:

(3) Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, * * *, literary, or educational purposes, * * *, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation, and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office.

Section 1.501(c)(3)-1(a) of the Income Tax Regulations provides that in order for an organization to be exempt under section 501(c)(3) of the Code, it must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Section 1.501(c)(3)-1(c)(3) of the regulations provides that an organization is not operated exclusively for one or more exempt purposes if it is an "action" organization as described therein. One of the three types of "action" organizations described in that section is an organization which has the following two characteristics: (a) its main or primary objective or objectives (as distinguished from its incidental or secondary objectives) may be attained only by legislation or a defeat of proposed legislation; and (b) it advocates, or campaigns for, the attainment of such main or primary objective or objectives as distinguished from engaging in nonpartisan analysis, study, or research and making the results thereof available to the public. In determining whether an organization has such characteristics, all the surrounding facts and circumstances, including the articles and all activities of the organization, are to be considered.

While that part of the activities of the instant organization which consists of engaging in nonpartisan analysis, study and research and making the results thereof available to the public, when considered alone, may be classified as educational within the meaning of section 501(c)(3) of the Code, the organization is primarily engaged in teaching and advocating the adoption of a particular doctrine or theory. This doctrine or theory is of a nature which can become effective only by the enactment of legislation. Since the primary objective of the organization can be attained only by legislative action, a step which the organization encourages or advocates as a part of its announced policy, as opposed to engaging in nonpartisan analysis, study and research and making the results thereof available to the public, the organization is an "action" organization as that term is defined in section 1.501(c)(3)-1(c)(3) of the regulations.

In view of the foregoing, it is held that the instant organization does not qualify for exemption under section 501(c)(3) of the Code, since it is an "action" organization and thus is not operated exclusively for any of the exempt purposes specified in that section.

Rev. Rul. 62-78

Organizations exempt from Federal income tax under section 501 as described in section 501(c)(3) of the Internal Revenue Code of 1954 may make distributions of income or other unrestricted funds to a state or municipality, or to an activity which is an integral part thereof, without jeopardizing their exempt status, provided such distributions are in furtherance of the exempt purposes of the donor organizations.

Advice has been requested whether an exempt organization, which has qualified as one described in section 501(c)(3) of the Internal Revenue Code of 1954, may distribute its income or other unrestricted funds, in part, to a state, or municipality, or to an activity which is an

integral part thereof, without jeopardizing its exempt status under section 501 of the Code.

Revenue Ruling 60-384, C.B. 1960-2, 172, holds, in part, that a state or municipality itself does not qualify as an organization described in section 501(c)(3) of the Code since its purposes are clearly not exclusively those described in that section of the Code. It also states that where the particular branch or department, under whose jurisdiction an activity for which exemption is claimed is being conducted, is an integral part of the state or municipal government, the provisions of section 501(c)(3) would not be applicable and such an activity could not meet the requirements for exemption under that section.

However, an organization exempt from Federal income tax pursuant to section 501(c)(3) of the Code may properly make distributions of income or other unrestricted funds to a state or a municipality, or to an activity which is an integral part thereof, without jeopardizing its exempt status under that section of the Code, provided such funds are to be used to carry out the purposes which constitute the basis of the donor-organization's exemption.

26 CFR 1.501(c)(5)-1: Labor, agricultural, and horticultural organizations.

Rev. Rul. 62-17

The payment by a labor organization, otherwise described in section 501(c)(5) of the Internal Revenue Code of 1954, of death, sick, accident, and similar benefits to its individual members with funds contributed by its members, if made under a plan which has as its object the betterment of the conditions of the members of the organization, does not preclude exemption of the organization under section 501(c)(5) of the Code.

Revenue Ruling 58-143, C.B. 1958-1, 239, revoked.

Reconsideration has been given to Revenue Ruling 58-143, C.B. 1958-1, 239, concerning the tax-exempt status of a labor union which pays death, sick, accident, and other benefits to its members.

Revenue Ruling 58-143 holds that the operation of an established system for the payment of sick, death, accident, and other benefits, which members are entitled to receive as a matter of right in consideration of the payment of assessments, has no customary relation to the purposes of a labor union within the contemplation of section 501(c)(5) of the Internal Revenue Code of 1954, and that the operation of such a system by a labor organization will, unless merely incidental, preclude such organization from exemption.

Section 1.501(c)(5)-1(a) of the Income Tax Regulations provides that the labor, agricultural, and horticultural organizations contemplated by section 501(c)(5) of the Code as entitled to exemption from income taxation are those which:

- (1) Have no net earnings inuring to the benefit of any member, and
- (2) Have as their objects the betterment of the conditions of those engaged in such pursuits, the improvement of the grade of their products, and the development of a higher degree of efficiency in their respective occupations.

A further review of the subject, including the legislative history of the provisions exempting labor organizations from income taxation, indicates that labor organizations were exempted for the very reason that they operated, in part, as mutual benefit organizations providing death, sick, accident, and similar benefits to their members.

Accordingly, it is held that payment by a labor organization of death, sick, accident, and similar benefits to its individual members with funds contributed by its members, if made under a plan which has as its object the betterment of the conditions of the members, does not preclude exemption of the organization under section 501(c) (5) of the Code.

Inasmuch as Revenue Ruling 58-143, holds that the operation by a labor organization of an established system funded by assessments against its members for the payment of death, sick, accident, and other benefits, to which such members are entitled as a matter of right, will cause withdrawal of the labor organization's exemption, it is hereby revoked.

SUBCHAPTER I.—NATURAL RESOURCES

PART I.—DEDUCTIONS

SECTION 613.—PERCENTAGE DEPLETION

26 CFR 1.613-3: Gross income from the property. Rev. Rul. 62-5¹
(Also Part II, Section 23(m); Regulations 111,
Section 29.23(m)-1, Regulations 118, Section
39.23(m)-1.)

In the case of chemical grade limestone, agricultural limestone, granite, and other stone sold as broken or crushed rock, processes (other than fine pulverization) applied to reduce those materials in size will be treated as ordinary treatment processes for taxable years beginning before January 1, 1961.

The term "fine pulverization" does not include the coincidental production of fines as a by-product of allowable size reduction processes nor does it include any process applied in reducing the product in size so that it will pass a No. 20 screen (U.S. Standard Sieve Series) provided five percent or more of the product of such process will remain on a No. 45 screen (U.S. Standard Sieve Series). U.S. Standard Sieve Series is the same as ASTM designation E-11-61. Separating or screening the material for size prior to fine pulverization will be considered an allowable process.

Revenue Rulings 56-405, C.B. 1956-2, 332, and 61-17, C.B. 1961-1, 193, are modified.

The Internal Revenue Service has been asked to reconsider its position with respect to the ordinary treatment processes allowable for taxable years beginning before the year 1961 in the case of the minerals described in Revenue Ruling 56-405, C.B. 1956-2, 332, namely chemical grade limestone, crushed rock for road ballast, and agricultural limestone, and in the case of granite and other stone sold as broken or crushed stone products.

In determining gross income from the property for purposes of computing percentage depletion, section 39.23(m)-1(f)(2) of Regulations 118 (and corresponding provisions of Regulations 111), made applicable to the Internal Revenue Code of 1954 by T.D. 6091, C.B. 1954-2, 47, provides that "fine pulverization" is not an "ordinary treatment process" unless necessary or incidental to a mining process otherwise provided for in such regulations.

¹ Also released as Technical Information Release 355, dated December 28, 1961.

Referring to the production of chemical grade limestone, crushed rock for road ballast, and agricultural limestone, Revenue Ruling 56-405 states that in crushing rock for chemical grade limestone and crushed rock products, the production of pulverized limestone as a by-product from the primary and secondary crushing will not exclude such processes from treatment as ordinary treatment processes within the meaning of section 613 of the Internal Revenue Code of 1954. That Revenue Ruling also provides that the pulverization of limestone for the purpose of making agricultural limestone is excluded from such ordinary treatment processes. Revenue Ruling 61-17, C.B. 1961-1, 193, modified Revenue Ruling 56-405 to the extent that the latter permits any process subsequent to primary crushing to be treated as an ordinary treatment process.

There are substantial differences in the physical structure of rock and it is difficult to distinguish between the wide variety of types and methods of size reduction processes used in producing broken and crushed stone. Because of the foregoing considerations, and in the interests of uniform administrative application of the statute, processes, other than fine pulverization, applied for size reduction purposes will be treated as ordinary treatment processes in the case of the minerals described in Revenue Ruling 56-405 (chemical grade limestone, crushed rock for road ballast, and agricultural limestone) and in the case of granite and other stone sold as broken or crushed rock or stone products. For this purpose, and as under Revenue Ruling 56-405, the term "fine pulverization" does not include the coincidental production of fines as a by-product of allowable size reduction processes.

In addition, the term "fine pulverization" does not include any process applied to reduce the product in size so that it will pass a No. 20 screen (U.S. Standard Sieve Series) provided five percent or more of the product of such process will remain on a No. 45 screen (U.S. Standard Sieve Series). U.S. Standard Sieve Series is the same as ASTM designation E-11-61. Separating or screening the material for size prior to fine pulverization will be considered an allowable process.

This Revenue Ruling has no application to processes or minerals in respect of which specific provision is otherwise made by statute or regulations, such as the pulverization of talc and the breaking or sizing of coal. Furthermore, it has no application to calcium carbonates or other minerals when used in making cement, or quartzite when used in making refractory products, since the same considerations are not applicable to these minerals and because of the enactment of P.L. 86-781, C.B. 1960-2, 726 and P.L. 87-321, C.B. 1961-2, 341, concerning these minerals.

Revenue Rulings 61-17 and 56-405 are hereby modified so that any size reduction process, other than fine pulverization, applied in the case of chemical grade limestone, agricultural limestone, granite and other stone sold as broken or crushed rock or stone will be considered as a mining process.

This Revenue Ruling applies only to taxable years beginning before January 1, 1961. For taxable years beginning after December 31, 1960, the treatment processes considered as mining must be determined under section 613(c) of the Internal Revenue Code of 1954 as amended by P.L. 86-564, C.B. 1960-2, 681, and the regulations thereunder.

PART III.—SALES AND EXCHANGES

SECTION 631.—GAIN OR LOSS IN THE CASE OF TIMBER OR COAL

26 CFR 1.631-2: Gain or loss upon the disposal of timber under cutting contract.

Treatment of income received by the owner of timber lands under a long-term agreement for the sale of all timber and timber rights growing and to be grown on such lands. See Rev. Rul. 62-81, page 153.

Lump sum payment for lease of land and the right to cut timber. See Rev. Rul. 62-82, page 155.

SUBCHAPTER L.—INSURANCE COMPANIES**PART I.—LIFE INSURANCE COMPANIES**

Subpart C.—Gain and Loss From Operations

SECTION 809.—IN GENERAL

26 CFR 1.809-6: Modifications.

The conversion of a net operating loss carryover of an insurance company into an “operations loss deduction” disallowed. See Rev. Rul. 62-43, below.

SECTION 812.—OPERATIONS LOSS DEDUCTION

26 CFR 1.812-2: Operations loss deduction.
(Also Sections 172, 809; 1.172-1, 1.809-6.)

Rev. Rul. 62-43¹

The net operating loss carryover of an insurance company previously taxable under section 831 of the Internal Revenue Code of 1954 may not be converted into an “operations loss deduction” for the taxable year when the taxpayer qualifies as a “life insurance company” under section 801 of the Code.

Advice has been requested whether the amount of a net operating loss carryover available under section 172 of the Internal Revenue Code of 1954 to an insurance company previously taxable under section 831 of the Code may be converted into an operations loss deduction under section 812 of the Code for the taxable year when the taxpayer qualifies as a “life insurance company” within the meaning of section 801 of the Code.

¹ Also released as Technical Information Release 365, dated March 7, 1962.

For several years the taxpayer has operated as an insurance company taxable under section 831 of the Code. During several of the most recent years, the taxpayer sustained net operating losses. As of the close of the taxable year 1960, the taxpayer had a net operating loss carryover available for use in computing its taxable income in succeeding taxable years.

On December 31, 1961, the taxpayer's life insurance reserves, plus its unearned premiums and unpaid losses on noncancellable life, health, or accident policies not included in life insurance reserves, comprised more than 50 percent of its total reserves and the taxpayer qualified as a "life insurance company" within the meaning of section 801 of the Code.

Under section 812 of the Code, a life insurance company is allowed an "operations loss deduction" equal to the aggregate of the operations loss carryovers to such year, plus the operations loss carrybacks to such year. However, section 809(e) (5) of the Code specifically denies a life insurance company a deduction for net operating losses provided in section 172 of the Code. There is no provision of the Code which authorizes the conversion of an amount previously allowable to an insurance company as a net operating loss carryover into an operations loss deduction of a life insurance company.

For Federal income tax purposes, a deduction must be based upon explicit statutory authority. See *New Colonial Ice Co., Inc. v. Helvering*, 292 U.S. 435, at 440 (1934), Ct. D. 841, C.B. XIII-1, 194 (1934) and *United States v. Olympic Radio and Television, Inc.*, 349 U.S. 232, at 236 (1955), Ct. D. 1785, C.B. 1955-1, 376. In the absence of such authority, the carryover and deduction of such net operating losses by a life insurance company must be denied.

Accordingly, it is held that the amount of the net operating loss carryover available to the taxpayer insurance company under section 172 of the Code may not be converted into an operations loss deduction under section 812 of the Code for the taxable year 1961 when the taxpayer company qualifies as a "life insurance company" within the meaning of section 801 of the Code.

Subpart E.—Miscellaneous Provisions

SECTION 819.—FOREIGN LIFE INSURANCE COMPANIES

26 CFR 1.819-2: Foreign life insurance companies.

Percentage to be used by foreign life insurance companies in computing income tax for the taxable year 1961 and estimated tax for the taxable year 1962. See T.D. 6594, page 406.

PART II.—MUTUAL INSURANCE COMPANIES (OTHER THAN LIFE OR MARINE OR FIRE INSURANCE COMPANIES ISSUING PERPETUAL POLICIES)

SECTION 821.—TAX ON MUTUAL INSURANCE COMPANIES (OTHER THAN LIFE OR MARINE OR FIRE INSURANCE COMPANIES ISSUING PERPETUAL POLICIES)

26 CFR 1.821-1: Tax on mutual insurance companies Rev. Rul. 62-3
other than life or marine or fire insurance com-
panies subject to the tax imposed by section 831.

Section 821(a) of the Internal Revenue Code of 1954 provides, in part, "There shall be imposed for each taxable year on the income of every mutual insurance company * * * a tax computed under paragraph (1) or paragraph (2), whichever is the greater." However, section 1201(a) of the Code, under specified circumstances, provides for an alternative tax, computed as therein directed, "in lieu of the tax imposed by sections * * * 821 (a) (1) or (b), * * * (if such tax is less than the tax imposed by such sections) * * *."

Held, Section 821(a) involves a comparison of the computations made under paragraphs (1) or (2) to determine the tax imposed by such section. Although section 1201(a) of the Code refers to the tax imposed by section 821(a)(1), such reference was made for the purpose of making a comparison, under specified circumstances, of the computations made under section 1201(a) with those made under section 821(a)(1).

Accordingly, it is held that the alternative method of taxation, under section 1201(a), if applicable, is in lieu of the computation made under section 821(a)(1) of the Code and such substitution must be made before comparing the results of section 821(a)(1) with those of section 821(a)(2).

**SUBCHAPTER M.—REGULATED INVESTMENT COMPANIES
AND REAL ESTATE INVESTMENT TRUSTS**

**SECTION 856.—DEFINITION OF REAL ESTATE
INVESTMENT TRUST**

26 CFR 1.856: Definition of real estate T.D. 6598¹
investment trust.

**TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 1.—IN-
COME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953**

Regulations under part II, subchapter M, chapter 1 of the Internal Revenue Code of 1954 and other related amendments of the Income Tax Regulations, relating to real estate investment trusts.

¹ The publication of this Treasury Decision in 27 F.R. 4081, dated April 28, 1962, contains (1) instructions for modifying the notice of proposed rulemaking published in 26 F.R. 603, dated January 20, 1961, and (2) the full context of the regulations with such modifications. As here published, the Treasury Decision reflects the full context of such regulations, with modifications. The individual instructions have been omitted.

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

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

On January 20, 1961, notice of proposed rulemaking was published in the Federal Register (26 F.R. 603) regarding amendment of the Income Tax Regulations (26 CFR Part 1) prescribing regulations under part II, subchapter M, chapter 1 of the Internal Revenue Code of 1954 as added by section 10 of the Act of September 14, 1960 (Pub. Law 86-779, 74 Stat. 1003 [C.B. 1960-2, 709]), and to reflect amendments to sections 11, 34, 116, 243, 318, 443, 852, 855, and 1504 of the Code made by such Act. After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the following regulations are hereby adopted.

PARAGRAPH 1. There is inserted immediately after § 1.855-1 the following new sections:

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Real Estate Investment Trusts

§ 1.856 STATUTORY PROVISIONS; DEFINITION OF REAL ESTATE INVESTMENT TRUST.

SEC. 856. DEFINITION OF REAL ESTATE INVESTMENT TRUST.

(a) IN GENERAL.—For purposes of this subtitle, the term “real estate investment trust” means an unincorporated trust or an unincorporated association—

- (1) Which is managed by one or more trustees;
- (2) The beneficial ownership of which is evidenced by transferable shares, or by transferable certificates of beneficial interest;
- (3) Which (but for the provisions of this part) would be taxable as a domestic corporation;
- (4) Which does not hold any property primarily for sale to customers in the ordinary course of its trade or business;
- (5) The beneficial ownership of which is held by 100 or more persons;

(6) Which would not be a personal holding company (as defined in section 542) if all of its gross income constituted personal holding company income (as defined in section 543); and

(7) Which meets the requirements of subsection (c).

(b) DETERMINATION OF STATUS.—The conditions described in paragraphs (1) to (4), inclusive, of subsection (a) must be met during the entire taxable year, and the condition described in paragraph (5) must exist during at least 335 days of a taxable year of 12 months, or during a proportionate part of a taxable year of less than 12 months.

(c) LIMITATIONS.—A trust or association shall not be considered a real estate investment trust for any taxable year unless—

(1) It files with its return for the taxable year an election to be a real estate investment trust or has made such election for a previous taxable year which began after December 31, 1960;

(2) At least 90 percent of its gross income is derived from—

(A) Dividends;

(B) Interest;

(C) Rents from real property;

(D) Gain from the sale or other disposition of stock, securities, and real property (including interests in real property and interests in mortgages on real property); and

(E) Abatements and refunds of taxes on real property;

(3) At least 75 percent of its gross income is derived from—

(A) Rents from real property;

(B) Interest on obligations secured by mortgages on real property or on interests in real property;

(C) Gain from the sale or other disposition of real property (including interests in real property and interests in mortgages on real property);

(D) Dividends or other distributions on, and gain from the sale or other disposition of, transferable shares (or transferable certificates of beneficial interest) in other real estate investment trusts which meet the requirements of this part; and

(E) Abatements and refunds of taxes on real property;

(4) Less than 30 percent of its gross income is derived from the sale or other disposition of—

(A) Stock or securities held for less than 6 months; and

(B) Real property (including interests in real property) not compulsorily or involuntarily converted within the meaning of section 1033, held for less than 4 years; and

(5) At the close of each quarter of the taxable year—

(A) At least 75 percent of the value of its total assets is represented by real estate assets, cash and cash items (including receivables), and Government securities; and

(B) Not more than 25 percent of the value of its total assets is represented by securities (other than those includible under subparagraph (A)) for purposes of this calculation limited in respect of any one issuer to an amount not greater in value than 5 percent of the value of the total assets of the trust and to not more than 10 percent of the outstanding voting securities of such issuer.

A real estate investment trust which meets the requirements of this paragraph at the close of any quarter shall not lose its status as a real estate investment trust because of a discrepancy during a subsequent quarter between the value of its various investments and such requirements unless such discrepancy exists immediately after the acquisition of any security or other property and is wholly or partly the result of such acquisition. A real estate investment trust which does not meet such requirements at the close of any quarter by reason of a discrepancy existing immediately after the acquisition of any security or other property which is wholly or partly the result of such acquisition during such quarter shall not lose its status for such quarter as a real estate investment trust if such discrepancy is eliminated within 30 days after the close of such quarter and in such cases it shall be considered to have met such requirements at the close of such quarter for purposes of applying the preceding sentence.

(6) For purposes of this part—

(A) The term “value” means, with respect to securities for which market quotations are readily available, the market value of such securities; and with respect to other securities and assets, fair value as determined in good faith by the trustees, except that in the case of securities of real estate investment trusts such fair value shall not exceed market value or asset value, whichever is higher.

(B) The term “real estate assets” means real property (including interests in real property and interests in mortgages on real property) and shares (or transferable certificates of beneficial interest) in other real estate investment trusts which meet the requirements of this part.

(C) The term “interests in real property” includes fee ownership and co-ownership of land or improvements thereon and leaseholds of land or improvements thereon, but does not include mineral, oil, or gas royalty interests.

(D) All other terms shall have the same meaning as when used in the Investment Company Act of 1940, as amended.

(d) RENTS FROM REAL PROPERTY DEFINED.—For purposes of paragraphs (2) and (3) of subsection (c), the term “rents from real property” includes rents from interests in real property but does not include—

(1) Any amount received or accrued, directly or indirectly, with respect to any real property, if the determination of such amount depends in whole or in part on the income or profits derived by any person from such property (except that any amount so received or accrued shall not be excluded from the term “rents from real property” solely by reason of being based on a fixed percentage or percentages of receipts or sales);

(2) Any amount received or accrued directly or indirectly from any person if the real estate investment trust owns, directly or indirectly—

(A) In the case of any person which is a corporation, stock of such person possessing 10 percent or more of the total combined voting power of all classes of stock entitled to vote, or 10 percent or more of the total number of shares of all classes of stock of such person; or

(B) In the case of any person which is not a corporation, an interest of 10 percent or more in the assets or net profits of such person; and

(3) Any amount received or accrued, directly or indirectly, with respect to any real property, if the real estate investment trust furnishes or renders services to the tenants of such property, or manages or operates such property, other than through an independent contractor from whom the trust itself does not derive or receive any income. For purposes of this paragraph, the term “independent contractor” means—

(A) A person who does not own, directly or indirectly, more than 35 percent of the shares, or certificates of beneficial interest, in the real estate investment trust, or

(B) A person, if a corporation, not more than 35 percent of the total combined voting power of whose stock (or 35 percent of the total shares of all classes of whose stock), or, if not a corporation, not more than 35 percent of the interest in whose assets or net profits is owned, directly or indirectly, by one or more persons owning 35 percent or more of the shares or certificates of beneficial interest in the trust.

For purposes of paragraphs (2) and (3), the rules prescribed by section 318(a) for determining the ownership of stock shall apply in determining the ownership of stock, assets, or net profits of any person; except that “10 percent” shall be substituted for “50 percent” in subparagraph (C) of section 318(a) (2).

[Sec. 856 as added by sec. 10(a), Act of Sept. 14, 1960 (Pub. Law 86-779, 74 Stat. 1004 through 1006 [C.B. 1960-2, 709])]]

§ 1.856-1 **DEFINITION OF REAL ESTATE INVESTMENT TRUST.**—(a) *In general.*—The term “real estate investment trust” means an unincorporated trust or unincorporated association which (1) meets the status conditions in section 856(a) and paragraph (b) of this section, and (2) satisfies the gross income and asset diversification requirements under the limitations of section 856(c) and § 1.856-2.

(b) *Qualifying conditions.*—To qualify as a “real estate investment trust”, an unincorporated organization must be one—

(1) Which is managed by one or more trustees,

(2) The beneficial ownership of which is evidenced by transferable shares or by transferable certificates of beneficial interest,

(3) Which would be taxable as a domestic corporation but for the provisions of part II, subchapter M, chapter 1 of the Code,

(4) Which does not hold any property primarily for sale to customers in the ordinary course of its trade or business,

(5) The beneficial ownership of which is held by 100 or more persons, and

(6) Which would not be a personal holding company (as defined in section 542) if all of its gross income constituted personal holding company income (as defined in section 543).

(c) *Determination of status.*—The conditions described in subparagraphs (1) through (4), inclusive, of paragraph (b) of this section must be met during the entire taxable year and the condition described in subparagraph (5) of such paragraph must exist during at least 335 days of a taxable year of 12 months or during a proportionate part of a taxable year of less than 12 months. The days during which the latter condition must exist need not be consecutive. In determining the minimum number of days during which the condition described in paragraph (b)(5) of this section is required to exist in a taxable year of less than 12 months, fractional days shall be disregarded. For example, in a taxable year of 310 days, the actual number of days prescribed would be 284-38/73 days (310/365 of 335). The fractional day is disregarded so that the required condition in such taxable year need exist for only 284 days.

(d) *Rules applicable to status requirements.*—For purposes of determining whether an unincorporated organization meets the conditions and requirements in section 856(a), the following rules shall apply.

(1) *Trustee.*—The term “trustee” means a person who holds legal title to the property of the real estate investment trust, and has such rights and powers as will meet the requirement of “centralization of management” under paragraph (c) of § 301.7701-2 of the regulations (Regulations on Procedure and Administration). Thus, the trustee must have continuing exclusive authority over the management of the trust, the conduct of its affairs, and (except as limited by section 856(d)(3) and § 1.856-4) the management and disposition of the trust property. For example, such authority will be considered to exist even though the trust instrument grants to the shareholders any or all of the following rights and powers: To elect or remove trustees; to terminate the trust; and to ratify amendments to the trust instrument proposed by the trustee. The existence of a mere fiduciary relationship does not, in itself, make one a trustee for purposes of section 856(a)(1). The trustee will be considered to hold legal title

to the property of the trust, for purposes of this subparagraph, whether the title is held in the name of the trust itself, in the name of one or more of the trustees, or in the name of a nominee for the exclusive benefit of the trust. Furthermore, a trustee of a real estate investment trust may not be an officer or employee of, or have any direct or indirect proprietary interest in, any independent contractor which furnishes or renders services pertaining to the trust property, or manages or operates such property. See section 856(d)(3) and § 1.856-4 for definition of independent contractor.

(2) *Beneficial ownership.*—Beneficial ownership shall be evidenced by transferable shares, or by transferable certificates of beneficial interest, and (subject to the provisions of paragraph (c) of this section) must be held by 100 or more persons, determined without reference to any rules of attribution. Provisions in the trust instrument which permit the trustee to redeem shares or to refuse to transfer shares in any case where the trustee, in good faith, believes that a failure to redeem shares or that a transfer of shares would result in the loss of status as a real estate investment trust will not render the shares “nontransferable.” For purposes of the regulations under part II of subchapter M, the terms “stockholder”, “stockholders”, “shareholder”, and “shareholders” include holders of beneficial interest in a real estate investment trust, and the terms “stock”, “shares”, and “shares of stock” include certificates of beneficial interest.

(3) *Unincorporated organization taxable as a domestic corporation.*—The determination of whether an unincorporated organization would be taxable as a domestic corporation, in the absence of the provisions of part II of subchapter M, shall be made in accordance with the provisions of section 7701(a)(3) and (4) and the regulations thereunder and for such purposes an otherwise qualified real estate investment trust is deemed to satisfy the “objective to carry on business” requirement of paragraph (a) of § 301.7701-2 of this chapter (Regulations on Procedure and Administration).

(4) *Property held for sale to customers.*—A real estate investment trust may not hold any property primarily for sale to customers in the ordinary course of its trade or business. Whether property is held for sale to customers in the ordinary course of the trade or business of a real estate investment trust depends upon the facts and circumstances in each case.

(5) *Personal holding company.*—An unincorporated organization, even though it may otherwise meet the requirements of part II of subchapter M, will not be a real estate investment trust if, by considering all of its gross income as personal holding company income under section 543, it would be a personal holding company as defined in section 542. Thus, if at any time during the last half of the trust’s taxable year more than 50 percent in value of its outstanding stock is owned (directly or indirectly under the provisions of section 544) by or for not more than 5 individuals, the stock ownership requirement in section 542(a)(2) will be met and the trust would be a personal holding company. See § 1.857-6, relating to record requirements for purposes of determining whether the trust is a personal holding company.

(e) *Other rules applicable.*—To the extent that other provisions of chapter 1 of the Code are not inconsistent with those under part

II of subchapter M thereof and the regulations thereunder, such provisions will apply with respect to both the real estate investment trust and its shareholders in the same manner that they would apply to any other unincorporated trust which would be taxable as a domestic corporation. For example:

(1) Taxable income of a real estate investment trust is computed in the same manner as that of a domestic corporation;

(2) Section 301, relating to distributions of property, applies to distributions by a real estate investment trust in the same manner as it would apply to a domestic corporation;

(3) Sections 302, 303, 304, and 331 are applicable in determining whether distributions by a real estate investment trust are to be treated as in exchange for stock;

(4) Section 305 applies to distributions by a real estate investment trust of its own stock;

(5) Section 311 applies to distributions by a real estate investment trust;

(6) Except as provided in section 857(d), earnings and profits of a real estate investment trust are computed in the same manner as in the case of a domestic corporation;

(7) Section 316, relating to the definition of a dividend, applies to distributions by a real estate investment trust; and

(8) Section 341, relating to collapsible corporations, applies to gain on the sale or exchange of, or a distribution which is in exchange for, stock in a real estate investment trust in the same manner that it would apply to a domestic corporation.

§ 1.856-2 LIMITATIONS.—(a) *Effective date.*—The provisions of part II, subchapter M, chapter 1 of the Code and the regulations thereunder apply only to taxable years of a real estate investment trust beginning after December 31, 1960.

(b) *Election.*—Under the provisions of section 856(c)(1), a trust, even though it satisfies the other requirements of part II of subchapter M for the taxable year, will not be considered a “real estate investment trust” for such year, within the meaning of such part II, unless it elects to be a real estate investment trust for such taxable year, or has made such an election for a previous taxable year which began after December 31, 1960. The election shall be made by the trust by computing taxable income as a real estate investment trust in its return for the first taxable year for which it desires the election to apply, even though it may have otherwise qualified as a real estate investment trust for a prior year. No other method of making such election is permitted. An election once made is irrevocable for such taxable year and all succeeding taxable years.

(c) *Gross income requirements.*—(1) Section 856(c)(2), (3), and (4) further provides that a trust shall not be considered a “real estate investment trust” for a taxable year unless for such year:

(i) At least 90 percent of its gross income is derived from—

(a) Dividends;

(b) Interest;

(c) Rents from real property;

(d) Gain from the sale or other disposition of stock, securities, real property, and interests in mortgages on real property; and

(e) Abatements and refunds of taxes on real property;

- (ii) At least 75 percent of its gross income is derived from—
 - (a) Rents from real property;
 - (b) Interest on obligations secured by mortgages on real property;
 - (c) Gain from the sale or other disposition of real property and interests in mortgages on real property;
 - (d) Dividends or other distributions on, and gain from the sale or other disposition of, transferable shares in another qualified real estate investment trust which is so qualified for its taxable year to which the dividends or other distributions relate or during which the gain was realized; and
 - (e) Abatements and refunds of taxes on real property; and
- (iii) Less than 30 percent of its gross income is derived from the sale or other disposition of—

- (a) Stock or securities held for less than 6 months; and
- (b) Real property, not compulsorily or involuntarily converted within the meaning of section 1033, held for less than 4 years.

All three of the gross income requirements in section 856(c) and this subparagraph must be met for the taxable year. Thus, at least 75 percent of gross income must be derived from the sources described in section 856(c)(3) and another 15 percent of gross income must likewise be derived from such sources or from the sources described in section 856(c)(2), or from a combination of such sources. A maximum of 10 percent of gross income is not restricted as to source.

(2) In determining whether the gross income of a real estate investment trust satisfies the percentage requirements in section 856(c) and subparagraph (1) of this paragraph, the term “gross income” has the same meaning as that term has under section 61 and the regulations thereunder for purposes of the denominator in the computation of the specified percentages, but for purposes of the various numerators in such computations the following rules shall apply:

(i) *Dividends*.—The 90-percent requirement in section 856(c)(2)(A) permits the inclusion of dividends generally, while the 75-percent requirement in section 856(c)(3)(D) includes dividends only to the extent that they represent dividends or other distributions on transferable shares in other qualified real estate investment trusts.

(ii) *Interest*.—In computing the percentage requirements in section 856(c)(2)(B) and (3)(B) there shall be included as interest only the amount which constitutes lawful interest for the loan or forbearance of money. Thus, for example, usurious or illegal interest, or fees imposed upon borrowers which are in fact a charge for services in addition to the charge for the use of borrowed money, shall not be included as interest. To the extent limited by this subdivision, the 90-percent requirement in section 856(c)(2)(B) permits the inclusion of interest generally, while the 75-percent requirement in section 856(c)(3)(B) includes interest only to the extent that it relates to obligations secured by mortgages on real property. Where a mortgage covers both real and other property an apportionment of the interest income must be made for purposes of the 75-percent requirement.

(iii) *Rents from real property*.—See § 1.856-4 for the definition of rents from real property.

(iv) *Gain from sale or other disposition of property*.—The 90-percent requirement in section 856(c)(2)(D) permits the inclusion

of net gain from the sale or other disposition of stock, securities, and real property, while the 75-percent requirement in section 856(c)(3)(C) limits the includible amount to the net gain from the sale or other disposition of only real property and transferable shares in other qualified real estate investment trusts.

(v) *Gross income from sale or other disposition of property.*—For purposes of the 30-percent limitation in section 856(c)(4), a loss from the sale or other disposition of the property described in such section is not netted with gain from the sale or other disposition of such property. A determination of the period for which such property has been held shall be governed by the provisions of section 1223 and the regulations thereunder.

(d) *Diversification of investment requirements.*—(1) *75-percent test.*—Section 856(c)(5)(A) requires that at the close of each quarter of the taxable year at least 75 percent of the value of the total assets of the trust be represented by one or more of the following:

- (i) Real estate assets;
- (ii) Government securities; and
- (iii) Cash and cash items (including receivables).

For purposes of this subparagraph the term “receivables” means only those receivables which arise in the ordinary course of the trust’s operation and does not include receivables purchased from another person. Subject to the limitations in section 856(c)(5)(B) and subparagraph (2) of this paragraph, the character of the remaining 25 percent (or less) of the value of the total assets is not restricted.

(2) *Limitations on certain securities.*—Under section 856(c)(5)(B), not more than 25 percent of the value of the total assets of the trust may be represented by securities other than those described in section 856(c)(5)(A). The ownership of securities under the 25-percent limitation in section 856(c)(5)(B) is further limited in respect of any one issuer to an amount not greater in value than 5 percent of the value of the total assets of the trust and to not more than 10 percent of the outstanding voting securities of such issuer. Thus, if the real estate investment trust meets the 75-percent asset diversification requirement in section 856(c)(5)(A), it will also meet the first test under section 856(c)(5)(B) since it will, of necessity, have not more than 25 percent of its total assets represented by securities other than those described in section 856(c)(5)(A). However, the trust must also meet two additional tests under section 856(c)(5)(B), i.e. it cannot own the securities of any one issuer in an amount (i) greater in value than 5 percent of the value of the trust’s total assets, or (ii) representing more than 10 percent of the outstanding voting securities of such issuer.

(3) *Determination of investment status.*—The term “total assets” means the gross assets of the trust determined in accordance with generally accepted accounting principles. In order to determine the effect, if any, which an acquisition of any security or other property may have with respect to the status of a trust as a real estate investment trust, section 856(c)(5) requires a revaluation of the trust’s assets at the end of the quarter in which such acquisition was made. A revaluation of assets is not required at the end of any quarter during which there has been no acquisition of a security or other property since the mere change in market value of property held by

the trust does not, of itself, affect the status of the trust as a real estate investment trust. A change in the nature of "cash items", for example, the prepayment of insurance or taxes, does not constitute the acquisition of "other property" for purposes of this subparagraph. A real estate investment trust shall keep sufficient records as to investments so as to be able to show that it has complied with the provisions of section 856(c)(5) during the taxable year. Such records shall be kept at all times available for inspection by any internal revenue officer or employee and shall be retained so long as the contents thereof may become material in the administration of any internal revenue law.

(4) *Illustrations.*—The application of section 856(c)(5) and this paragraph may be illustrated by the following examples:

Example (1). Real Estate Investment Trust M, at the close of the first quarter of its taxable year, has its assets invested as follows:

	Percent
Cash	6
Government securities	7
Real estate assets	63
Securities of various corporations (not exceeding, with respect to any one issuer, 5 percent of the value of the total assets of the trust nor 10 percent of the outstanding voting securities of such issuer)	24
Total	100

Trust M meets the requirements of section 856(c)(5) for that quarter of its taxable year.

Example (2). Real Estate Investment Trust P, at the close of the first quarter of its taxable year, has its assets invested as follows:

	Percent
Cash	6
Government securities	7
Real estate assets	63
Securities of Corporation Z	20
Securities of Corporation X	4
Total	100

Trust P meets the requirement of section 856(c)(5)(A) since at least 75 percent of the value of the total assets is represented by cash, Government securities, and real estate assets. However, Trust P does not meet the diversification requirements of section 856(c)(5)(B) because its investment in the voting securities of Corporation Z exceeds 5 percent of the value of the trust's total assets.

Example (3). Real Estate Investment Trust G, at the close of the first quarter of its taxable year, has its assets invested as follows:

	Percent
Cash	4
Government securities	9
Real estate assets	70
Securities of Corporation S	5
Securities of Corporation L	4
Securities of Corporation U	4
Securities of Corporation M	4
(which equals 25 percent of Corporation M's outstanding voting securities)	
Total	100

Trust G meets the 75-percent requirement of section 856(c)(5)(A), but does not meet the requirements of section 856(c)(5)(B) because its investment in the voting securities of Corporation M exceeds 10 percent of Corporation M's outstanding voting securities.

Example (4). Real Estate Investment Trust R, at the close of the first quarter of its taxable year (i.e., calendar year), is a qualified real estate investment trust and has its assets invested as follows:

Cash	\$5,000
Government securities.....	4,000
Receivables	4,000
Real estate assets.....	68,000
Securities of Corporation P.....	4,000
Securities of Corporation O.....	5,000
Securities of Corporation U.....	5,000
Securities of Corporation T.....	5,000
Total assets.....	100,000

During the second calendar quarter the stock in Corporation P increases in value to \$50,000 while the value of the remaining assets has not changed. If Real Estate Investment Trust R has made no acquisition of stock or other property during such second quarter it will not lose its status as a real estate investment trust merely by reason of the appreciation in the value of P's stock. If, during the third quarter, Trust R acquires stock of Corporation S worth \$2,000, such acquisition will necessitate a revaluation of all of the assets of Trust R as follows:

Cash	\$3,000
Government securities.....	4,000
Receivables	4,000
Real estate assets.....	68,000
Securities in Corporation P.....	50,000
Securities in Corporation O.....	5,000
Securities in Corporation U.....	5,000
Securities in Corporation T.....	5,000
Securities in Corporation S.....	2,000
Total assets.....	146,000

Because of the discrepancy between the value of its various investments and the 25-percent limitation in section 856(c)(5), resulting in part from the acquisition of the stock of Corporation S, Trust R, at the end of the third quarter, loses its status as a real estate investment trust. However, if Trust R, within 30 days after the close of such quarter, eliminates the discrepancy so that it meets the 25-percent limitation, the trust will be considered to have met the requirements of section 856(c)(5) at the close of the third quarter, even though the discrepancy between the value of its investment in Corporation P and the 5-percent limitation in section 856(c)(5) (resulting solely from appreciation) may still exist. If instead of acquiring stock of Corporation S, Trust R had acquired additional stock of Corporation P, then, because of the discrepancy between the value of its investments and both the 5-percent and the 25-percent limitations in section 856(c)(5) resulting in part from this acquisition, Trust R, at the end of the third quarter, would lose its status as a real estate investment trust, unless within 30 days after the close of such quarter both of the discrepancies are eliminated.

Example (5). If, in the previous example, the stock of Corporation P appreciates only to \$10,000 during the second quarter and, in the third quarter, Trust R acquires stock of Corporation S worth \$1,000, the assets as of the end of the third quarter would be as follows:

Cash	\$4, 000
Government securities.....	4, 000
Receivables	4, 000
Real estate assets.....	68, 000
Securities in Corporation P.....	10, 000
Securities in Corporation O.....	5, 000
Securities in Corporation U.....	5, 000
Securities in Corporation T.....	5, 000
Securities in Corporation S.....	1, 000
Total assets.....	106, 000

Because the discrepancy between the value of its investment in Corporation P and the 5-percent limitation in section 856(c)(5) results solely from appreciation, and because there is no discrepancy between the value of its various investments and the 25-percent limitation, Trust R, at the end of the third quarter, does not lose its status as a real estate investment trust. If, instead of acquiring stock of Corporation S, Trust R had acquired additional stock of Corporation P worth \$1,000, then, because of the discrepancy between the value of its investment in Corporation P and the 5-percent limitation resulting in part from this acquisition, Trust R, at the end of the third quarter, would lose its status as a real estate investment trust, unless within 30 days after the close of such quarter this discrepancy is eliminated.

§ 1.856-3 DEFINITIONS.—For purposes of the regulations under part II, subchapter M, chapter 1 of the Code, the following definitions shall apply.

(a) *Value*.—The term “value” means, with respect to securities for which market quotations are readily available, the market value of such securities; and with respect to other securities and assets, fair value as determined in good faith by the trustees of the real estate investment trust. In the case of securities of other qualified real estate investment trusts, fair value shall not exceed market value or asset value, whichever is higher.

(b) *Real estate assets*.—The term “real estate assets” means real property, interests in mortgages on real property (including interests in mortgages on leaseholds of land or improvements thereon), and shares in other qualified real estate investment trusts. The term “mortgages on real property” includes deeds of trust on real property.

(c) *Interests in real property*.—The term “interests in real property” includes fee ownership and co-ownership of land or improvements thereon and leaseholds of land or improvements thereon. Such term does not, however, include mineral, oil, or gas royalty interests, as, for example, a retained economic interest in coal with respect to which the special provisions of section 631(c) apply.

(d) *Real property*.—The term “real property” means land or improvements thereon, such as buildings or other inherently permanent structures thereon (including items which are structural components of such buildings or structures). In addition, the term “real property” includes interests in real property. Local law definitions will not be controlling for purposes of determining the meaning of the term “real property” as used in section 856 and the regulations thereunder.

The term includes, for example, the wiring in a building, plumbing systems, central heating or central air-conditioning machinery, pipes or ducts, elevators or escalators installed in the building, or other items which are structural components of a building or other permanent structure. The term does not include assets accessory to the operation of a business, such as machinery, printing press, transportation equipment which is not a structural component of the building, office equipment, refrigerators, individual air-conditioning units, grocery counters, furnishings of a motel, hotel, or office building, etc., even though such items may be termed fixtures under local law.

(e) *Securities*.—The term “securities” does not include “interests in real property” or “real estate assets” as those terms are defined in section 856 and this section.

(f) *Qualified real estate investment trusts*.—The term “qualified real estate investment trust” means a real estate investment trust within the meaning of part II of subchapter M which is taxable under such part as a real estate investment trust. For purposes of the 75-percent requirement in section 856(c)(5)(A), the trust whose stock has been included by another trust as “real estate assets” must be a “qualified real estate investment trust” for its full taxable year in which falls the close of each quarter of the trust’s taxable year for which the computation is made. For example, Real Estate Investment Trust Z for its taxable year ending December 31, 1963, holds as “real estate assets” stock in Real Estate Investment Trust Y, which is also on a calendar year. If Trust Y is not a qualified real estate investment trust for its full taxable year ending December 31, 1963, Trust Z may not include the stock of Trust Y as “real estate assets” in computing the 75-percent requirement as of the close of any quarter of its taxable year ending December 31, 1963.

(g) *Partnership interest*.—In the case of a real estate investment trust which is a partner in a partnership, as defined in section 7701(a)(2) and the regulations thereunder, the trust will be deemed to own its proportionate share of each of the assets of the partnership and will be deemed to be entitled to the income of the partnership attributable to such share. For purposes of section 856, the interest of a partner in the partnership’s assets shall be determined in accordance with his capital interest in the partnership. The character of the various assets in the hands of the partnership and items of gross income of the partnership shall retain the same character in the hands of the partners for all purposes of section 856. Thus, for example, if the trust owns a 30-percent capital interest in a partnership which owns a piece of rental property the trust will be treated as owning 30 percent of such property and as being entitled to 30 percent of the rent derived from the property by the partnership. Similarly, if the partnership holds any property primarily for sale to customers in the ordinary course of its trade or business, the trust will be treated as holding its proportionate share of such property primarily for such purpose. Also, for example, where a partnership sells real property or a trust sells its interest in a partnership which owns real property, any gross income realized from such sale, to the extent that it is attributable to the real property, shall be deemed gross income from the sale or disposition of real property held for either the period that the partnership has held the real property or the period that the trust was a member of the partnership, whichever is the shorter.

§ 1.856-4 RENTS FROM REAL PROPERTY.—(a) *In general.*—Subject to the limitations of section 856(d) and paragraph (b) of this section, the term “rents from real property” means, generally, the gross amounts received for the use of, or the right to use, real property of the real estate investment trust. Where an amount of rent is received with respect to property consisting of both real and other property, such as a furnished apartment building, hotel, or motel, an apportionment of the rent is required. Only that part of the rent which is attributable to “real property” shall be included for purposes of the gross income requirements in section 856(c) (2) and (3) and paragraph (c) of § 1.856-2.

(b) *Amounts not includible as rent.*—Section 856(d) contains restrictions and limitations under which certain amounts, although received or accrued for the use of, or the right to use, real property of the trust, will not be includible as “rents from real property” for purposes of the gross income requirements in section 856(c) (2) and (3) and paragraph (c) of § 1.856-2. Thus, section 856(d) specifically excludes the following:

(1) *Where amount of rent depends on income or profits of any person.*—Any amount received or accrued, directly or indirectly, with respect to any real property if the determination of such amount depends in whole or in part on the income or profits derived by any person from such property. However, any amount so accrued or received shall not be excluded from the term “rents from real property” *solely* by reason of being based on a fixed percentage or percentages of receipts or sales (whether or not receipts or sales are adjusted for returned merchandise, or Federal, State or local sales taxes). Thus, for example, “rents from real property” would include rents where the lease provides for differing percentages of receipts or sales from different departments or from separate floors of a retail store so long as each percentage is fixed at the time of entering into the lease. However, where a trust leases real property to a tenant under terms other than solely on a fixed sum rental (i.e., for example, a percentage of the tenant’s gross receipts), and the tenant subleases all or a part of such property under an agreement which provides for a rental based in whole or in part on the income or profits of the sublessee, the entire amount of the rent received by the trust from the prime tenant with respect to such property is disqualified as “rents from real property.” Where in accordance with the terms of an agreement an amount received or accrued as rent for the taxable year includes both a fixed rental and a percentage of the lessee’s income or profits in excess of a specific amount (usually determined before deducting the fixed rental and sometimes called “overage rents”), neither the fixed rental nor the additional amount will qualify as “rents from real property.” However, where the amount received or accrued for the taxable year under such an agreement includes only the fixed rental, the determination of which does not depend in whole or in part on the income or profits derived by the lessee, such amount may qualify as “rents from real property.” In any event, an amount will not qualify as “rents from real property” if, considering the lease and all the surrounding circumstances, the arrangement does not conform with normal business practices but is in reality used as a means of basing the rent on income or profits.

(2) *Ownership of person from whom trust receives rent.*—Any amount received or accrued, directly or indirectly, from any person in which the real estate investment trust owns at any time during its taxable year the specified percentage or number of shares of stock (or interest in the assets or net profits) of such person. Any amount received from such person will not qualify as “rents from real property” if such person is a corporation and the trust owns 10 percent or more of the total combined voting power of all classes of its stock entitled to vote or 10 percent or more of the total number of shares of all classes of its outstanding stock, or if such person is not a corporation and the trust owns a 10-percent-or-more interest in its assets or net profits. For example, a trust leases an office building to a tenant for which it receives rent of \$100,000 for the taxable year 1962. The lessee of the building subleases space to various subtenants for which it receives gross rent of \$500,000 for the year 1962. The trust owns 15 percent of the total assets of an unincorporated subtenant. The rent paid by this subtenant for the taxable year is \$50,000. Therefore, $\$10,000$ ($50,000/500,000 \times \$100,000$) of the rent paid to the trust does not qualify as “rents from real property”. Where the real estate investment trust receives, directly or indirectly, any amount of rent from any person in which it owns any proprietary interest, the trust shall submit, at the time it files its return for the taxable year (or before June 1, 1962, whichever is later), a schedule setting forth—

(i) The name and address of such person and the amount received as rent from such person; and

(ii) If such person is a corporation, the highest percentage of the total combined voting power of all classes of its stock entitled to vote, and the highest percentage of the total number of shares of all classes of its outstanding stock, owned by the trust at any time during the trust's taxable year; or

(iii) If such person is not a corporation, the highest percentage of the trust's interest in the assets or net profits of such person, owned by the trust at any time during its taxable year.

(3) *Trust furnishing services or managing property through an independent contractor.*—(i) *In general.*—(a) *General rule.*—Any amount received or accrued, directly or indirectly, with respect to any real property if the real estate investment trust furnishes or renders services to the tenants of such property or manages or operates such property other than through an independent contractor from whom the trust itself does not derive or receive any income. Thus, for example, the trust may not receive any dividends from the independent contractor.

(b) *Customary services for which no separate charge is made.*—Under section 856(d)(3), the trust (through its trustees or its own employees) may not directly furnish or render any services to the tenants of its property and may not directly manage or operate the property. However, for purposes of part II of subchapter M, an amount will not be disqualified as “rent” if services, such as are usually or customarily furnished or rendered in connection with the mere rental of real property, are furnished or rendered to tenants of the property through an independent contractor. The independent contractor must not, however, be an employee of the trust (i.e., the

manner in which he carries out his duties as independent contractor must not be subject to the control of the trust). The supplying of water, heat, and light; the cleaning of windows, public entrances, exits, and lobbies; the collection of trash; and the furnishing of elevator service, telephone answering service, unattended parking lots, and watchman or guard services are examples of services which may or may not (depending upon the circumstances) be customary or incidental to the mere rental of multiple-occupancy real estate. Although the cost of such incidental services may be borne by the trust, the services must, nevertheless, be furnished or rendered through an independent contractor. Furthermore, the facilities through which such services are furnished must be maintained and operated by an independent contractor. For example, if a heating plant is located in the building, it must be maintained and operated by an independent contractor. Where no separate charge is made for such services, no apportionment is required to be made between rents from real property and compensation for these services.

(c) *Services for which a separate charge is made.*—Under section 856(d)(3), the trust may not derive or receive any income from an independent contractor who furnishes or renders services to the tenants of the trust property or who manages or operates such property, regardless of the source from which such income was derived by the independent contractor. To the extent that services, other than those usually or customarily rendered in connection with the mere rental of real property, are rendered to the tenants of the property by the independent contractor, the cost of such services must be borne by the independent contractor, a separate charge must be made therefor, and the amount thereof must be received and retained by the independent contractor; no amount attributable to such services shall be included in the gross income of the trust. In any event, the independent contractor must be adequately compensated for such services. Also, if a separate charge is made for the customary services described in (b) of this subdivision, such charge must be made, and the amount thereof must be received and retained, by the independent contractor rather than by the real estate investment trust. The furnishing of hotel, maid, boarding house, motel, attended parking lot, warehouse, or storage services are examples of services which are not usually or customarily furnished or rendered in connection with the mere rental of real estate, and the trust must not receive any income which is attributable to the furnishing or rendering of such services to tenants of the trust property. Furthermore, where electric current is purchased and then sold to the tenants at a price in excess of the purchase price (for example, submetered), such purchase and sale must be made by the independent contractor and no income therefrom may inure, directly or indirectly, to the trust.

(d) *Trustee functions.*—The requirement that the trust not receive any income from an independent contractor requires that the relationship between the two be an arm's-length relationship. In furtherance of this objective, the term "independent contractor" is specifically defined in subdivision (ii) of this subparagraph. The independent contractor must be adequately compensated for any services which are performed for the trust. Compensation to an independent contractor determined by reference to an unadjusted percentage of gross

rents will generally be considered to be adequate where such percentage is reasonable taking into account the going rate of compensation for managing similar property in the same locality, the services rendered, and other relevant factors. The trustees of the real estate investment trust are not required to delegate or contract out their fiduciary duty to manage the trust itself, as distinguished from rendering or furnishing services to the tenants of its property or managing or operating the property. Thus, the trustees may do all those things necessary, in their fiduciary capacities, to manage and conduct the affairs of the trust itself. For example, the trustees may establish rental terms, choose tenants, enter into and renew leases, and deal with taxes, interest, and insurance, relating to the trust's property. The trustees may also make capital expenditures with respect to the trust's property (as defined in section 263) and may make decisions as to repairs of the trust's property (of the type which would be deductible under section 162), the cost of which may be borne by the trust.

(ii) *Independent contractor defined.*—The term “independent contractor” means—

(a) A person who does not own, directly or indirectly, at any time during the trust's taxable year more than 35 percent of the shares in the real estate investment trust, or

(b) A person—

(i) If a corporation, not more than 35 percent of the total combined voting power of whose stock (or 35 percent of the total shares of all classes of whose stock), or

(ii) If not a corporation, not more than 35 percent of the interest in whose assets or net profits

is owned, directly or indirectly, at any time during the trust's taxable year by one or more persons owning at any time during such taxable year 35 percent or more of the shares in the trust.

(iii) *Information required.*—The real estate investment trust shall submit with its return for the taxable year (or before June 1, 1962, whichever is later) a statement setting forth the name and address of each independent contractor; and

(a) The highest percentage of the outstanding shares in the trust owned at any time during its taxable year by such independent contractor and by any person owning at any time during such taxable year any shares of stock or interest in the independent contractor.

(b) If the independent contractor is a corporation such statement shall set forth the highest percentage of the total combined voting power of its stock and the highest percentage of the total number of shares of all classes of its stock owned at any time during its taxable year by any person owning shares in the trust at any time during such taxable year.

(c) If the independent contractor is not a corporation such statement shall set forth the highest percentage of any interest in its assets or net profits owned at any time during its taxable year by any person owning shares in the trust at any time during such taxable year.

(4) *Attribution rules.*—Paragraphs (2) and (3) of section 856(d) relate to direct or indirect ownership of stock, assets, or net profits by the persons described therein. For purposes of determining such direct or indirect ownership, the rules prescribed by section 318(a)

(for determining the ownership of stock) shall apply except that "10 percent" shall be substituted for "50 percent" in subparagraph (C) of section 318(a) (2).

§ 1.857 STATUTORY PROVISIONS; TAXATION OF REAL ESTATE INVESTMENT TRUSTS AND THEIR BENEFICIARIES.

SEC. 857. TAXATION OF REAL ESTATE INVESTMENT TRUSTS AND THEIR BENEFICIARIES.

(a) **REQUIREMENTS APPLICABLE TO REAL ESTATE INVESTMENT TRUSTS.**—The provisions of this part (other than subsection (d) of this section) shall not apply to a real estate investment trust for a taxable year unless—

(1) The deduction for dividends paid during the taxable year (as defined in section 561, but without regard to capital gains dividends) equal or exceeds 90 percent of its real estate investment trust taxable income for the taxable year (determined without regard to subsection (b) (2) (C)), and

(2) The real estate investment trust complies for such year with regulations prescribed by the Secretary or his delegate for the purpose of ascertaining the actual ownership of the outstanding shares, or certificates of beneficial interest, of such trust.

(b) **METHOD OF TAXATION OF REAL ESTATE INVESTMENT TRUSTS AND HOLDERS OF SHARES OR CERTIFICATES OF BENEFICIAL INTEREST.**—

(1) **IMPOSITION OF NORMAL TAX AND SURTAX ON REAL ESTATE INVESTMENT TRUSTS.**—There is hereby imposed for each taxable year on the real estate investment trust taxable income of every real estate investment trust a normal tax and surtax computed as provided in section 11, as though the real estate investment trust taxable income were the taxable income referred to in section 11. For purposes of computing the normal tax under section 11, the taxable income and the dividends paid deduction of such real estate investment trust for the taxable year (computed without regard to capital gains dividends) shall be reduced by the deduction provided by section 242 (relating to partially tax-exempt interest).

(2) **REAL ESTATE INVESTMENT TRUST TAXABLE INCOME.**—For purposes of this part, the term "real estate investment trust taxable income" means the taxable income of the real estate investment trust, adjusted as follows:

(A) There shall be excluded the excess, if any, of the net long-term capital gain over the net short-term capital loss.

(B) The deductions for corporations provided in part VIII (except section 248) of subchapter B (section 241 and following, relating to the deduction for dividends received, etc.) shall not be allowed.

(C) The deduction for dividends paid (as defined in section 561) shall be allowed, but shall be computed without regard to capital gains dividends.

(D) The taxable income shall be computed without regard to section 443(b) (relating to computation of tax on change of annual accounting period).

(E) The net operating loss deduction provided in section 172 shall not be allowed.

(3) **CAPITAL GAINS.**—

(A) **IMPOSITION OF TAX.**—There is hereby imposed for each taxable year in the case of every real estate investment trust a tax of 25 percent of the excess, if any, of the net long-term capital gain over the sum of—

(i) The net short-term capital loss; and

(ii) The deduction for dividends paid (as defined in section 561) determined with reference to capital gains dividends only.

(B) **TREATMENT OF CAPITAL GAIN DIVIDENDS BY SHAREHOLDERS.**—A capital gain dividend shall be treated by the shareholders or holders of beneficial interests as a gain from the sale or exchange of a capital asset held for more than 6 months.

(C) DEFINITION OF CAPITAL GAIN DIVIDEND.—For purposes of this part, a capital gain dividend is any dividend, or part thereof, which is designated by the real estate investment trust as a capital gain dividend in a written notice mailed to its shareholders or holders of beneficial interests at any time before the expiration of 30 days after the close of its taxable year. If the aggregate amount so designated with respect to a taxable year of the trust (including capital gain dividends paid after the close of the taxable year described in section 858) is greater than the excess of the net long-term capital gain over the net short-term capital loss of the taxable year, the portion of each distribution which shall be a capital gain dividend shall be only that proportion of the amount so designated which such excess of the net long-term capital gain over the net short-term capital loss bears to the aggregate amount so designated.

(4) LOSS ON SALE OR EXCHANGE OF STOCK HELD LESS THAN 31 DAYS.—If—

(A) Under subparagraph (B) of paragraph (3) a shareholder of, or a holder of a beneficial interest in, a real estate investment trust is required, with respect to any share or beneficial interest, to treat any amount as a long-term capital gain, and

(B) Such share or interest is held by the taxpayer for less than 31 days,

then any loss on the sale or exchange of such share or interest shall, to the extent of the amount described in subparagraph (A) of this paragraph, be treated as loss from the sale or exchange of a capital asset held for more than 6 months. For purposes of this paragraph, the rules of section 246(c)(3) shall apply in determining whether any share of stock or beneficial interests has been held for less than 31 days; except that "30 days" shall be substituted for the number of days specified in subparagraph (B) of section 246(c)(3).

(c) RESTRICTIONS APPLICABLE TO DIVIDENDS RECEIVED FROM REAL ESTATE INVESTMENT TRUSTS.—For purposes of section 34(a) (relating to credit for dividends received by individuals), section 116 (relating to an exclusion for dividends received by individuals), and section 243 (relating to deductions for dividends received by corporations), a dividend received from a real estate investment trust which meets the requirements of this part shall not be considered as a dividend.

(d) EARNINGS AND PROFITS.—The earnings and profits of a real estate investment trust for any taxable year (but not its accumulated earnings and profits) shall not be reduced by any amount which is not allowable as a deduction in computing its taxable income for such taxable year. For purposes of this subsection, the term "real estate investment trust" includes a domestic unincorporated trust or association which is a real estate investment trust determined without regard to the requirements of subsection (a).

[Sec. 857 as added by sec. 10(a), Act of Sept. 14, 1960 (Pub. Law 86-779, 74 Stat. 1003) [C.B. 1960-2, 709]]

§ 1.857-1 TAXATION OF REAL ESTATE INVESTMENT TRUSTS.—(a) *Requirements applicable thereto.*—Section 857(a) denies the application of the provisions of part II, subchapter M, chapter 1 of the Code (other than section 857(d), relating to earnings and profits) to a real estate investment trust for a taxable year unless—

(1) The deduction for dividends paid for such taxable year as defined in section 561 (computed without regard to capital gains dividends) is equal to at least 90 percent of its real estate investment trust taxable income for such taxable year (determined without regard to the provisions of section 857(b)(2)(C) and paragraph (c) of § 1.857-3); and

(2) The trust complies for such taxable year with the provisions of § 1.857-6 (relating to records required to be maintained by a real estate investment trust).

See section 858 and § 1.858-1, relating to dividends paid after the close of the taxable year.

(b) *Failure to qualify*.—If a real estate investment trust does not meet the requirements of section 857(a) and paragraph (a) of this section for the taxable year, it will, even though it may otherwise be classified as a real estate investment trust, be taxed in such year as an ordinary corporation and not as a real estate investment trust. In such case, none of the provisions of part II of subchapter M (other than section 857(d)) will be applicable to it. For the rules relating to the applicability of section 857(d), see § 1.857-5.

§ 1.857-2 METHOD OF TAXATION OF REAL ESTATE INVESTMENT TRUSTS.—(a) *Imposition of normal tax and surtax*.—Section 857(b) (1) imposes a normal tax and surtax, computed at the rates and in the manner prescribed in section 11, on the “real estate investment trust taxable income”, as defined in section 857(b) (2) and § 1.857-3, for each taxable year of a real estate investment trust. The tax is imposed as if the real estate investment trust taxable income were the taxable income referred to in section 11. In computing the normal tax under section 11, the real estate investment trust taxable income and the dividends paid deduction (computed without regard to capital gains dividends) shall both be reduced by the deduction for partially tax-exempt interest provided by section 242.

(b) *Taxation of capital gains*.—Section 857(b) (3) (A) imposes a tax of 25 percent for each taxable year on the excess, if any, of the net long-term capital gain of a qualified real estate investment trust over the sum of its net short-term capital loss and its deduction for dividends paid (as defined in section 561) determined with reference to capital gains dividends only. For the definition of capital gains dividend paid by a real estate investment trust, see section 857(b) (3) (C) and paragraph (e) of § 1.857-4. See section 858 and § 1.858-1 for rules relating to dividends paid after the close of the taxable year.

§ 1.857-3 REAL ESTATE INVESTMENT TRUST TAXABLE INCOME.—Section 857(b) (2) requires certain adjustments to be made to convert taxable income of the real estate investment trust to “real estate investment trust taxable income” as follows:

(a) The excess, if any, of the net long-term capital gain over the net short-term capital loss shall be excluded;

(b) The special deductions provided in part VIII of subchapter B (except the deduction under section 248) shall not be allowed. Those not allowed are the deduction for partially tax-exempt interest provided by section 242, the deductions for dividends received provided by sections 243, 244, and 245, and the deduction for certain dividends paid provided by section 247. However, the deduction provided by section 248 (relating to organizational expenditures), otherwise allowable in computing taxable income, shall likewise be allowed in computing “real estate investment trust taxable income”. See section 857(b) (1) and paragraph (a) of § 1.857-2 for treatment of the deduction for partially tax-exempt interest (provided by section 242) for purposes of computing the normal tax under section 11;

(c) The deduction for dividends paid (as defined in section 561) shall be allowed, but shall be computed without regard to capital gains dividends (as defined in section 857(b)(3)(C) and paragraph (e) of § 1.857-4);

(d) The taxable income shall be computed without regard to section 443(b). Thus, the taxable income for a period of less than 12 months shall not be placed on an annual basis even though such short taxable year results from a change of accounting period; and

(e) The net operating loss deduction provided in section 172 shall not be allowed.

§ 1.857-4 METHOD OF TAXATION OF SHAREHOLDERS OF REAL ESTATE INVESTMENT TRUSTS.—(a) *Ordinary income*.—Except as otherwise provided in paragraph (b) of this section (relating to capital gains), a shareholder receiving dividends from a real estate investment trust shall include such dividends in gross income for the taxable year in which they are received. See section 858(b) and paragraph (c) of § 1.858-1 for treatment by shareholders of dividends paid by a real estate investment trust after the close of its taxable year in the case of an election under section 858(a).

(b) *Capital gains*.—Under section 857(b)(3)(B), shareholders of a real estate investment trust who receive capital gains dividends (as defined in paragraph (e) of this section), in respect of the capital gains of an investment trust for a taxable year for which it is taxable under part II of subchapter M as a real estate investment trust, shall treat such capital gains dividends as gains from the sale or exchange of capital assets held for more than six months and realized in the taxable year of the shareholder in which the dividend was received.

(c) *Special treatment of loss on the sale or exchange of real estate investment trust stock held less than 31 days*.—(1) *In general*.—Under section 857(b)(4), if any person with respect to a share of real estate investment trust stock held for a period of less than 31 days is required by section 857(b)(3)(B) to include in gross income as a gain from the sale or exchange of a capital asset held for more than six months the amount of a capital gains dividend, then such person shall, to the extent of such amount, treat any loss on the sale or exchange of such share as a loss from the sale or exchange of a capital asset held for more than six months.

(2) *Determination of holding period*.—The rules contained in section 246(c)(3) (relating to the determination of holding periods for purposes of the deduction for dividends received) shall be applied in determining whether, for purposes of section 857(b)(4)(B) and this paragraph, a share of real estate investment trust stock has been held for a period of less than 31 days. In applying those rules, however, “30 days” shall be substituted for the number of days specified in subparagraph (B) of such section.

(3) *Illustration*.—The application of section 857(b)(4) and this paragraph may be illustrated by the following example:

Example. On December 15, 1961, A purchased a share of stock in the S Real Estate Investment Trust for \$20. The S trust declared a capital gains dividend of \$2 per share to shareholders of record on December 31, 1961. A, therefore, received a capital gain dividend of \$2 which, pursuant to section 857(b)(3)(B), he must treat as a gain from the sale or exchange of a capital asset held for more than

six months. On January 5, 1962, A sold his share of stock in the S trust for \$17.50, which sale resulted in a loss of \$2.50. Under section 857(b) (4) and this paragraph, A must treat \$2 of such loss (an amount equal to the capital gain dividend received with respect to such share of stock) as a loss from the sale or exchange of a capital asset held for more than six months.

(d) *Dividend received credit, exclusion, and deduction not allowed.*—Any dividend received from a real estate investment trust which, for the taxable year to which the dividend relates, is a qualified real estate investment trust, shall not be eligible for the dividend received credit under section 34(a), the dividend received exclusion under section 116, or the dividend received deduction under section 243.

(e) *Definition of capital gain dividend.*—A capital gain dividend, as defined in section 857(b) (3) (C), is any dividend or part thereof which is designated by a real estate investment trust as a capital gain dividend in a written notice mailed to its shareholders not later than 30 days after the close of its taxable year. If the aggregate amount so designated with respect to the taxable year (including capital gain dividends paid after the close of the taxable year pursuant to an election under section 858) is greater than the excess of the net long-term capital gain over the net short-term capital loss of the taxable year, the portion of each distribution which shall be a capital gain dividend shall be only that proportion of the amount so designated which such excess of the net long-term capital gain over the net short-term capital loss bears to the aggregate of the amount so designated. For example, a real estate investment trust making its return on the calendar year basis advised its shareholders by written notice mailed December 30, 1961, that of a distribution of \$500,000 made December 15, 1961, \$200,000 constituted a capital gain dividend, amounting to \$2 per share. It was later discovered that an error had been made in determining the excess of the net long-term capital gain over the net short-term capital loss of the taxable year and that such excess was \$100,000 instead of \$200,000. In such case, each shareholder would have received a capital gain dividend of \$1 per share instead of \$2 per share.

§ 1.857-5 EARNINGS AND PROFITS OF A REAL ESTATE INVESTMENT TRUST.—(a) Any real estate investment trust, whether or not such trust meets the requirements of section 857(a) and paragraph (a) of § 1.857-1 for any taxable year beginning after December 31, 1960, shall apply paragraph (b) of this section in computing its earnings and profits for such taxable year.

(b) In the determination of the earnings and profits of a real estate investment trust, section 857(d) provides that such earnings and profits for any taxable year (but not the accumulated earnings and profits) shall not be reduced by any amount which is not allowable as a deduction in computing its taxable income for the taxable year. Thus, if a trust would have had earnings and profits of \$500,000 for the taxable year except for the fact that it had a net capital loss of \$100,000, which amount was not deductible in determining its taxable income, its earnings and profits for that year if it is a real estate investment trust would be \$500,000. If the real estate investment

trust had no accumulated earnings and profits at the beginning of the taxable year, in determining its accumulated earnings and profits as of the beginning of the following taxable year, the earnings and profits for the taxable year to be considered in such computation would amount to \$400,000 assuming that there had been no distribution from such earnings and profits. If distributions had been made in the taxable year in the amount of the earnings and profits then available for distribution, \$500,000, the trust would have as of the beginning of the following taxable year neither accumulated earnings and profits nor a deficit in accumulated earnings and profits, and would begin such year with its paid-in capital reduced by \$100,000, an amount equal to the excess of the \$500,000 distributed over the \$400,000 accumulated earnings and profits which would otherwise have been carried into the following taxable year.

§ 1.857-6 RECORDS TO BE KEPT BY A REAL ESTATE INVESTMENT TRUST.—(a) *In general.*—Under section 857(a)(2) a real estate investment trust is required to keep such records as will disclose the actual ownership of its outstanding stock. Thus, every real estate investment trust shall maintain in the internal revenue district in which it is required to file its income tax return permanent records showing the information relative to the actual owners of its stock contained in the written statements required by this section to be demanded from its shareholders. Such records shall be kept at all times available for inspection by any internal revenue officer or employee, and shall be retained so long as the contents thereof may become material in the administration of any internal revenue law.

(b) *Actual owner of stock.*—The actual owner of stock of a real estate investment trust is the person who is required to include in gross income in his return the dividends received on the stock. Generally, such person is the shareholder of record of the real estate investment trust. However, where the shareholder of record is not the actual owner of the stock, the stockholding record of the real estate investment trust may not disclose the actual ownership of such stock. Accordingly, the real estate investment trust shall demand written statements from shareholders of record disclosing the actual owners of stock as required in paragraph (d) of this section.

(c) *Stock ownership for personal holding company determination.*—For the purpose of determining under section 856(a)(6) whether a trust, claiming to be a real estate investment trust, is a personal holding company, the permanent records of the trust shall show the maximum number of shares of the trust (including the number and face value of securities convertible into stock of the trust) to be considered as actually or constructively owned by each of the actual owners of any of its stock at any time during the last half of the trust's taxable year, as provided in section 544.

(d) *Statements to be demanded from shareholders.*—The information required by paragraphs (b) and (c) of this section shall be set forth in written statements which shall be demanded from shareholders of record as follows:

(1) In the case of a trust having 2,000 or more shareholders of record of its stock on any dividend record date, from each record holder of 5 percent or more of its stock; or

(2) In the case of a trust having less than 2,000 and more than 200 shareholders of record of its stock on any dividend record date, from each record holder of 1 percent or more of its stock; or

(3) In the case of a trust having 200 or less shareholders of record of its stock on any dividend record date, from each record holder of one-half of 1 percent or more of its stock.

(e) *Demands for statements.*—The written statements from shareholders of record shall be demanded by the real estate investment trust in accordance with paragraph (d) of this section within 30 days after the close of the real estate investment trust's taxable year (or before June 1, 1962, whichever is later). When making demand for such written statements, the trust shall inform each such shareholder of his duty to submit at the time he files his income tax return (or before July 1, 1962, whichever is later) the statements which are required by § 1.857-7 if he fails or refuses to comply with such demand. A list of the persons failing or refusing to comply in whole or in part with the trust's demand for statements under this section shall be maintained as a part of the trust's records required by this section. A trust which fails to keep such records to show, to the extent required by this section, the actual ownership of its outstanding stock shall be taxable as an ordinary corporation and not as a real estate investment trust.

§ 1.857-7 INFORMATION REQUIRED IN RETURNS OF SHAREHOLDERS.—

(a) *In general.*—Any person who fails or refuses to submit to a real estate investment trust the written statements required under § 1.857-6 to be demanded by such trust from its shareholders of record shall submit at the time he files his income tax return for his taxable year which ends with, or includes, the last day of the trust's taxable year (or before July 1, 1962, whichever is later) a statement setting forth the information required by this section.

(b) *Information required.*—(1) *Shareholder of record not actual owner.*—In the case of any person holding shares of stock in any trust claiming to be a real estate investment trust who is not the actual owner of such stock, the name and address of each actual owner, the number of shares owned by each actual owner at any time during such person's taxable year, and the amount of dividends belonging to each actual owner. The requirements of this subparagraph will be met if the person holding such shares submits a copy of Form 1087, pursuant to paragraph (c)(1) of § 1.6042-1, setting forth such information.

(2) *Actual owner of shares.*—In the case of an actual owner of shares of stock in any trust claiming to be a real estate investment trust—

(i) The name and address of each such trust, the number of shares actually owned by him at any and all times during his taxable year, and the amount of dividends from each such trust received during his taxable year;

(ii) If shares of any such trust were acquired or disposed of during such person's taxable year, the name and address of the trust, the number of shares acquired or disposed of, the dates of acquisition or disposition, and the names and addresses of the persons from whom such shares were acquired or to whom they were transferred;

(iii) If any shares of stock (including securities convertible into

stock) of any such trust are also owned by any member of such person's family (as defined in section 544(a)(2)), or by any of his partners, the name and address of the trust, the names and addresses of such members of his family and his partners, and the number of shares owned by each such member of his family or partner at any and all times during such person's taxable year; and

(iv) The names and addresses of any corporation, partnership, association, or trust, in which such person had a beneficial interest of 10 percent or more at any time during his taxable year.

§ 1.857-8 INFORMATION RETURNS.—Nothing in §§ 1.857-6 and 1.857-7 shall be construed to relieve a real estate investment trust or its shareholders from the duty of filing information returns required by regulations prescribed under the provisions of subchapter A, chapter 61 of the Code.

§ 1.858 STATUTORY PROVISIONS; DIVIDENDS PAID BY REAL ESTATE INVESTMENT TRUST AFTER CLOSE OF TAXABLE YEAR.

SEC. 858. DIVIDENDS PAID BY REAL ESTATE INVESTMENT TRUST AFTER CLOSE OF TAXABLE YEAR.

(a) GENERAL RULE.—For purposes of this part, if a real estate investment trust—

(1) Declares a dividend before the time prescribed by law for the filing of its return for a taxable year (including the period of any extension of time granted for filing such return), and

(2) Distributes the amount of such dividend to shareholders or holders of beneficial interests in the 12-month period following the close of such taxable year and not later than the date of the first regular dividend payment made after such declaration, the amount so declared and distributed shall, to the extent the trust elects in such return in accordance with regulations prescribed by the Secretary or his delegate, be considered as having been paid during such taxable year, except as provided in subsections (b) and (c).

(b) RECEIPT BY SHAREHOLDER.—Amounts to which subsection (a) applies shall be treated as received by the shareholder or holder of a beneficial interest in the taxable year in which the distribution is made.

(c) NOTICE TO SHAREHOLDERS.—In the case of amounts to which subsection (a) applies, any notice to shareholders or holders of beneficial interests required under this part with respect to such amounts shall be made not later than 30 days after the close of the taxable year in which the distribution is made.

[Sec. 858 as added by sec. 10(a), Act of Sept. 14, 1960 (Pub. Law 86-779, 74 Stat. 1008) [C.B. 1960-2, 709]]

§ 1.858-1 DIVIDENDS PAID BY REAL ESTATE INVESTMENT TRUST AFTER CLOSE OF TAXABLE YEAR.—(a) General rule.—In—

(1) Determining under section 857(a) and paragraph (a) of § 1.857-1 whether the deduction for dividends paid during the taxable year (without regard to capital gains dividends) by a real estate investment trust equals or exceeds 90 percent of its real estate investment trust taxable income (determined without regard to the provisions of section 857(b)(2)(C)),

(2) Computing its real estate investment trust taxable income (under section 857(b)(2) and § 1.857-3), and

(3) Determining the amount of capital gains dividends (as defined in section 857(b)(3) and paragraph (e) of § 1.857-4) paid during the taxable year, any dividend (or portion thereof) declared by the real estate investment trust either before or after the close of the taxable year but in

any event before the time prescribed by law for the filing of its return for the taxable year (including the period of any extension of time granted for filing such return) shall, to the extent the trust so elects in such return, be treated as having been paid during such taxable year. This rule is applicable only if the entire amount of such dividend is actually distributed to the shareholders in the 12-month period following the close of such taxable year and not later than the date of the first regular dividend payment made after such declaration.

(b) *Election.*—(1) *Method of making election.*—The election must be made in the return filed by the trust for the taxable year. The election shall be made by the real estate investment trust by treating the dividend (or portion thereof) to which such election applies as a dividend paid during the taxable year of the trust in computing its real estate investment trust taxable income, or if the dividend (or portion thereof) to which such election applies is to be designated by the trust as a capital gains dividend, in computing the amount of capital gains dividends paid during such taxable year. The election provided in section 858(a) may be made only to the extent that the earnings and profits of the taxable year (computed with the application of section 857(d) and § 1.857-5) exceed the total amount of distributions out of such earnings and profits actually made during the taxable year (not including distributions with respect to which an election has been made for a prior year under section 858(a)). The dividend or portion thereof, with respect to which the real estate investment trust has made a valid election under section 858(a), shall be considered as paid out of the earnings and profits of the taxable year for which such election is made, and not out of the earnings and profits of the taxable year in which the distribution is actually made.

(2) *Irrevocability of the election.*—After the expiration of the time for filing the return for the taxable year for which an election is made under section 858(a), such election shall be irrevocable with respect to the dividend or portion thereof to which it applies.

(c) *Receipt by shareholders.*—Under section 858(b), the dividend or portion thereof, with respect to which a valid election has been made, will be includible in the gross income of the shareholders of the real estate investment trust for the taxable year in which the dividend is received by them.

(d) *Illustrations.*—The application of paragraphs (a), (b), and (c) of this section may be illustrated by the following examples:

Example (1). The X Trust, a real estate investment trust, had taxable income (and earnings and profits) for the calendar year 1961 of \$100,000. During that year the trust distributed to shareholders taxable dividends aggregating \$88,000. On March 10, 1962, the trust declared a dividend of \$37,000 payable to shareholders on March 20, 1962. Such dividend consisted of the first regular quarterly dividend for 1962 of \$25,000 plus an additional \$12,000 representing that part of the taxable income for 1961 which was not distributed in 1961. On March 15, 1962, the X Trust filed its Federal income tax return and elected therein to treat \$12,000 of the total dividend of \$37,000 to be paid to shareholders on March 20, 1962, as having been paid during the taxable year 1961. Assuming that the X Trust actually distributed the entire amount of the dividend of \$37,000 on

March 20, 1962, an amount equal to \$12,000 thereof will be treated for the purposes of section 857(a) as having been paid during the taxable year 1961. Upon distribution of such dividend the trust becomes a qualified real estate investment trust for the taxable year 1961. Such amount (\$12,000) will be considered by the X Trust as a distribution out of the earnings and profits for the taxable year 1961, and will be treated by the shareholders as a taxable dividend for the taxable year in which such distribution is received by them. However, assuming that the X Trust is not a qualified real estate investment trust for the calendar year 1962, nevertheless, the \$12,000 portion of the dividend (paid on March 20, 1962) which the trust elected to relate to the calendar year 1961, will not qualify as a dividend for purposes of section 34, 116, or 243.

Example (2). The Y Trust, a real estate investment trust, had taxable income (and earnings and profits) for the calendar year 1964 of \$100,000, and for 1965 taxable income (and earnings and profits) of \$125,000. On January 1, 1964, the trust had a deficit in its earnings and profits accumulated since February 28, 1913, of \$115,000. During the year 1964 the trust distributed to shareholders taxable dividends aggregating \$85,000. On March 5, 1965, the trust declared a dividend of \$65,000 payable to shareholders on March 31, 1965. On March 15, 1965, the Y Trust filed its Federal income tax return in which it included \$40,000 of the total dividend of \$65,000 payable to shareholders on March 31, 1965, as a dividend paid by it during the taxable year 1964. On March 31, 1965, the Y Trust distributed the entire amount of the dividend of \$65,000 declared on March 5, 1965. The election under section 858(a) is valid only to the extent of \$15,000, the amount of the undistributed earnings and profits for 1964 (\$100,000 earnings and profits less \$85,000 distributed during 1964). The remainder (\$50,000) of the \$65,000 dividend paid on March 31, 1965, could not be the subject of an election, and such amount will be regarded as a distribution by the Y Trust out of earnings and profits for the taxable year 1965. Assuming that the only other distribution by the Y Trust during 1965 was a distribution of \$75,000 paid as a dividend on October 31, 1965, the total amount of the distribution of \$65,000 paid on March 31, 1965, is to be treated by the shareholders as taxable dividends for the taxable year in which such dividend is received. The Y Trust will treat the amount of \$15,000 as a distribution of the earnings or profits of the trust for the taxable year 1964, and the remaining \$50,000 as a distribution of the earnings or profits for the year 1965. The distribution of \$75,000 on October 31, 1965, is, of course, a taxable dividend out of the earnings and profits for the year 1965.

(e) *Notice to shareholders.*—Section 858(c) provides that, in the case of dividends with respect to which a real estate investment trust has made an election under section 858(a), any notice to shareholders required under part II of subchapter M, with respect to such amounts, shall be made not later than 30 days after the close of the taxable year in which the distribution is made. Thus, the notice requirement of section 857(b)(3)(C) and paragraph (e) of § 1.857-4 with respect to capital gains dividends may be satisfied with respect to amounts to which section 858(a) and this section apply if the notice relating to such amounts is mailed to the shareholders not later than 30 days after

the close of the taxable year in which the distribution is made. If the notice under section 858(c) relates to an election with respect to any capital gains dividends, such capital gains dividends shall be aggregated by the real estate investment trust with the designated capital gains dividends actually paid during the taxable year to which the election applies (not including such dividends with respect to which an election has been made for a prior year under section 858) for the purpose of determining whether the aggregate of the designated capital gains dividends with respect to such taxable year of the trust is greater than the excess of the net long-term capital gain over the net short-term capital loss of the trust. See section 857(b) (3) (C) and paragraph (e) of § 1.857.4.

PAR. 2. The principal heading for the regulations under subchapter M, chapter 1 of the Code is stricken and the following new heading is inserted in lieu thereof:

REGULATED INVESTMENT COMPANIES AND REAL ESTATE INVESTMENT TRUSTS

Regulated Investment Companies

PAR 3. Paragraph (a) of § 1.851-2 is amended by revising the first and second sentences. This amended provision reads as follows:

§ 1.851-2 LIMITATIONS.—(a) *Election to be a regulated investment company.*—Under the provisions of section 851(b) (1), a corporation, even though it satisfies the other requirements of part I, subchapter M, chapter 1 of the Code for the taxable year, will not be considered a regulated investment company for such year, within the meaning of such part I, unless it elects to be a regulated investment company for such taxable year, or has made such an election for a previous taxable year which began after December 31, 1941. The election shall be made by the taxpayer by computing taxable income as a regulated investment company in its return for the first taxable year for which the election is applicable. No other method of making such election is permitted. An election once made is irrevocable for such taxable year and all succeeding taxable years.

PAR. 4. Section 1.851-4 is amended by revising the first sentence. This amended provision reads as follows:

§ 1.851-4 DETERMINATION OF STATUS.—With respect to the effect which certain discrepancies between the value of its various investments and the requirements of section 851(b) (4) and paragraph (c) of § 1.851-2, or the effect that the elimination of such discrepancies will have on the status of a company as a regulated investment company for purposes of part I, subchapter M, chapter 1 of the Code, see section 851(d). A company claiming to be a regulated investment company shall keep sufficient records as to investments so as to be able to show that it has complied with the provisions of section 851 during the taxable year. Such records shall be kept at all times available for inspection by any internal revenue officer or employee and shall be retained so long as the contents thereof may become material in the administration of any internal revenue law.

PAR. 5. Section 1.852 is amended by revising subsection (a) and by revising subsection (b) (3) (C) of section 852 and by revising the historical note. These amended provisions read as follows:

§ 1.852 STATUTORY PROVISIONS; TAXATION OF REGULATED INVESTMENT COMPANIES AND THEIR SHAREHOLDERS.

SEC. 852. TAXATION OF REGULATED INVESTMENT COMPANIES AND THEIR SHAREHOLDERS.

(a) REQUIREMENTS APPLICABLE TO REGULATED INVESTMENT COMPANIES.—The provisions of this part (other than subsection (c) of this

section) shall not be applicable to a regulated investment company for a taxable year unless—

(1) The deduction for dividends paid during the taxable year (as defined in section 561, but without regard to capital gains dividends) equals or exceeds 90 percent of its investment company taxable income for the taxable year (determined without regard to subsection (b) (2) (D)), and

(2) The investment company complies for such year with regulations prescribed by the Secretary or his delegate for the purpose of ascertaining the actual ownership of its outstanding stock.

(b) METHOD OF TAXATION OF COMPANIES AND SHAREHOLDERS. * * *

(3) CAPITAL GAINS. * * *

(C) DEFINITION OF CAPITAL GAIN DIVIDEND.—For purposes of this part, a capital gain dividend is any dividend, or part thereof, which is designated by the company as a capital gain dividend in a written notice mailed to its shareholders not later than 30 days after the close of its taxable year. If the aggregate amount so designated with respect to a taxable year of the company (including capital gains dividends paid after the close of the taxable year described in section 855) is greater than the excess of the net long-term capital gain over the net short-term capital loss of the taxable year, the portion of each distribution which shall be a capital gain dividend shall be only that proportion of the amount so designated which such excess of the net long-term capital gain over the net short-term capital loss bears to the aggregate amount so designated.

* * * * *

[Sec. 852 as amended by sec. 2, Act of July 11, 1956 (Pub. Law 700, 84th Cong., 70 Stat. 530 [C.B. 1956-2, 1169]); secs. 39, 101, Technical Amendments Act 1958 (72 Stat. 1638, 1674 [P.L. 85-866, C.B. 1958-3, 254]); sec. 10(b), Act of Sept. 14, 1960 (Pub. Law 86-779, 74 Stat. 1009 [C.B. 1960-2, 779]).]

PAR. 6. Section 1.852-1 is amended by revising first sentence in subparagraph (1) and revising subparagraph (2) in paragraph (a), and the second sentence in paragraph (b). These amended provisions read as follows:

§ 1.852-1 TAXATION OF REGULATED INVESTMENT COMPANIES.—(a) *Requirements applicable thereto.*—(1) *In general.*—Section 852(a) denies the application of the provisions of part I, subchapter M, chapter 1 of the Code (other than section 852(c), relating to earnings and profits), to a regulated investment company for a taxable year beginning after February 28, 1958, unless—

(i) The deduction for dividends paid for such taxable year as defined in section 561 (computed without regard to capital gain dividends) is equal to at least 90 percent of its investment company taxable income for such taxable year (determined without regard to the provisions of section 852(b) (2) (D) and paragraph (d) of § 1.852-3); and

(ii) The company complies for such taxable year with the provisions of § 1.852-6 (relating to records required to be maintained by a regulated investment company).

See section 853(b) (1) (B) and paragraph (a) of § 1.853-2 for amounts to be added to the dividends paid deduction, and section 855 and § 1.855-1, relating to dividends paid after the close of the taxable year.

(2) *Special rule for taxable years of regulated investment companies beginning before March 1, 1958.*—The provisions of part I of subchapter M (including section 852(c)) are not applicable to a regulated investment company for a taxable year beginning before March 1, 1958, unless such company meets the requirements of section 852(a) and subparagraph (1) (i) and (ii) of this paragraph.

(b) *Failure to qualify.*—If a regulated investment company does not meet the requirements of section 852(a) and paragraph (a) (1) (i) and (ii) of this section for the taxable year, it will, even though it may otherwise be classified as a regulated investment company, be taxed in such year as an ordinary corporation and not as a regulated investment company. In such case, none of the provisions of part I of subchapter M (other than section 852(c) in the case

of taxable years beginning after February 28, 1958) will be applicable to it. For the rules relating to the applicability of section 852(c), see § 1.852-5.

PAR. 7. Paragraph (b) of § 1.852-2 is amended by—revising subparagraph (1) and subdivision (i) of subparagraph (2). These amended provisions read as follows:

§ 1.852-2 METHOD OF TAXATION OF REGULATED INVESTMENT COMPANIES.

* * * * *

(b) *Taxation of capital gains.*—(1) *In general.*—Section 852(b)(3)(A) imposes a tax of 25 percent for each taxable year on the excess, if any, of the net long-term capital gain of a regulated investment company (subject to tax under part I, subchapter M, chapter 1 of the Code) over the sum of its net short-term capital loss and its deduction for dividends paid (as defined in section 561) determined with reference to capital gain dividends only. For the definition of capital gain dividend paid by a regulated investment company, see section 852(b)(3)(C) and paragraph (c) of § 1.852-4. See section 855 and § 1.855-1, relating to dividends paid after the close of the taxable year.

(2) *Undistributed capital gains.*—(i) *In general.*—A regulated investment company (subject to tax under part I of subchapter M) may, for taxable years beginning after December 31, 1956, designate under section 852(b)(3)(D) an amount of undistributed capital gains to each shareholder of the company. For the definition of the term “undistributed capital gains” and for the treatment of such amounts by a shareholder, see paragraph (b)(2) of § 1.852-4. For the rules relating to the method of making such designation, the returns to be filed, and the payment of the tax in such cases, see paragraph (a) of § 1.852-9.

PAR. 8. Paragraph (b) of § 1.852-4 is amended by revising subparagraph (1), and subdivision (i) of subparagraph (2). These amended provisions read as follows:

§ 1.852-4 METHOD OF TAXATION OF SHAREHOLDERS OF REGULATED INVESTMENT COMPANIES.

* * * * *

(b) *Capital gains.*—(1) *In general.*—Under section 852(b)(3)(B), shareholders of a regulated investment company who receive capital gain dividends (as defined in paragraph (c) of this section), in respect of the capital gains of an investment company for a taxable year for which it is taxable under part I, subchapter M, chapter 1 of the Code, as a regulated investment company, shall treat such capital gain dividends as gains from the sale or exchange of capital assets held for more than 6 months and realized in the taxable year of the shareholder in which the dividend was received.

(2) *Undistributed capital gains.*—(i) A person who is a shareholder of a regulated investment company at the close of a taxable year of such company for which it is taxable under part I of subchapter M shall include in his gross income as a gain from the sale or exchange of a capital asset held for more than 6 months any amount of undistributed capital gains. The term “undistributed capital gains” means the amount designated as undistributed capital gains in accordance with paragraph (a) of § 1.852-9, but such amount shall not exceed the shareholder's proportionate part of the amount subject to tax under section 852(b)(3)(A). Such amount shall be included in gross income for the taxable year of the shareholder in which falls the last day of the taxable year of the regulated investment company in respect of which the undistributed capital gains were designated. For certain administrative provisions relating to undistributed capital gains, see § 1.852-9.

PAR. 9. Section 1.855 is amended by—revising section 855(c), and adding a historical note. These amended and added provisions read as follows:

§ 1.855 STATUTORY PROVISIONS; DIVIDENDS PAID BY REGULATED INVESTMENT COMPANY AFTER CLOSE OF TAXABLE YEAR.

SEC. 855. DIVIDENDS PAID BY REGULATED INVESTMENT COMPANY AFTER CLOSE OF TAXABLE YEAR. * * *

(c) NOTICE TO SHAREHOLDERS.—In the case of amounts to which subsection (a) is applicable, any notice to shareholders required

under this part with respect to such amounts shall be made not later than 30 days after the close of the taxable year in which the distribution is made.

* * * * *

[Sec. 855 as amended by sec. 10(b), Act of Sept. 14, 1960 (Pub. Law 86-779, 74 Stat. 1009) [C.B. 1960-2, 709]]

PAR. 10. Section 1.11 is amended by—revising section 11(d)(3), and the historical note. These amended provisions read as follows:

§ 1.11 STATUTORY PROVISIONS; TAX IMPOSED.

SEC. 11. TAX IMPOSED. * * *

(d) EXCEPTIONS.—Subsection (a) shall not apply to a corporation subject to a tax imposed by—

* * * * *

(3) Subchapter M (sec. 851 and following, relating to regulated investment companies and real estate investment trusts), or

* * * * *

[Sec. 11 as amended by sec. 2, Tax Rate Extension Act 1955 (69 Stat. 14) [P.L. 18, C.B. 1955-1, 619]; sec. 2, Tax Rate Extension Act 1956 (70 Stat. 66) [P.L. 458, C.B. 1956-1, 869]; sec. 2, Tax Rate Extension Act 1957 (71 Stat. 9) [P.L. 85-12, C.B. 1957-1, 666]; sec. 2, Tax Rate Extension Act 1958 (72 Stat. 259) [P.L. 85-475, C.B. 1958-3, 73]; sec. 2, Tax Rate Extension Act 1959 (73 Stat. 157) [P.L. 86-75, C.B. 1959-2, 679]; sec. 201, Public Debt and Tax Rate Extension Act 1960 (74 Stat. 290); sec. 10(d), Act of Sept. 14, 1960 (Pub. Law 86-779, 74 Stat. 1009 [C.B. 1960-2, 709])]]

PAR. 11. Section 1.34 is amended by—revising paragraphs (1) and (2) (B) and adding paragraph (3) in section 34(c), and revising the historical note. These amended and added provisions read as follows:

§ 1.34 STATUTORY PROVISIONS; DIVIDENDS RECEIVED BY INDIVIDUALS.

SEC. 34. DIVIDENDS RECEIVED BY INDIVIDUALS. * * *

(c) NO CREDIT ALLOWED FOR DIVIDENDS FROM CERTAIN CORPORATIONS.—Subsection (a) shall not apply to any dividend from—

(1) A corporation organized under the China Trade Act, 1922 (see sec. 941);

(2) A corporation which, for the taxable year of the corporation in which the distribution is made, or for the next preceding taxable year of the corporation, is—

(A) A corporation exempt from tax under section 501 (relating to certain charitable, etc., organizations) or section 521 (relating to farmers' cooperative associations); or

(B) A corporation to which section 931 (relating to income from sources within possessions of the United States) applies; or

(3) A real estate investment trust which, for the taxable year of the trust in which the dividend is paid, qualifies under part II of subchapter M (sec. 856 and following).

* * * * *

[Sec. 34 as amended by sec. 3(a), Life Insurance Company Income Tax Act 1959 (73 Stat. 139) [P.L. 86-69, C.B. 1959-2, 911]; sec. 10(e), Act of Sept. 14, 1960 (Pub. Law 86-779, 74 Stat. 1009 [C.B. 1960-2, 709])]]

PAR. 12. Paragraph (b) of § 1.34-3 is amended by adding the following new subparagraph (4) at the end thereof:

§ 1.34-3 DIVIDENDS TO WHICH THE CREDIT AND EXCLUSION APPLY.

* * * * *

(b) *Dividends from certain corporations.* * * *

(4) See section 857(c) and paragraph (d) of § 1.857-4 for special rules which deny a credit under section 34 and exclusion under section 116 in the case of

dividends received from a real estate investment trust with respect to a taxable year for which such trust is taxable under part II, subchapter M, chapter 1 of the Code.

PAR. 13. Section 1.116 is amended by revising paragraphs (1) and (2) (B) and adding paragraph (3) in section 116, and revising the historical note. These amended and added provisions read as follows:

§ 1.116 STATUTORY PROVISIONS; PARTIAL EXCLUSION OF DIVIDENDS RECEIVED BY INDIVIDUALS.

SEC. 116. PARTIAL EXCLUSION OF DIVIDENDS RECEIVED BY INDIVIDUALS. * * *

(b) CERTAIN DIVIDENDS EXCLUDED.—Subsection (a) shall not apply to any dividend from—

(1) A corporation organized under the China Trade Act, 1922 (see sec. 941);

(2) A corporation which, for the taxable year of the corporation in which the distribution is made, or for the next preceding taxable year of the corporation, is—

(A) A corporation exempt from tax under section 501 (relating to certain charitable, etc., organizations) or section 521 (relating to farmers' cooperative associations); or

(B) A corporation to which section 931 (relating to income from sources within possessions of the United States) applies;

or

(3) A real estate investment trust which, for the taxable year of the trust in which the dividend is paid, qualifies under part II of subchapter M (sec. 856 and following).

* * * * *

[Sec. 116 as amended by sec. 3(a), Life Insurance Company Income Tax Act 1959 (73 Stat. 139) [P.L. 86-69, C.B. 1959-2, 911]; sec. 10(f), Act of Sept. 14, 1960 (Pub. Law 86-779, 74 Stat. 1009 [C.B. 1960-2, 709]).]

PAR. 14. Section 1.243 is amended by adding paragraph (3) in section 243(c), and revising the historical note. These added and amended provisions read as follows:

§ 1.243 STATUTORY PROVISIONS; DIVIDENDS RECEIVED BY CORPORATIONS.

SEC. 243. DIVIDENDS RECEIVED BY CORPORATIONS. * * *

(c) SPECIAL RULES FOR CERTAIN DISTRIBUTIONS. For purposes of subsections (a) and (b)—

* * * * *

(3) Any dividend received from a real estate investment trust which, for the taxable year of the trust in which the dividend is paid, qualifies under part II of subchapter M (sec. 856 and following) shall not be treated as a dividend.

[Sec. 243 as amended by sec. 57(b), Technical Amendments Act 1958 (72 Stat. 1645) [P.L. 85-866, C.B. 1958-3, 254]; sec. 10(g), Act of Sept. 14, 1960 (Pub. Law 86-779, 74 Stat. 1009 [C.B. 1960-2, 709]).]

PAR. 15. Section 1.243-2 is amended by adding paragraph (c). This added provision reads as follows:

§ 1.243-2 SPECIAL RULES FOR CERTAIN DISTRIBUTIONS.

* * * * *

(c) *Dividends received from real estate investment trusts.*—See section 857(c) and paragraph (d) of § 1.857-4 for special rules which deny a deduction under section 243 in the case of dividends received from a real estate investment trust with respect to a taxable year for which such trust is taxable under part II, subchapter M, chapter 1 of the Code.

PAR. 16. Section 1.246-1 is amended by revising paragraph (c), and adding paragraph (d). These amended and added provisions read as follows:

§ 1.246-1 DEDUCTIONS NOT ALLOWED FOR DIVIDENDS FROM CERTAIN CORPORATIONS.—The deductions provided in sections 243 (relating to dividends received by corporations), 244 (relating to dividends received on certain preferred stock), and 245 (relating to dividends received from certain foreign corporations), are not allowable with respect to any dividend received from:

* * * * *

(c) A corporation to which section 931 (relating to income from sources within possessions of the United States) applies for the taxable year of the corporation in which the distribution is made or for its next preceding taxable year; or

(d) A real estate investment trust which, for its taxable year in which the distribution is made, is taxable under part II, subchapter M, chapter 1 of the Code. See section 243(c)(3), paragraph (c) of § 1.243-2, section 857(c), and paragraph (d) of § 1.857-4.

PAR. 17. Section 1.318 is amended by revising paragraphs (4) and (5) and adding paragraph (6) in section 318(b), and adding a historical note. These amended and added provisions read as follows:

§ 1.318 STATUTORY PROVISIONS; CONSTRUCTIVE OWNERSHIP OF STOCK.

SEC. 318. CONSTRUCTIVE OWNERSHIP OF STOCKS.

* * * * *

(b) CROSS REFERENCES.—For provisions to which the rules contained in subsection (a) apply, see—

- (1) Section 302 (relating to redemption of stock);
- (2) Section 304 (relating to redemption by related corporations);
- (3) Section 306(b)(1)(A) (relating to disposition of section 306 stock);
- (4) Section 334(b)(3)(C) (relating to basis of property received in certain liquidations of subsidiaries);
- Section 382(a)(3) (relating to special limitations on net operating loss carryovers); and
- (6) Section 856(d) (relating to definition of rents from real property in the case of real estate investment trusts).

[Sec. 318 as amended by sec. 10(h), Act of Sept. 14, 1960 (Pub. Law 86-779, 74 Stat. 1009 [C.B. 1960-2, 709]).]

PAR. 18. Section 1.318-1 is amended by revising subparagraphs (4) and (5) and adding subparagraph (6) in paragraph (a), and revising subparagraphs (2)(ii) and (3) and adding subparagraph (4) in paragraph (b). These amended and added provisions read as follows:

§ 1.318-1 CONSTRUCTIVE OWNERSHIP OF STOCK; INTRODUCTION.—(a) For the purposes of certain provisions of subchapter C, chapter 1 of the Code, section 318(a) provides that stock owned by a taxpayer includes stock constructively owned by such taxpayer under the rules set forth in such section. An individual is considered to own the stock owned, directly or indirectly, by or for his spouse (other than a spouse who is legally separated from the individual under a decree of divorce or separate maintenance), and by or for his children, grandchildren, and parents. Under section 318(a)(2), constructive ownership rules are established for partnerships and partners, estates and beneficiaries, trusts and beneficiaries, and corporations and stockholders. If any person has an option to acquire stock, such stock is considered as owned by such person. The term "option" includes an option to acquire such an option and each of a series of such options. The rules of section 318(a) are applicable to the following sections:

- (1) Section 302 (relating to redemption of stock);
- (2) Section 304 (relating to redemption by related corporations);
- (3) Section 306(b)(1)(A) (relating to disposition of section 306 stock);
- (4) Section 334(b)(3)(C) (relating to basis of property received in certain liquidations of subsidiaries);

(5) Section 382(a) (3) (relating to special limitations on net operating loss carryovers); and

(6) Section 856(d) (relating to definition of rents from real property in the case of real estate investment trusts).

Stock constructively owned by a person by reason of the application of paragraph (1), (2), or (3) of section 318(a) is, for purposes of applying paragraph (1), (2), or (3) treated as actually owned by such person, except as provided in section 318(a) (4) (B) and § 1.318-4.

(b) In applying section 318(a) to determine the stock ownership of any person for any one purpose—

(1) A corporation shall not be considered to own its own stock by reason of section 318(a) (2) (C) (ii),

(2) In any case in which an amount of stock owned by any person may be included in the computation more than one time—

(i) Such stock shall be used in such computation only once, and

(ii) Such stock shall be used in such computation in the manner in which it will impute to the person concerned the largest total stock ownership,

(3) In determining the 50-percent requirement of section 318(a) (2) (C) all of the stock owned actually and constructively by the person concerned shall be aggregated, and

(4) Under section 856(d) (relating to rents received by a real estate investment trust) "10 percent" shall be substituted for "50 percent" in subparagraph (C) of section 318(a) (2) in determining actual and constructive ownership of stock, assets, or net profits.

PAR. 19. Section 1.443 is amended by adding paragraph (5) under section 443(d), and a historical note. These added provisions read as follows:

§ 1.443 STATUTORY PROVISIONS; RETURNS FOR A PERIOD OF LESS THAN 12 MONTHS.

SEC 443. RETURNS FOR A PERIOD OF LESS THAN 12 MONTHS. * * *

(d) CROSS REFERENCES.—For inapplicability of subsection (b) in computing—

* * * * *

(5) The taxable income of a real estate investment trust, see section 857(b) (2) (d).

[Sec. 443 as amended by sec. 10(i), Act of Sept. 14, 1960 (Pub. Law 86-779, 74 Stat. 1009 [C.B. 1960-2; 709]).]

PAR. 20. Paragraph (d) of § 1.443-1 is amended by revising subparagraphs (3) and (4) and adding subparagraph (5). These amended and added provisions read as follows:

§ 1.443-1 RETURNS FOR PERIODS OF LESS THAN 12 MONTHS.

* * * * *

(d) *Cross references.*—For inapplicability of section 443(b) and paragraph (b) of this section in computing—

(1) Accumulated earnings tax, see section 536 and the regulations thereunder;

(2) Personal holding company tax, see section 546 and the regulations thereunder;

(3) Undistributed foreign personal holding company income, see section 557 and the regulations thereunder;

(4) The taxable income of a regulated investment company, see section 852(b) (2) (E) and the regulations thereunder; and

(5) The taxable income of a real estate investment trust, see section 857(b) (2) (D) and the regulations thereunder.

PAR. 21. Section 1.1504 is amended by revising paragraph (6) in section 1504(b), and the historical note. These amended provisions read as follows:

§ 1.1504 STATUTORY PROVISIONS; DEFINITIONS.

SEC. 1504. DEFINITIONS. * * *

(b) DEFINITION OF "INCLUDIBLE CORPORATION".—As used in this chapter, the term "includible corporation" means any corporation except—

* * * * *

(6) Regulated investment companies and real estate investment trusts subject to tax under subchapter M of chapter 1.

* * * * *

[Sec. 1504 as amended by sec. 5, Act of March 13, 1956 (Pub. Law 429, 84th Cong., 70 Stat. 49 [C.B. 1956-1, 858]); sec. 64(d)(3), Technical Amendments Act 1958 (72 Stat. 1657) [P.L. 85-866, C.B. 1958-3, 254]; sec. 3(f)(1), Life Insurance Company Income Tax Act 1959 (73 Stat. 140) [P.L. 86-69, C.B. 1959-2, 911]; sec. 2(c), Act of Sept. 23, 1959 (Pub. Law 86-376, 73 Stat. 699); sec. 10(j), Act of Sept. 14, 1960 (Pub. Law 86-779, 74 Stat. 1009 [C.B. 1960-2, 709]).]

PAR. 22. Paragraph (b) of § 1.1502-2 is amended by revising subdivision (vi) in, and the last sentence of, subparagraph (1). These amended provisions read as follows:

§ 1.1502-2 DEFINITIONS.

* * * * *

(b) *Affiliated group*.—(1) The term "affiliated group" is defined in section 1504 and includes the common parent corporation and every other corporation for the period during which such corporation is a member of the affiliated group within the meaning of such section. It does not include any corporation which is not an "includible corporation" as defined by section 1504(b). An includible corporation is defined by such section to mean any corporation, except—

(i) A corporation exempt under section 501 from the taxes imposed by subtitle A;

(ii) An insurance company subject to taxation under section 802 or 821 (except as provided in section 1504(c));

(iii) A foreign corporation (except as provided in section 1504(d));

(iv) A corporation entitled to the benefits of section 931 by reason of receiving a large percentage of its income from sources within possessions of the United States;

(v) A corporation organized under the China Trade Act of 1922;

(vi) A regulated investment company or a real estate investment trust subject to tax under subchapter M, chapter 1 of the Code;

(vii) An unincorporated business enterprise subject to tax as a corporation under section 1361; and

(viii) For periods before September 24, 1959, an electing small business corporation as defined in section 1371(b).

The consolidated income tax return must include every includible corporation which, under the provisions of section 1504, is a member of the affiliated group. No corporation which is connected by stock ownership with an affiliated group of includible corporations through a nonincludible corporation may be included in the consolidated return of such group. In no case may a consolidated return be filed by subsidiary corporations as an affiliated group unless the common parent corporation through which the subsidiaries are connected is a member of the group. For instance, there will not be recognized as an affiliated group two domestic industrial corporations, the common parent corporation of which is a regulated investment company subject to tax under part I, subchapter M, chapter 1 of the Code.

PAR. 23. Paragraph (a) of § 1.61-9 is amended by revising the third sentence. This amended provision reads as follows:

§ 1.61-9 DIVIDENDS.—(a) *In general.*—Except as otherwise specifically provided, dividends are included in gross income under sections 61 and 301. For the principal rules with respect to dividends includible in gross income, see section 316 and the regulations thereunder. As to distributions made or deemed to be made by regulated investment companies, see sections 851 through 855, and the regulations thereunder. As to distributions made by real estate investment trusts, see sections 856 through 858, and the regulations thereunder. See section 116 for the exclusion from gross income of \$50 of dividend received by an individual, except those from certain corporations. Furthermore, dividends may give rise to a credit against tax under section 34, relating to dividends received by individuals, and under section 37, relating to retirement income.

PAR. 24. Paragraph (a) of § 1.561-1 is amended by revising the first sentence. This amended provision reads as follows:

§ 1.561-1 DEDUCTION FOR DIVIDENDS PAID.—(a) The deduction for dividends paid is applicable in determining accumulated taxable income under section 535, undistributed personal holding company income under section 545, undistributed foreign personal holding company income under section 556, investment company taxable income under section 852, and real estate investment trust taxable income under section 857. The deduction for dividends paid includes—

(1) The dividends paid during the taxable year:

(2) The consent dividends for the taxable year, determined as provided in section 565; and

(3) In the case of a personal holding company, the dividend carryover computed as provided in section 564.

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

MORTIMER M. CAPLIN,

Commissioner of Internal Revenue.

Approved April 24, 1962.

STANLEY S. SURREY,

Assistant Secretary of the Treasury.

(Filed by the Division of the Federal Register on April 25, 1962, 3:13 p.m., and published in the issue of the Federal Register for April 28, 1962, 27 F.R. 4081)

SUBCHAPTER N.—TAX BASED ON INCOME FROM SOURCES WITHIN OR WITHOUT THE UNITED STATES

PART I.—DETERMINATION OF SOURCES OF INCOME

SECTION 861.—INCOME FROM SOURCES WITHIN THE UNITED STATES

26 CFR 1.861-1: Income from sources within the United States.

Compensation paid by a foreign corporation for services performed in the United States. See Rev. Rul. 62-67, page 128.

PART II.—NONRESIDENT ALIENS AND FOREIGN CORPORATIONS**Subpart A.—Nonresident Alien Individuals**

SECTION 871.—TAX ON NONRESIDENT ALIEN INDIVIDUALS

26 CFR 1.871-7: Tax on nonresident alien individuals.

Deductibility of legal fees paid to contest foreign tax assessed on nonresident alien's income from sources within the United States. See Rev. Rul. 62-9, page 35.

Subpart B.—Foreign Corporations

SECTION 882.—TAX ON RESIDENT FOREIGN CORPORATIONS

26 CFR 1.882-1: Tax on resident foreign corporations.

An office or showroom with a group of salesmen maintained in the United States by a foreign corporation managed and controlled in the United Kingdom. See Rev. Rul. 62-31, page 367.

PART III.—INCOME FROM SOURCES WITHOUT THE UNITED STATES**Subpart A.—Foreign Tax Credit**

SECTION 901.—TAXES OF FOREIGN COUNTRIES AND OF POSSESSIONS OF UNITED STATES

26 CFR 1.901-2: Definitions.

Source of income received from a foreign corporation for services performed in the United States. See Rev. Rul. 62-67, below.

SECTION 904.—LIMITATION ON CREDIT

26 CFR 1.904-1: Limitation on credit for foreign taxes.
(Also Sections 861, 901; 1.861-1, 1.901-2.)

Rev. Rul. 62-67

The amount of compensation received from a foreign corporation for services performed by a taxpayer within the United States may not be included in the numerator of the fraction provided in section 904 of the Internal Revenue Code of 1954 as a limitation on the allowance of a foreign tax credit. Further, no foreign tax credit is allowable in respect of taxes paid to a foreign country where the numerator of the limiting fraction is zero because the taxpayer had no income from sources without the United States subject to United States income tax for the same taxable year.

In view of the decision of the Tax Court of the United States in the case of *Gordon Duke et ux. v. Commissioner*, 34 T.C. 772 (1960), advice has been requested whether the amount of compensation received from a foreign corporation for services performed by a taxpayer within the United States may be included in the numerator of the fraction provided in section 904 of the Internal Revenue Code of 1954 as a limitation on the allowance of a foreign tax credit.

Section 904 of the Code provides, in part, that, in the case of a taxpayer who does not elect the overall limitation, the total amount of credit for taxes paid or accrued to any country shall not exceed the same proportion of the tax against which such credit is taken which the taxpayer's taxable income from sources within such country bears to his entire taxable income for the same taxable year. However, in the case of a taxpayer who elects the overall limitation allowed by that section, the total amount of the credit for taxes paid or accrued to all foreign countries and possessions of the United States shall not exceed the same proportion of the tax against which such credit is taken which the taxpayer's taxable income from sources without the United States bears to his entire taxable income for the same taxable year.

Section 861(a) of the Code provides, insofar as here pertinent, that compensation for personal services performed in the United States shall be treated as income from sources within the United States. The source rules of section 861 are made applicable to the determination of the source of income for foreign tax credit purposes by section 1.901-2(d) of the Income Tax Regulations.

For the purpose of determining the limitation on the credit allowable on account of income taxes paid to all foreign countries and possessions of the United States, where a taxpayer elects the overall limitations provided in section 904 of the Code, the taxpayer's taxable income from sources outside the United States becomes the numerator and his entire taxable income becomes the denominator of the fraction used in determining the proportion set forth in section 904 of the Code.

Where a taxpayer does not elect the overall limitation, the taxpayer's taxable income from sources within a foreign country or possession of the United States becomes the numerator and his entire taxable income becomes the denominator of the fraction used in determining the limitation on the credit allowable for income taxes paid to such foreign country or possession of the United States. See *I. B. Dexter et ux. v. Commissioner*, 47 B.T.A. 285, at 290 (1942), acquiescence, C.B. 1948-2, 1, interpreting the credit limitation provided in section 131(b) of the Revenue Act of 1936.

In the *Duke* case the taxpayer, a citizen of the United States and a bona fide resident of Mexico, claimed a foreign tax credit for taxes paid to Mexico on salaries received from two Mexican corporations as compensation for personal services performed partly without and partly within the United States. He also received a salary from a United States corporation. He excluded from his gross income, under section 116(a) of the Internal Revenue Code of 1939 (section 911 of the 1954 Code), the portion of salary income attributable to services performed without the United States. However, in computing the limitation on the allowable foreign tax credit, he included

the entire amount of salary income in the denominator of the limiting fraction and used the salaries paid by the Mexican corporations as the numerator.

The Commissioner of Internal Revenue, in the *Duke* case, took the position that income which is excluded from taxation by the United States should not be included in either the numerator or the denominator of the limiting fraction and computed the foreign tax credit limitation under section 131(b) of the 1939 Code (section 904 of the 1954 Code) by using the portion of the salary paid by the Mexican corporations for services performed in the United States as the numerator of the fraction and the total amount of taxable income reported in the return as the denominator. The court agreed with the Commissioner and held that the taxpayer's credit for income taxes paid to a foreign country was limited to the amount determined by the Commissioner.

Since the court had before it two computations, it did not analyze the source of the income which both the taxpayer and the Commissioner included in the numerator of the limiting fraction but considered only the issue before it, that is, whether income which is not subject to United States tax is includible in either the numerator or the denominator of the limiting fraction. Thus, the decision of the court is not deemed to be a precedent for resolving the question whether a taxpayer, who is entitled to exclude from his gross income for Federal income tax purposes all of his income from sources without the United States, is entitled to a credit for taxes paid to a foreign country where he also receives income from a foreign corporation for services performed within the United States.

As the source rules of section 861 of the 1954 Code apply to the determination of the source of income for foreign tax credit purposes, it is held that salaries paid by a foreign corporation to a citizen of the United States for services performed within the United States may not be treated as income from sources within a foreign country in computing the foreign tax credit limitation and, therefore, may not be included in the numerator of the fraction limiting the foreign tax credit. Further, where none of the taxpayer's income from sources without the United States is subject to United States tax for the taxable year, the numerator of the limiting fraction is zero and no credit against Federal income tax is allowable on account of taxes paid to a foreign country.

Subpart B.—Earned Income of Citizens of United States

SECTION 911.—EARNED INCOME FROM SOURCES
WITHOUT THE UNITED STATES

26 CFR 1.911-1: Earned income from sources
without the United States.

Grants received by an American citizen performing professional services as a lecturer at a foreign university. See Rev. Rul. 62-2, page 9.

SUBCHAPTER O.—GAIN OR LOSS ON DISPOSITION OF PROPERTY

PART I.—DETERMINATION OF AMOUNT OF AND RECOGNITION OF GAIN OR LOSS

SECTION 1002.—RECOGNITION OF GAIN OR LOSS

26 CFR 1.1002-1: Sales or exchanges.

An exchange of stock for stock plus cash in the absence of a statutory reorganization. See Ct. D. 1868, page 317.

PART II.—BASIS RULES OF GENERAL APPLICATION

SECTION 1014.—BASIS OF PROPERTY ACQUIRED FROM A DECEDENT

26 CFR 1.1014-1: Basis of property acquired from a decedent.

Basis for computing gain from sale of allotted and restricted land previously held by the United States in trust for Indians. See Rev. Rul. 62-48, below.

SECTION 1015.—BASIS OF PROPERTY ACQUIRED BY GIFTS AND TRANSFERS IN TRUST

26 CFR 1.1015-2: Transfer of property in trust after December 31, 1920.

Basis of lands acquired by Indians from the United States by trust allotment. See Rev. Rul. 62-48, below.

26 CFR 1.1015-3: Gift or transfer in trust before January 1, 1921.

Rev. Rul. 62-48

(Also 1.1015-2.)

(Also Section 1014; 1.1014-1.)

The basis, for determining gain for Federal income tax purposes, of an Indian allottee's fee simple allotment where the land had previously been held in trust for him by the United States under section 5 of the General Allotment Act of 1887, as amended, is the market value as of the date the fee simple patent is received, except that if such value is less than the basis computed under the rules set forth in Revenue Ruling 58-341, C.B. 1958-2, 400, the latter basis shall apply.

Revenue Ruling 58-341, C.B. 1958-2, 400, modified.

Reconsideration has been given to Revenue Ruling 58-341, C.B. 1958-2, 400, in the light of the decision in *James Shepard et ux. v. United States*, 162 Fed. Supp. 313 (1958).

Revenue Ruling 58-341 holds that the basis for determining an original Indian allottee's gain from the sale or exchange of his fee simple

allotment, where the land had previously been held in trust for him by the United States under section 5 of the General Allotment Act of 1887, as amended, 25 U.S.C. 348, is its market value as of the date he had received his trust allotment if he had received it prior to January 1, 1921, but not less than the March 1, 1913, value if he had received his trust allotment prior to that date. If the original Indian allottee had received his trust allotment subsequent to December 31, 1920, his basis for determining gain after he has been issued fee simple patent is the March 1, 1913, value.

The Revenue Ruling holds further that if an Indian had inherited such a trust allotment and sold or exchanged the land after he had received fee simple patent, his basis for determining gain is the fair market value as of the decedent's death, but if the decedent had died before March 1, 1913, it was not less than its fair market value as of that date.

The foregoing rules are not applicable in those situations where Congress had provided otherwise in statutes dealing with particular tribes.

In the *Shepard* case the taxpayer, a Potawatomi Indian, was allotted 80 acres of land in trust in 1905 by a certificate of allotment pursuant to the General Allotment Act of 1887. In 1952, the taxpayer informed the Indian agent that he desired to sell the land to enable him to buy a home in another part of the country. Accordingly, the Federal Government issued the taxpayer a fee simple patent on September 23, 1952, immediately following which the latter sold the land for \$5,200. In March 1953, the taxpayer filed an income tax return reporting the sale and showing a basis as of March 1, 1913, of \$2,800. A timely claim for refund was filed alleging that the basis should have been the value of the land as of September 23, 1952, which the court found was equal to the sale price.

The court held that in order to carry out the language and purposes of the General Allotment Act of 1887, it is necessary that land transferred in fee under the Act after its period of trust carry a basis for tax purposes immediately after the transfer no lower than the fair market value of the land at the time of transfer in fee.

In *Squire v. Capoeman, et ux.*, 351 U.S. 1, Ct. D. 1796, C.B. 1956-1, 605, the Supreme Court of the United States held that proceeds from the sale of timber grown on allotted lands while such lands were held in trust by the United States under section 5 of the General Allotment Act were exempt from tax. Under sections 5 and 6 of that Act, the United States was required at the conclusion of the trust period to convey the allotted lands in fee, "free of all charge or incumbrance whatsoever" with "all restrictions as to * * * taxation * * * removed." On the basis of these provisions, the Court found that allotments under the General Allotment Act were exempt from taxation while held in trust and continued to hold that the purposes of the Act required that during that period not only the trust corpus but also the income derived directly therefrom should be preserved free from taxation.

Since imposition of a capital-gains tax upon the appreciation during the trust period of such an allotment would also appear to be at variance with the tax exemption and the purposes of the Act, as construed in the *Capoeman* decision, the Internal Revenue Service will

follow the holding of the *Shepard* case in determining an Indian's basis in his fee simple allotment. Insofar, however, as language in the latter case may indicate that the court considered the right of an Indian to receive an allotment "free of all charge or incumbrance" in itself sufficient to confer an exemption upon income from the land, such language will not be followed.

Accordingly, the basis for determining an Indian allottee's gain from the sale or exchange of his fee simple allotment, where the land had previously been held in trust for him by the United States under section 5 of the General Allotment Act of 1887, as amended, is its market value as of the date he received his fee simple patent. However, in those instances where, for purposes of determining gain upon the sale by an Indian of his fee simple allotment, his basis under the foregoing rule would be less than under the applicable method of computing basis set forth in Revenue Ruling 58-341, basis will be computed in accordance with that Revenue Ruling.

In addition, in any instance in which the taxpayer obtained his trust interest through an arm's length purchase rather than, for example, through allotment, gift, devise or inheritance, the *Shepard* case will not be deemed applicable and under Revenue Ruling 58-341 the taxpayer's cost will be his basis.

Revenue Ruling 58-341 is modified accordingly.

SECTION 1016.—ADJUSTMENTS TO BASIS

26 CFR 1.1016-2: Items properly chargeable
to capital amount.

Rev. Rul. 62-42

(Also Sections 162, 212; 1.162-1, 1.212-1.)

I.T. 1764, C.B. II-2, 22 (1923), holds in effect, that the gain or loss on stock purchased to close a short sale is the difference between the proceeds of the short sale and the cost of the shares purchased to close the short sale, plus the total amount paid by the taxpayer which is attributable to dividends on the stock borrowed to cover such short sale.

S.M. 4281, C.B. IV-2, 187 (1925), states that sums debited to short sellers' accounts, by the brokers carrying them, to cover sums accreted to the accounts of "long" clients whose stock has been "loaned," are properly deducted by the short seller in computing his profit, if any, resultant upon a covering purchase.

However, I.T. 3989, C.B. 1950-1, 34, as distinguished by Revenue Ruling 60-359, C.B. 1960-2, 104, holds, in part, that amounts equal to ordinary cash dividends, paid by an investor with respect to stock borrowed to cover short sales, are allowable deductions under section 23(a)(2) of the Internal Revenue Code of 1939, now section 212 of the Internal Revenue Code of 1954. That ruling also holds that the deductibility of amounts paid in connection with ordinary cash dividends on stock borrowed under such conditions should be determined by the same standards whether the taxpayer is a trader or an investor.

In view of the position expressed in I.T. 3989, the decisions announced in I.T. 1764 and S.M. 4281 are hereby modified to remove from those rulings the implication that amounts, paid by investors

or traders in securities, with respect to ordinary cash dividends on stock borrowed to cover a short sale, are proper adjustments to the basis of the stock purchased to close the short sale.

PART III.—COMMON NONTAXABLE EXCHANGES

SECTION 1031.—EXCHANGE OF PROPERTY HELD FOR
PRODUCTIVE USE OR INVESTMENT

26 CFR 1.1031(b)-1: Receipt of other property
or money in tax-free exchange.

Recognition of gain where cash is received in a tax-free exchange of United States obligations. See Rev. Ruls. 62-27, page 135, and 62-28, page 136.

SECTION 1037.—CERTAIN EXCHANGES OF UNITED
STATES OBLIGATIONS

Rev. Rul. 62-26

Under section 1037(a) of the Internal Revenue Code of 1954, no gain or loss will be recognized upon the exchange of the 2½ percent Treasury Bonds of 1965-70 or the 2½ percent Treasury Bonds of 1966-71 solely for the 3½ percent Treasury Bonds of 1980 as offered by Department Circular No. 1065, 26 F.R. 8646.

In Treasury Department Circular No. 1065, dated September 11, 1961, 26 F.R. 8646, the Secretary of the Treasury offered 3½ percent Treasury Bonds of 1980 in exchange for other Treasury Bonds as follows:

(1) at 102.25 percent of their face value for 2½ percent Treasury Bonds of 1965-70, dated February 1, 1944, due March 15, 1970; or

(2) at 103.50 percent of their face value for 2½ percent Treasury Bonds of 1966-71, dated December 1, 1944, due March 15, 1971.

The income derived from the bonds is subject to all taxes imposed under the Internal Revenue Code of 1954. The bonds are subject to estate, inheritance, gift or other excise taxes, whether Federal or State, but are exempt from all taxation now or hereafter imposed on the principal or interest thereof by any State, or any of the possessions of the United States, or by any local taxing authority.

The bonds will be acceptable to secure deposits of public moneys. They may, upon the death of the owner, be redeemed at par, plus accrued interest to date of payment, in payment of Federal estate taxes due from the deceased owner's estate.

Pursuant to the provisions of section 1037(a) of the Code, the Secretary of the Treasury has declared that no gain or loss shall be recognized, for Federal income tax purposes, upon the exchange with the United States of 2½ percent Treasury Bonds of 1965-70 or 2½ percent Treasury Bonds of 1966-71 solely for the 3½ percent Treasury Bonds of 1980 as offered by Department Circular No. 1065, *supra*.

Gain or loss, if any, upon the obligations surrendered in exchange will be taken into account upon the disposition or redemption of the new obligations.

(Also Section 1031; 26 CFR 1.1031(b)-1.)

Rev. Rul. 62-27

Under section 1037(a) of the Internal Revenue Code of 1954, no gain or loss will be recognized upon the exchange of the 2½ percent Treasury Bonds of 1965-70 or the 2½ percent Treasury Bonds of 1966-71 solely for the 3½ percent Treasury Bonds of 1990 as offered by Department Circular No. 1066, 26 F.R. 8647.

In Treasury Department Circular No. 1066, dated September 11, 1961, 26 F.R. 8647, the Secretary of the Treasury offered 3½ percent Treasury Bonds of 1990 in exchange for other Treasury Bonds as follows:

(1) at 99.00 percent of their face value for 2½ percent Treasury Bonds of 1965-70, dated February 1, 1944, due March 15, 1970; or

(2) at 100.25 percent of their face value for 2½ percent Treasury Bonds of 1966-71, dated December 1, 1944, due March 15, 1971.

The income derived from the bonds is subject to all taxes imposed under the Internal Revenue Code of 1954. The bonds are subject to estate, inheritance, gift or other excise taxes, whether Federal or State, but are exempt from all taxation now or hereafter imposed on the principal or interest thereof by any State, or any of the possessions of the United States, or by any local taxing authority.

The bonds will be acceptable to secure deposits of public moneys. They may, upon the death of the owner, be redeemed at par, plus accrued interest to date of payment, in payment of Federal estate taxes due from the deceased owner's estate.

Pursuant to the provisions of section 1037(a) of the Code, the Secretary of the Treasury has declared that no gain or loss shall be recognized, for Federal income tax purposes, upon the exchange with the United States of 2½ percent Treasury Bonds of 1965-70 or 2½ percent Treasury Bonds of 1966-71 solely for the 3½ percent Treasury Bonds of 1990 as offered by Department Circular No. 1066, *supra*.

However, section 1031(b) of the Code requires the recognition of any gain realized on the exchange to the extent that money is received by the bond holder in connection with the exchange.

Treasury Department Circular No. 1066 provides that accrued interest from August 15 to September 15, 1961, in the amount of \$2.94837 per \$1,000, on the bonds to be issued will be charged subscribers. In the case of the 2½ percent bonds of 1965-70, the accrued interest will be deducted from the payment of \$10 per \$1,000 due to the subscriber on account of the issue price of the new bonds, and the difference of \$7.05163 per \$1,000 will be paid to the subscriber. Under section 1031(b) of the Code, the \$10 per \$1,000 due the subscriber on account of the issue price of the new bonds is the money received, and is the maximum amount of gain, if any, recognized at the time of the exchange.

To the extent not recognized at the time of the exchange, gain or loss, if any, upon the obligations surrendered in exchange will be taken into account upon the disposition or redemption of the new obligations.

(Also Section 1031; 26 CFR 1.1031(b)-1.)

Rev. Rul. 62-28

Under section 1037(a) of the Internal Revenue Code of 1954, no gain or loss will be recognized upon the exchange of the 2½ percent Treasury Bonds of 1965-70 or the 2½ percent Treasury Bonds of 1966-71 solely for the 3½ percent Treasury Bonds of 1998 as offered by Department Circular No. 1067, 26 F.R. 8648.

In Treasury Department Circular No. 1067, dated September 11, 1961, 26 F.R. 8648, the Secretary of the Treasury offered 3½ percent Treasury Bonds of 1998 in exchange for other Treasury Bonds as follows:

(1) at 98.00 percent of their face value for 2½ percent Treasury Bonds of 1965-70, dated February 1, 1944, due March 15, 1970; or

(2) at 99.00 percent of their face value for 2½ percent Treasury Bonds of 1966-71, dated December 1, 1944, due March 15, 1971.

The income derived from the bonds is subject to all taxes imposed under the Internal Revenue Code of 1954. The bonds are subject to estate, inheritance, gift or other excise taxes, whether Federal or State, but are exempt from all taxation now or hereafter imposed on the principal or interest thereof by any State, or any of the possessions of the United States, or by any local taxing authority.

The bonds will be acceptable to secure deposits of public moneys. They may, upon the death of the owner, be redeemed at par, plus accrued interest to date of payment, in payment of Federal estate taxes due from the deceased owner's estate.

Pursuant to the provisions of section 1037(a) of the Code, the Secretary of the Treasury has declared that no gain or loss shall be recognized, for Federal income tax purposes, upon the exchange with the United States of 2½ percent Treasury Bonds of 1965-70 or 2½ percent Treasury Bonds of 1966-71 solely for the 3½ percent Treasury Bonds of 1998 as offered by Department Circular No. 1067, *supra*.

However, section 1031(b) of the Code requires the recognition of any gain realized on the exchange to the extent that money is received by the bond holder in connection with the exchange.

Treasury Department Circular No. 1067 provides that accrued interest from May 15 to September 15, 1961, in the amount of \$11.69837 per \$1,000, on the bonds to be issued will be charged subscribers. In the case of the 2½ percent Treasury Bonds of 1965-70, the accrued interest will be deducted from the payment of \$20 per \$1,000 due to the subscriber on account of the issue price of the new bonds and the difference of \$8.30163 per \$1,000 will be paid to the subscriber. Under section 1031(b) of the Code, the \$20 per \$1,000 due the subscriber on account of the issue price of the new bonds is the money received, and is the maximum amount of gain, if any, recognized at the time of the exchange.

In the case of the 2½ percent Treasury Bonds of 1966-71, a cash payment of \$1.69837 per \$1,000 will be made by the subscriber when the subscription is tendered, which is the difference between the ac-

crued interest in the amount of \$11.69837 per \$1,000 charged to the subscriber and the payment of \$10 per \$1,000 credited to the subscriber. Under section 1031(b) of the Code, the \$10 per \$1,000 due the subscriber on account of the issue price of the new bonds is the money received, and is the maximum amount of gain, if any, recognized at the time of the exchange.

To the extent not recognized at the time of the exchange, gain or loss, if any, upon the obligations surrendered in exchange will be taken into account upon the disposition or redemption of the new obligations.

Rev. Rul. 62-93

Under section 1037(a) of the Internal Revenue Code of 1954, no gain or loss will be recognized upon the exchange of the 3 percent Treasury Bonds of 1964 or the 2½ percent Treasury Bonds of 1965 as offered by Department Circular, Public Debt Series No. 4-62.

In Treasury Department Circular, Public Debt Series No. 4-62, dated February 19, 1962, 27 F.R. 1855, the Secretary of the Treasury offered 4 percent Treasury Bonds of 1971 in exchange for other Treasury Bonds as follows:

(1) at par in exchange for 3 percent Treasury Bonds of 1964, dated February 14, 1958, due February 15, 1964; or

(2) at 102 percent of their face value in exchange for 2½ percent Treasury Bonds of 1965, dated June 15, 1958, due February 15, 1965.

The income derived from the bonds is subject to all taxes imposed under the Internal Revenue Code of 1954. The bonds are subject to estate, inheritance, gift or other excise taxes, whether Federal or State, but are exempt from all taxation now or hereafter imposed on the principal or interest thereof by any State, or any of the possessions of the United States, or by any local taxing authority.

The bonds will be acceptable to secure deposits of public moneys. However, they will not be acceptable in payment of taxes.

Pursuant to the provisions of section 1037(a) of the Code, the Secretary of the Treasury has declared that no gain or loss shall be recognized, for Federal income tax purposes, upon the exchange with the United States of 3 percent Treasury Bonds of 1964 or 2½ percent Treasury Bonds of 1965 solely for the 4 percent Treasury Bonds of 1971 as offered by Department Circular, Public Debt Series No. 4-62, *supra*.

Gain or loss, if any, upon the obligations surrendered in exchange will be taken into account upon the disposition or redemption of the new obligations.

Rev. Rul. 62-94

Under section 1037(a) of the Internal Revenue Code of 1954, no gain or loss will be recognized upon the exchange of the 2½ percent Treasury Bonds of 1965 or the 2½ percent Treasury Bonds of 1967-72, dated October 20, 1941, June 1, 1945, and November 15, 1945, as offered by Department Circular, Public Debt Series Nos. 5-62, 6-62, and 7-62, respectively.

In the Treasury Department circulars listed below, the Secretary of the Treasury offered the Treasury Bonds specified in exchange for other Treasury Bonds as follows:

*Treasury Department Circular, Public Debt Series No. 5-62,
dated February 19, 1962, 27 F.R. 1855*

Bonds offered

4 percent Treasury Bonds of 1980 at 100.25 percent of their face value and accrued interest.

Exchanges accepted

2½ percent Treasury Bonds of 1965, dated June 15, 1958, due February 15, 1965.

*Treasury Department Circular, Public Debt Series No. 6-62,
dated February 19, 1962, 27 F.R. 1857*

Bonds offered

3½ percent Treasury Bonds of 1990 at 101.50 percent of their face value.

3½ percent Treasury Bonds of 1990 at 101.25 percent of their face value.

3½ percent Treasury Bonds of 1990 at 101.75 percent of their face value.

Exchanges accepted

2½ percent Treasury Bonds of 1967-72, dated October 20, 1941, due September 15, 1972, in amounts of \$500 or multiples thereof.

2½ percent Treasury Bonds of 1967-72, dated June 1, 1945, due June 15, 1972.

2½ percent Treasury Bonds of 1967-72, dated November 15, 1945, due December 15, 1972.

*Treasury Department Circular, Public Debt Series No. 7-62,
dated February 19, 1962, 27 F.R. 1858*

Bonds offered

3½ percent Treasury Bonds of 1998 at 100.25 percent of their face value.

3½ percent Treasury Bonds of 1998 at par.

3½ percent Treasury Bonds of 1998 at 100.50 percent of their face value.

Exchanges accepted

2½ percent Treasury Bonds of 1967-72, dated October 20, 1941, due September 15, 1972, in amounts of \$500 or multiples thereof.

2½ percent Treasury Bonds of 1967-72, dated June 1, 1945, due June 15, 1972.

2½ percent Treasury Bonds of 1967-72, dated November 15, 1945, due December 15, 1972.

The income derived from the bonds is subject to all taxes imposed under the Internal Revenue Code of 1954. The bonds are subject to estate, inheritance, gift or other excise taxes, whether Federal or State, but are exempt from all taxation now or hereafter imposed on the principal or interest thereof by any State, or any of the possessions of the United States or by any local taxing authority.

The bonds will be acceptable to secure deposits of public moneys. They may, upon the death of the owner, be redeemed at par, plus accrued interest to date of payment, in payment of Federal estate taxes due from the deceased owner's estate.

Pursuant to the provisions of section 1037(a) of the Code, the Secretary of the Treasury has declared that no gain or loss shall be recognized, for Federal income tax purposes, upon the exchange with the United States of the bonds indicated solely for the bonds specified as offered by the Treasury Department circulars listed above.

Gain or loss, if any, upon the obligations surrendered in exchange will be taken into account upon the disposition or redemption of the new obligations.

PART VIII.—DISTRIBUTIONS PURSUANT TO BANK HOLDING COMPANY ACT OF 1956

SECTION 1101.—DISTRIBUTIONS PURSUANT TO BANK HOLDING COMPANY ACT OF 1956

26 CFR 1.1101: Statutory provisions; distributions T.D. 6587¹
pursuant to Bank Holding Company Act of 1956.

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

Income Tax Regulations relating to sections 1101, 1102, and
1103 of the Internal Revenue Code of 1954, as added by section
10(a) of the Bank Holding Company Act of 1956 (70 Stat. 133, 139).

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

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

On January 20, 1961, notice of proposed rulemaking with respect to sections 1101, 1102, and 1103 of the Internal Revenue Code of 1954, as added by the Bank Holding Company Act of 1956 (70 Stat. 139) [P.L. 511, C.B. 1956-1, 875] was published in the Federal Register (26 F.R. 615). The following regulations are hereby adopted:

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DISTRIBUTIONS PURSUANT TO BANK HOLDING COMPANY ACT
OF 1956

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1.1103	Statutory provisions; distributions pursuant to Bank Holding Company Act of 1956; definitions.

AUTHORITY: §§ 1.1101 to 1.1103, incl., issued under sec. 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).

¹ The publication of this Treasury Decision in 27 F.R. 33, dated January 4, 1962, contains (1) instructions for modifying the notice of proposed rulemaking in 26 F.R. 615, dated January 20, 1961, and (2) the full context of the regulations with such modifications. As here published, the Treasury Decision reflects the full context of such regulations, with modifications. The individual instructions have been omitted.

DISTRIBUTIONS PURSUANT TO BANK HOLDING COMPANY ACT OF 1956

§ 1.1101 STATUTORY PROVISIONS; DISTRIBUTIONS PURSUANT TO BANK HOLDING COMPANY ACT OF 1956.

SEC. 1101. DISTRIBUTIONS PURSUANT TO BANK HOLDING COMPANY ACT OF 1956.

(a) DISTRIBUTIONS OF CERTAIN NON-BANKING PROPERTY.—

(1) DISTRIBUTIONS OF PROHIBITED PROPERTY.—If—

(A) A qualified bank holding corporation distributes prohibited property (other than stock received in an exchange to which subsection (c) (2) applies)—

(i) To a shareholder (with respect to its stock held by such shareholder), without the surrender by such shareholder of stock in such corporation; or

(ii) To a shareholder, in exchange for its preferred stock; or

(iii) To a security holder, in exchange for its securities; and

(B) The Board has, before the distribution, certified that the distribution of such prohibited property is necessary or appropriate to effectuate section 4 of the Bank Holding Company Act of 1956,

then no gain to the shareholder or security holder from the receipt of such property shall be recognized.

(2) DISTRIBUTIONS OF STOCK AND SECURITIES RECEIVED IN AN EXCHANGE TO WHICH SUBSECTION (C) (2) APPLIES.—If—

(A) A qualified bank holding corporation distributes—

(i) Common stock received in an exchange to which subsection (c) (2) applies to a shareholder (with respect to its stock held by such shareholder), without the surrender by such shareholder of stock in such corporation; or

(ii) Common stock received in an exchange to which subsection (c) (2) applies to a shareholder, in exchange for its common stock; or

(iii) Preferred stock or common stock received in an exchange to which subsection (c) (2) applies to a shareholder, in exchange for its preferred stock; or

(iv) Securities or preferred or common stock received in an exchange to which subsection (c) (2) applies to a security holder, in exchange for its securities; and

(B) Any preferred stock received has substantially the same terms as the preferred stock exchanged, and any securities received have substantially the same terms as the securities exchanged.

then, except as provided in subsection (f), no gain to the shareholder or security holder from the receipt of such stock or such securities or such stock and securities shall be recognized.

(3) **NON PRO RATA DISTRIBUTIONS.**—Paragraphs (1) and (2) shall apply to a distribution whether or not the distribution is pro rata with respect to all of the shareholders of the distributing qualified bank holding corporation.

(4) **EXCEPTION.**—This subsection shall not apply to any distribution by a corporation which has made any distribution pursuant to subsection (b).

(5) **DISTRIBUTIONS INVOLVING GIFT OR COMPENSATION.**—In the case of a distribution to which paragraph (1) or (2) applies, but which—

(A) Results in a gift, see section 2501, and following, or

(B) Has the effect of the payment of compensation, see section 61(a) (1).

(b) CORPORATION CEASING TO BE A BANK HOLDING COMPANY.—

(1) **DISTRIBUTIONS OF PROPERTY WHICH CAUSE A CORPORATION TO BE A BANK HOLDING COMPANY.—If—**

(A) A qualified bank holding corporation distributes property (other than stock received in an exchange to which subsection (c) (3) applies)—

(i) To a shareholder (with respect to its stock held by such shareholder), without the surrender by such shareholder of stock in such corporation; or

(ii) To a shareholder, in exchange for its preferred stock; or

(iii) To a security holder, in exchange for its securities; and

(B) The Board has, before the distribution, certified that—

(i) Such property is all or part of the property by reason of which such corporation controls (within the meaning of section 2(a) of the Bank Holding Company Act of 1956) a bank or bank holding company, or such property is part of the property by reason of which such corporation did control a bank or a bank holding company before any property of the same kind was distributed under this subsection or exchanged under subsection (c) (3); and

(ii) The distribution is necessary or appropriate to effectuate the policies of such Act,

then no gain to the shareholder or security holder from the receipt of such property shall be recognized.

(2) DISTRIBUTION OF STOCK AND SECURITIES RECEIVED IN AN EXCHANGE TO WHICH SUBSECTION (c) (3) APPLIES.—If—

(A) A qualified bank holding corporation distributes—

(i) Common stock received in an exchange to which subsection (c) (3) applies to a shareholder (with respect to its stock held by such shareholder), without the surrender by such shareholder of stock in such corporation; or

(ii) Common stock received in an exchange to which subsection (c) (3) applies to a shareholder, in exchange for its common stock; or

(iii) Preferred stock or common stock received in an exchange to which subsection (c) (3) applies to a shareholder, in exchange for its preferred stock; or

(iv) Securities or preferred or common stock received in an exchange to which subsection (c) (3) applies to a security holder, in exchange for its securities; and

(B) Any preferred stock received has substantially the same terms as the preferred stock exchanged, and any securities received have substantially the same terms as the securities exchanged,

then, except as provided in subsection (f), no gain to the shareholder or security holder from the receipt of such stock or such securities or such stock and securities shall be recognized.

(3) NON PRO RATA DISTRIBUTIONS.—Paragraphs (1) and (2) shall apply to a distribution whether or not the distribution is pro rata with respect to all of the shareholders of the distributing qualified bank holding corporation.

(4) EXCEPTION.—This subsection shall not apply to any distribution by a corporation which has made any distribution pursuant to subsection (a).

(5) DISTRIBUTIONS INVOLVING GIFT OR COMPENSATION.—In the case of a distribution to which paragraph (1) or (2) applies, but which—

(A) Results in a gift, see section 2501, and following, or

(B) Has the effect of the payment of compensation, see section 61(a) (1).

(c) PROPERTY ACQUIRED AFTER MAY 15, 1955.—

(1) IN GENERAL.—Except as provided in paragraphs (2) and (3), subsection (a) or (b) shall not apply to—

(A) Any property acquired by the distributing corporation after May 15, 1955, unless (i) gain to such corporation with respect to the receipt of such property was not recognized by reason of subsection (a) or (b), or (ii) such property was received by it in exchange for all of its stock in an exchange to which paragraph (2) or (3) applies, or (iii) such property was

acquired by the distributing corporation in a transaction in which gain was not recognized under section 305(a) or section 332, or under section 354 with respect to a reorganization described in section 368(a)(1) (E) or (F), or

(B) Any property which was acquired by the distributing corporation in a distribution with respect to stock acquired by such corporation after May 15, 1955, unless such stock was acquired by such corporation (i) in a distribution (with respect to stock held by it on May 15, 1955, or with respect to stock in respect of which all previous applications of this clause are satisfied) with respect to which gain to it was not recognized by reason of subsection (a) or (b), or (ii) in exchange for all of its stock in an exchange to which paragraph (2) or (3) applies, or (iii) in a transaction in which gain was not recognized under section 305(a) or section 332, or under section 354 with respect to a reorganization described in section 368(a)(1) (E) or (F), or

(C) Any property acquired by the distributing corporation in a transaction in which gain was not recognized under section 332, unless such property was acquired from a corporation which, if it had been a qualified bank holding corporation, could have distributed such property under subsection (a)(1) or (b)(1).

(2) EXCHANGES INVOLVING PROHIBITED PROPERTY.—If—

(A) Any qualified bank holding corporation exchanges (i) property, which, under subsection (a)(1), such corporation could distribute directly to its shareholders or security holders without the recognition of gain to such shareholders or security holders, and other property (except property described in subsection (b)(1)(B) (i), for (ii) all of the stock of a second corporation created and availed of solely for the purpose of receiving such property;

(B) Immediately after the exchange, the qualified bank holding corporation distributes all of such stock in a manner prescribed in subsection (a)(2)(A); and

(C) Before such exchange, the Board has certified (with respect to the property exchanged which consists of property which, under subsection (a)(1), such corporation could distribute directly to its shareholders or security holders without the recognition of gain) that the exchange and distribution are necessary or appropriate to effectuate section 4 of the Bank Holding Company Act of 1956, then paragraph (1) shall not apply with respect to such distribution.

(3) EXCHANGES INVOLVING INTERESTS IN BANKS.—If—

(A) Any qualified bank holding corporation exchanges (i) property which, under subsection (b)(1), such corporation could distribute directly to its shareholders or security holders without the recognition of gain to such shareholders or security holders, and other property (except prohibited property), for (ii) all of the stock of a second corporation created and availed of solely for the purpose of receiving such property;

(B) Immediately after the exchange, the qualified bank holding corporation distributes all of such stock in a manner prescribed in subsection (b)(2)(A); and

(C) Before such exchange, the Board has certified (with respect to the property exchanged which consists of property which, under subsection (b)(1), such corporation could distribute directly to its shareholders or security holders without the recognition of gain) that—

(i) Such property is all or part of the property by reason of which such corporation controls (within the meaning of section 2(a) of the Bank Holding Company Act of 1956) a bank or bank holding company, or such property is part of the property by reason of which such corporation did control a bank or a bank holding company before any property of the same kind was distributed under subsection (b)(1) or exchanged under this paragraph; and

(ii) The exchange and distribution are necessary or appropriate to effectuate the policies of such Act, then paragraph (1) shall not apply with respect to such distribution.

(d) DISTRIBUTIONS TO AVOID FEDERAL INCOME TAX.—

(1) PROHIBITED PROPERTY.—Subsection (a) shall not apply to a distribution if, in connection with such distribution, the distributing corporation retains, or transfers after May 15, 1955, to any corporation, property (other than prohibited property) as part of a plan one of the principal purposes of which is the distribution of the earnings and profits of any corporation.

(2) BANKING PROPERTY.—Subsection (b) shall not apply to a distribution if, in connection with such distribution, the distributing corporation retains, or transfers after May 15, 1955, to any corporation, property (other than property described in subsection (b) (1) (B) (i)) as part of a plan one of the principal purposes of which is the distribution of the earnings and profits of any corporation.

(3) CERTAIN CONTRIBUTIONS TO CAPITAL.—In the case of a distribution a portion of which is attributable to a transfer which is a contribution to the capital of a corporation, made after May 15, 1955, and prior to the date of the enactment of this part, if subsection (a) or (b) would apply to such distribution but for the fact that, under paragraph (1) or (2) (as the case may be) of this subsection, such contribution to capital is part of a plan one of the principal purposes of which is to distribute the earnings and profits of any corporation, then, notwithstanding paragraph (1) or (2), subsection (a) or (b) (as the case may be) shall apply to that portion of such distribution not attributable to such contribution to capital, and shall not apply to that portion of such distribution attributable to such contribution to capital.

(e) FINAL CERTIFICATION.—

(1) FOR SUBSECTION (A).—Subsection (a) shall not apply with respect to any distribution by a corporation unless the Board certifies that, before the expiration of the period permitted under section 4(a) of the Bank Holding Company Act of 1956 (including any extensions thereof granted to such corporation under such section 4(a)), the corporation has disposed of all the property the disposition of which is necessary or appropriate to effectuate section 4 of such Act (or would have been so necessary or appropriate if the corporation had continued to be a bank holding company).

(2) FOR SUBSECTION (b).—

(A) Subsection (b) shall not apply with respect to any distribution by any corporation unless the Board certifies that, before the expiration of the period specified in subparagraph (B), the corporation has ceased to be a bank holding company.

(B) The period referred to in subparagraph (A) is the period which expires 2 years after the date of the enactment of this part or 2 years after the date on which the corporation becomes a bank holding company, whichever date is later. The Board is authorized, on application by any corporation, to extend such period from time to time with respect to such corporation for not more than one year at a time if, in its judgment, such an extension would not be detrimental to the public interest; except that such period may not in any case be extended beyond the date 5 years after the date of the enactment of this part or 5 years after the date on which the corporation becomes a bank holding company, whichever date is later.

(f) CERTAIN EXCHANGES OF SECURITIES.—In the case of an exchange described in subsection (a) (2) (A) (iv) or subsection (b) (2) (A) (iv), subsection (a) or subsection (b) (as the case may be) shall apply only to the extent that the principal amount of the securities received does not exceed the principal amount of the securities exchanged.

[Sec. 1101 as added by sec. 10(a), Bank Holding Company Act of 1956 (70 Stat. 139) [P.L. 511, C.B. 1956-1, 875]]

§ 1.1101-1 IN GENERAL.—The Bank Holding Company Act of 1956 (12 U.S.C. ch. 17) requires, in certain cases, the separation of interests in nonbanking businesses held by a bank holding company, as defined in section 2(a) of the Act (12 U.S.C. 1841(a)), from its interests in banking and closely related businesses. In order to facilitate such separation, part VIII (section 1101 and following), subchapter O, chapter 1 of the Code, provides, to a limited extent, for the nonrecognition of gain on the receipt, by shareholders or security holders of a qualified bank holding corporation, of property distributed pursuant to a certification by the Board of Governors of the Federal Reserve System that such distribution is necessary or appropriate to effectuate the policies of the Act. The provisions of such part VIII of subchapter O supersede other provisions of chapter 1 of the Code only to the extent that such provisions of part VIII specifically apply to a transaction and, where they are not applicable, do not prevent the application of any other provisions of law under which nonrecognition of gain may occur. For example, a bank holding company may retain, under section 4(c)(5) of the Act (12 U.S.C. 1843(c)(5)), up to five percent of the voting stock of another company. In such a case, a distribution of all the stock of such other company pursuant to a certification by the Board would result in nonrecognition of gain under section 1101 as to only 95 percent of such distribution. However, assuming the distribution is one that qualifies for nonrecognition of gain under section 355, relating to distribution of stock and securities of a controlled corporation, as well as under section 1101, nonrecognition of gain may be obtained under section 355 with respect to the five percent not qualifying for nonrecognition under section 1101. Further, the provisions of such part VIII of subchapter O do not provide for nonrecognition of gain to the distributing bank holding company. Accordingly, gain will be recognized to the distributing corporation in appropriate cases. For example, if a bank holding company, in a distribution qualifying under section 1101, distributes installment obligations, LIFO inventory, or property subject to a liability in excess of its adjusted basis, gain may be recognized to the corporation under section 453(d) or section 311. If, pursuant to section 1101(c)(2) or 1101(c)(3), a bank holding company places the property to be disposed of in a newly created corporation in exchange for all its stock which is then distributed by the bank holding company to its shareholders, the extent, if any, to which gain will be recognized to the bank holding company on either the exchange or the subsequent distribution is not affected by such part VIII of subchapter O and must be determined under other provisions of the Internal Revenue Code. For example, if the conditions of section 351 are satisfied, the exchange of property for stock will result in nonrecognition of gain to the bank holding company under that section.

§ 1.1101-2 CERTIFICATION BY BOARD.—(a) *Requirement of certification.*—Part VIII (section 1101 and following), subchapter O, chapter 1 of the Code, is applicable only with respect to distributions and exchanges by a qualified bank holding corporation as defined in section 1103(b). A bank holding company shall be treated as a qualified bank holding corporation only if the Board of Governors of the

Federal Reserve System issues a certification that the company satisfies the requirements of section 1103(b). (See 12 CFR 222.5(c).)

(b) *Nonrecognition of gain.*—Distributions of property (other than stock and securities in a corporation created in accordance with the provisions of section 1101 (c) (2) or (c) (3)) will not result in nonrecognition of gain to the shareholders and security holders of a bank holding company under section 1101 (a) (1) or (b) (1) unless, before the distribution, the Board has issued a certification pursuant to section 1101 (a) (1) (B) or (b) (1) (B), whichever is applicable. Distributions of stock and securities in a corporation created in accordance with section 1101 (c) (2) or (c) (3) will not result in nonrecognition of gain to the shareholders and security holders of a bank holding company under section 1101 (a) (2) or (b) (2) unless, before the exchange described in section 1101 (c) (2) (A) or (c) (3) (A), the Board has issued a certification pursuant to section 1101 (c) (2) (C) or (c) (3) (C), whichever is applicable. Further, unless a final certification is also made by the Board in accordance with section 1101(e), section 1101 (a) or (b) will not apply to any distribution made by a bank holding company. Provisionally, however, pending the issuance of such final certification, section 1101 (a) or (b) shall be deemed applicable to distributions otherwise qualifying under such part VIII of subchapter O which are made within the period prescribed in section 1101 (e) (1) or (e) (2) (B), whichever is applicable.

(c) *Limitations.*—The period of limitations in section 6501 with respect to any deficiency resulting solely from the receipt by a shareholder or security holder of property, in a distribution certified by the Board in accordance with section 1101 (a) (1) (B), (b) (1) (B), (c) (2) (C), or (c) (3) (C), shall not expire prior to the period prescribed in section 1102(b), notwithstanding that the shareholder or security holder relied on a provision of law other than section 1101 (a) or (b), for example section 355, to obtain nonrecognition of gain on the distribution. (See § 1.1102-2.)

§ 1.1101-3 TAX AVOIDANCE.—(a) *Recognition of gain.*—Irrespective of whether the transaction meets the other requirements of sections 1101, 1102, and 1103, a distribution will not qualify for nonrecognition of gain pursuant to the provisions of section 1101 if, in connection with such distribution, the distributing corporation retains or transfers to any corporation after May 15, 1955, property pursuant to a plan one of the principal purposes of which is the distribution of earnings and profits of a corporation so as to avoid the Federal income tax on dividends. A certification that a particular distribution of property is necessary or appropriate in order to comply with the Bank Holding Company Act of 1956 (12 U.S.C. ch. 17) shall not be considered as permitting nonrecognition of gain where such distribution is a part of a plan to distribute earnings and profits in avoidance of the Federal income tax on dividends.

Continuity and other factors.—Section 1101 contemplates a continuity of the enterprise as modified and a continuity of interest in all or part of the property received or retained on the part of those who, directly or indirectly, were the owners of the enterprise prior to the distribution or exchange. Whether or not a distribution is made under section 1101 in such a manner as to be in avoidance of Federal income tax is a question to be decided in the light of all

the facts and circumstances surrounding the transaction. Some of the factors which may evidence a tax avoidance plan in appropriate circumstances are the following:

(1) A company making acquisitions of property shortly before May 15, 1955, in anticipation of the legislation in order to qualify under the Bank Holding Company Act of 1956.

(2) A greatly disproportionate shift to banking or nonbanking assets shortly before or after May 15, 1955, from the normal course of holdings or any unusual shift within such groups of assets that is inconsistent with prior holdings, particularly if made to such assets that are or may be more readily marketable.

(3) A separation of assets, the acquisition of which was substantially financed out of the earnings of particular properties, from such properties (whether or not such properties are retained), particularly where said assets are in the form of cash or highly marketable securities, stocks, or other investments, and where such separation is not necessary or appropriate to effectuate the policies of the Bank Holding Company Act of 1956.

(4) A transfer of "other property" in an exchange described in section 1101(c)(2) or (c)(3), which property is greater in amount than that reasonably required by the newly created corporation for its working capital or is disproportionate to or inconsistent with the holding operations previously engaged in.

(5) An indication that a liquidation of either of the corporations separated pursuant to section 1101(c)(2) or 1101(c)(3) is contemplated or that dominant shareholders thereof intended to sell the stock received or retained.

(6) An indication that dominant shareholders contemplated the sale of property distributed directly.

A shift of assets to a corporation to be separated will not in itself establish a plan to avoid tax if such action is consistent with the holding operations previously engaged in and in conformity with good business practice. Similarly, a reasonable transfer of cash and securities to a corporation availed of under section 1101(c)(2) or 1101(c)(3) for the reasonable working capital needs of a newly organized corporation will not, by itself, establish an attempt to distribute earnings and profits. Where it is established that a contribution to capital was made after May 15, 1955, and prior to the enactment of the Bank Holding Company Act of 1956 with one of the principal purposes of distributing earnings and profits of any corporation, such action will not in itself cause the proportionate remainder of a distribution to fail to qualify for treatment under section 1101. (See section 1101(d)(3).)

§ 1.1101-4 RECORDS TO BE KEPT AND INFORMATION TO BE FILED WITH RETURNS.—Each stock or security holder who receives stock or securities or other property upon a distribution made by a qualified bank holding corporation under section 1101 shall maintain records of, and file as a part of his income tax return for the taxable year in which such distribution is received a complete statement of, all facts pertinent to the nonrecognition of gain upon such distribution, including—

(a) Name and address of the corporation from which the distribution is received; the date the distribution is received; and

that the distribution was made pursuant to the Bank Holding Company Act of 1956.

(b) A statement of the name or designation, type, class, number, and fair market value on the date of receipt of the stock or securities or other property received upon the distribution and a record of the disposition made thereof, or of any stock or securities retained in the distributing corporation in the year of receipt.

(c) If preferred stock is exchanged for preferred stock or securities are exchanged for securities within the meaning of section 1101(a)(2)(A) or section 1101(b)(2)(A), a statement of the terms and amount of such newly issued securities or preferred stock, as well as of those surrendered.

(d) A statement as to the distributee's holdings immediately prior to the record date for the distribution of each class of stock or securities outstanding of the distributing corporation, together with the date and manner of acquisition thereof.

(e) The value of the distributing corporation's stock per share or securities immediately prior to and after the distribution. In the case of a return filed on or before January 4, 1962, such information shall be filed on or before April 4, 1962, by the taxpayer with the district director for the internal revenue district in which such return was filed.

§ 1.1102 STATUTORY PROVISIONS; DISTRIBUTIONS PURSUANT TO BANK HOLDING COMPANY ACT OF 1956; SPECIAL RULES.

SEC. 1102. SPECIAL RULES.

(a) **BASIS OF PROPERTY ACQUIRED IN DISTRIBUTIONS.**—If, by reason of section 1101, gain is not recognized with respect to the receipt of any property, then, under regulations prescribed by the Secretary or his delegate—

(1) If the property is received by a shareholder with respect to stock, without the surrender by such shareholder of stock, the basis of the property received and of the stock with respect to which it is distributed shall, in the distributee's hands, be determined by allocating between such property and such stock the adjusted basis of such stock; or

(2) If the property is received by a shareholder in exchange for stock or by a security holder in exchange for securities, the basis of the property received shall, in the distributee's hands, be the same as the adjusted basis of the stock or securities exchanged, increased by—

(A) The amount of the property received which was treated as a dividend, and

(B) The amount of gain to the taxpayer recognized on the property received (not including any portion of such gain which was treated as a dividend).

(b) **PERIODS OF LIMITATION.**—The periods of limitation provided in section 6501 (relating to limitations on assessment and collection) shall not expire, with respect to any deficiency (including interest and additions to the tax) resulting solely from the receipt of property by shareholders in a distribution which is certified by the Board under subsection (a), (b), or (c) of section 1101, until five years after the distributing corporation notifies the Secretary or his delegate (in such manner and with such accompanying information as the Secretary or his delegate may by regulations prescribe) that the period (including extensions thereof) prescribed in section 4(a) of the Bank Holding Company Act of 1956, or section 1101(e)(2)(B), whichever is applicable, has expired; and such assessment may be made notwithstanding any provision of law or rule of law which would otherwise prevent such assessment.

(c) ALLOCATION OF EARNINGS AND PROFITS.—

(1) DISTRIBUTION OF STOCK IN A CONTROLLED CORPORATION.—In the case of a distribution by a qualified bank holding corporation under section 1101 (a) (1) or (b) (1) of stock in a controlled corporation, proper allocation with respect to the earnings and profits of the distributing corporation and the controlled corporation shall be made under regulations prescribed by the Secretary or his delegate.

(2) EXCHANGES DESCRIBED IN SECTION 1101 (C) (2) OR (3).—In the case of any exchange described in section 1101 (c) (2) or (3), proper allocation with respect to the earnings and profits of the corporation transferring the property and the corporation receiving such property shall be made under regulations prescribed by the Secretary or his delegate.

(3) DEFINITION OF CONTROLLED CORPORATION.—For purposes of paragraph (1), the term "controlled corporation" means a corporation with respect to which at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock is owned by the distributing qualified bank holding corporation.

(d) ITEMIZATION OF PROPERTY.—In any certification under this part, the Board shall make such specification and itemization of property as may be necessary to carry out the provisions of this part.

[Sec. 1102 as added by sec. 10(a), Bank Holding Company Act 1956 (70 Stat. 139) [P.L. 511, C.B. 1956-1, 875]]

§ 1.1102-1 BASIS OF PROPERTY ACQUIRED IN DISTRIBUTIONS BY QUALIFIED BANK HOLDING CORPORATIONS.—In the case of a distribution to a shareholder with respect to stock, without the surrender by such shareholder of stock, to which section 1101 (a) or (b) applies, the sum of the basis of all the stock in the distributing corporation held immediately after the transaction plus the basis of all the nonrecognition property received in the transaction shall be the same as the basis of all the stock in such corporation held immediately before the transaction allocated in proportion to the respective fair market value of each. In the case of an exchange to which section 1101 (a) or (b) applies, in which property is received by a shareholder in exchange for stock or by a security holder in exchange for securities, the basis of all the property received in the exchange and as a part thereof shall be the same as the adjusted basis of the stock or securities exchanged, increased by—

(a) The amount of the property received as part of the exchange which was treated as a dividend, and

(b) The amount of gain to the taxpayer recognized on the property received as part of the exchange (not including any portion of such gain which was treated as a dividend).

The basis, in a case involving an exchange, must be apportioned to the properties received, and for this purpose there must be allocated to such other property received as part of the exchange (not permitted to be received without the recognition of gain) an amount of such basis equivalent to the fair market value of such other property at the date of the exchange. Any other property received in connection with a transaction under section 1101 on which gain is realized shall receive a basis in accordance with whichever Code section may be applicable to that portion of the transaction.

§ 1.1102-2 FILING OF NOTIFICATION UNDER SECTION 1102(b) BY QUALIFIED BANK HOLDING CORPORATIONS.—Every distributing corporation which is certified as being a qualified bank holding corpora-

tion under section 1103 (b) shall, as soon as practical, by written statement notify the Commissioner of Internal Revenue, Washington 25, D.C., Attention: T:R:R, that the period (including extensions thereof granted by the Board of Governors of the Federal Reserve System) prescribed in section 4(a) of the Bank Holding Company Act of 1956 (12 U.S.C. 1843(a)), or section 1101(e)(2)(B) of the Code, whichever is applicable, has expired. In order for such statement to satisfy the requirements for notification under section 1102 (b), there shall be included a complete statement of all facts pertinent to the divestment of assets under part VIII (section 1101 and following), subchapter O, chapter 1 of the Code, including the following:

- (a) Name and address of the distributing corporation.
- (b) A copy of the plan of divestment forming the basis of the issuance by the Board of any certification under section 1101(a)(1)(B), section 1101(b)(1)(B), section 1101(c)(2)(C), or section 1101(c)(3)(C), as the case may be.
- (c) A copy of any such certifications issued to the distributing corporation by the Board.
- (d) A certified copy of the corporate resolution authorizing every distribution under section 1101.
- (e) Identification and date of acquisition by the distributing corporation of all property distributed under section 1101.
- (f) Identification and date of acquisition by the distributing corporation of all property which was transferred to a new corporation under section 1101(c)(2) or (3).
- (g) If the date of acquisition in paragraph (e) or (f) of this section 1101 contained installment obligations, LIFO inventory, or surrounding the acquisition. If any of such property was acquired in a distribution under section 1101, a copy of the certification covering such distribution.
- (h) A statement as to whether any of the distributions under section 1101 contained installment obligations, LIFO inventory, or property either subject to a liability in excess of its basis or in connection with the receipt of which any shareholder assumed a liability in excess of its basis. If so, the statement shall include complete details, including dates of distribution.
- (i) [Reserved.]
- (j) Name and address of each distributee.
- (k) Number of shares of outstanding stock of the corporation, by class, and amount of securities actually owned by each distributee prior to the distribution.
- (l) If preferred stock was exchanged for preferred stock or securities were exchanged for securities under section 1101(a)(2)(A) or section 1101(b)(2)(A), the terms and amount of the newly issued securities or preferred shares received and of those surrendered.
- (m) Identification of the property distributed to each distributee under section 1101, by date, together with the fair market value at date of distribution.
- (n) Fair market value of the distributing corporation's outstanding securities and stock per share immediately after a distribution.

(o) The amount of the undistributed earnings and profits of the distributing corporation accumulated after February 28, 1913, to date of transfer to a new corporation in an exchange to which section 1101(c) (2) or (3) applies.

(p) If property was transferred to a new corporation under the provisions of section 1101(c) (2) or (3), a statement giving the value of the assets transferred together with the value of assets retained. If cash was transferred, a complete substantiation thereof.

(q) If stock in a controlled corporation within the meaning of section 1102(c) (3) is distributed under section 1101 (a) (1) or (b) (1), a statement giving the accumulated earnings and profits of the controlled corporation (or deficit in earnings as the case may be) immediately prior to the distribution.

(r) A copy of the final certification if issued to the distributing corporation by the Board pursuant to section 1101 (e).

(s) The date of expiration of the period (including extensions thereof) prescribed in section 4(a) of the Bank Holding Company Act of 1956 (12 U.S.C. 1843(a)), or section 1101(e) (2) (B), whichever is applicable.

(t) A statement showing, for the 5-year period preceding any exchange or distribution described in section 1101, the amount of income and expenditures attributable to each of the respective activities and holdings of the bank holding company and further showing the holdings and activities, after the distributions and exchanges described in section 1101, of the bank holding company and the corporations the stock of which is distributed under section 1101.

The periods of limitation (section 6501) with respect to any deficiency, including interest and additions to the tax, resulting solely from the receipt of property by shareholders in a distribution certified by the Board under subsection (a), (b), or (c) of section 1101 shall not expire until 5 years following the date of the notification required under section 1102(b) and this section.

§ 1.1102-3 ALLOCATION OF EARNINGS AND PROFITS IN CERTAIN DISTRIBUTIONS BY QUALIFIED BANK HOLDING CORPORATIONS.—(a) *Exchanges described in section 1101(c) (2) or (3).*—Under section 1102(c), if a qualified bank holding corporation transfers property to a newly created corporation in exchange for all of its stock in a transaction described in section 1101(c) (2) (A) or (3) (A) and immediately thereafter the stock and securities of the controlled corporation are distributed in a distribution or exchange to which section 1101 (a) (2) or (b) (2) applies, the earnings and profits of the bank holding corporation immediately before the transaction shall be allocated between such bank holding corporation and the controlled corporation. Such allocation generally shall be made in proportion to the fair market value of the assets retained by the bank holding corporation and the assets of the controlled corporation immediately after the transaction. In a proper case, allocation shall be made in proportion to the net basis of the assets transferred and of the assets retained or by such other method as may be appropriate under the facts and circumstances of the case. The term “net basis” means the

basis of the assets less liabilities assumed or liabilities to which such assets are subject. The part of the earnings and profits of the taxable year of the bank holding corporation in which the transaction occurs allocable to the controlled corporation shall be included in the computation of the earnings and profits of the first taxable year of the controlled corporation ending after the date of the transaction.

(b) *Distribution of stock in a controlled corporation under section 1101 (a) (1) or (b) (1).*—If a qualified bank holding corporation distributes stock of a controlled corporation (as defined in section 1102(c) (3)) in a distribution or exchange to which section 1101 (a) (1) or (b) (1) applies, the earnings and profits of the bank holding corporation shall be decreased by the lesser of the following amounts:

(1) The amount by which the earnings and profits of the bank holding corporation would have been decreased if it had transferred the stock of the controlled corporation to a new corporation in a transaction to which section 1101(c) (2) or (3) applied and immediately thereafter distributed the stock of such new corporation under section 1101 (a) (2) or (b) (2) or,

(2) The net worth of the controlled corporation. (For this purpose the term “net worth” means the sum of the bases of all of the properties plus cash minus all liabilities.)

If the earnings and profits of the controlled corporation immediately before the transaction are less than the amount of the decrease in earnings and profits of the bank holding corporation (including the case in which the controlled corporation has a deficit) the earnings and profits of the controlled corporation, after the transaction, shall be equal to the amount of such decrease. If the earnings and profits of the controlled corporation immediately before the transaction are more than the amount of the decrease in the earnings and profits of the bank holding corporation they shall remain unchanged.

(c) *Deficits.*—A deficit of the distributing corporation shall in no case be allocated to a controlled corporation.

§ 1.1103 STATUTORY PROVISIONS; DISTRIBUTIONS PURSUANT TO BANK HOLDING COMPANY ACT OF 1956; DEFINITIONS.

SEC. 1103. DEFINITIONS.

(a) **BANK HOLDING COMPANY.**—For purposes of this part, the term “bank holding company” has the meaning assigned to such term by section 2 of the Bank Holding Company Act of 1956.

(b) **QUALIFIED BANK HOLDING CORPORATION.**—

(1) **IN GENERAL.**—Except as provided in paragraph (2), for purposes of this part the term “qualified bank holding corporation” means any corporation (as defined in section 7701(a) (3)) which is a bank holding company and which holds prohibited property acquired by it—

(A) On or before May 15, 1955,

(B) In a distribution in which gain to such corporation with respect to the receipt of such property was not recognized by reason of subsection (a) or (b) of section 1101, or

(C) In exchange for all of its stock in an exchange described in section 1101 (c) (2) or (c) (3).

(2) **LIMITATIONS.**—(A) A bank holding company shall not be a qualified bank holding corporation, unless it would have been a bank holding company on May 15, 1955, if the Bank Holding Company Act of 1956 had been in effect on such date, or unless it is a bank holding company determined solely by reference to—

- (i) Property acquired by it on or before May 15, 1955,
 - (ii) Property acquired by it in a distribution in which gain to such corporation with respect to the receipt of such property was not recognized by reason of subsection (a) or (b) of section 1101, and
 - (iii) Property acquired by it in exchange for all of its stock in an exchange described in section 1101(c) (2) or (3).
- (B) A bank holding company shall not be a qualified bank holding corporation by reason of property described in subparagraph (B) of paragraph (1) or clause (ii) of subparagraph (A) of this paragraph, unless such property was acquired in a distribution with respect to stock, which stock was acquired by such bank holding company—

- (i) On or before May 15, 1955,
- (ii) In a distribution (with respect to stock held by it on May 15, 1955, or with respect to stock in respect of which all previous applications of this clause are satisfied) with respect to which gain to it was not recognized by reason of subsection (a) or (b) of section 1101, or
- (iii) In exchange for all of its stock in an exchange described in section 1101(c) (2) or (3).

(C) A corporation shall be treated as a qualified bank holding corporation only if the Board certifies that it satisfies the foregoing requirements of this subsection.

(c) **PROHIBITED PROPERTY.**—For purposes of this part, the term “prohibited property” means, in the case of any bank holding company, property (other than nonexempt property) the disposition of which would be necessary or appropriate to effectuate section 4 of the Bank Holding Company Act of 1956 if such company continued to be a bank holding company beyond the period (including any extensions thereof) specified in subsection (a) of such section or in section 1101(e) (2) (B) of this part, as the case may be. The term “prohibited property” does not include shares of any company held by a bank holding company to the extent that the prohibitions of section 4 of the Bank Holding Company Act of 1956 do not apply to the ownership by such bank holding company of such property by reason of subsection (c) (5) of such section.

(d) **NONEXEMPT PROPERTY.**—For purposes of this part, the term “non-exempt property” means—

(1) Obligations (including notes, drafts, bills of exchange, and bankers’ acceptances) having a maturity at the time of issuance of not exceeding 24 months, exclusive of days of grace;

(2) Securities issued by or guaranteed as to principal or interest by a government or subdivision thereof or by any instrumentality of a government or subdivision; or

(3) Money, and the right to receive money not evidenced by a security or obligation (other than a security or obligation described in paragraph (1) or (2)).

(e) **BOARD.**—For purposes of this part, the term “Board” means the Board of Governors of the Federal Reserve System.

[Sec. 1103 as added by sec. 10(a), Bank Holding Company Act 1956 (70 Stat. 139) [P.L. 511, C.B. 1956-1, 875]]

MORTIMER M. CAPLIN,
Commissioner of Internal Revenue.

Approved December 26, 1961.

STANLEY S. SURREY,
Assistant Secretary of the Treasury.

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SUBCHAPTER P.—CAPITAL GAINS AND LOSSES**PART I.—TREATMENT OF CAPITAL GAINS**

SECTION 1201.—ALTERNATIVE TAX

26 CFR 1.1201-1: Alternative tax.

Computation of tax of a mutual insurance company. See Rev. Rul. 62-3, page 92.

PART III.—GENERAL RULES FOR DETERMINING CAPITAL GAINS AND LOSSES

SECTION 1221.—CAPITAL ASSET DEFINED

26 CFR 1.1221-1: Meaning of terms.

Rev. Rul. 62-81¹

(Also Sections 631, 1231; 1.631-2, 1.1231-1.)

The owner of a tract of timber land entered into a contract with a paper company whereby the latter was granted, for a term of 60 years, the right to grow timber and to cut timber growing and to be grown on the tract. The company is obligated to make payments in each year of the term of the contract. The obligation to pay is not contingent upon the quantities of timber which are cut. At the time of execution of the contract, there was a stand of timber upon the tract having a known fair market value. *Held*, the transaction is not a "disposal" of timber under section 631(b) of the Internal Revenue Code of 1954. Payments equal to the fair market value of the timber existing at the execution of the contract constitute proceeds of sale of timber. Any gain included in the above amount is capital gain provided the conditions described in sections 1221 or 1231 of the Code are met. Any excess of such payments over the fair market value of the timber existing at the execution of the contract is ordinary income.

Advice has been requested as to the manner in which the owner of timber land, who enters into a long-term contract, under the circumstances described below, should treat the income therefrom for Federal income tax purposes.

The contract entered into between the owner of the timber land and a paper company is to extend for 60 years. The contract provides that for the stated term the owner agrees to "sell" and the company to "buy" all timber growing and to be grown upon the tract. The paper company, during the first ten years of the contract, must pay for and may cut 4M cords of wood per year, and during the next ten years must pay for and may cut 8M cords of wood per year. During the succeeding 40 years, timber cruises are to be made at specified intervals and quantities of annual growth of timber are to be estimated. Over this period of 40 years, the company must make annual payment for 8M cords or the quantity of estimated annual growth, whichever is greater, but cutting in any year may not exceed the estimated annual growth. However, with respect to the entire contract term, timber permitted to be cut, which is not cut

¹ Also released as Technical Information Release 382, dated May 11, 1962.

in any year, may be cut in any of the succeeding twelve years, but not later than the expiration date of the contract, provided the quantity permitted to be cut in the later year is first cut.

The contract payment is at the rate of 3X dollars per cord, subject to periodic adjustment to reflect changes in the Wholesale Commodity Price Index of all commodities from that prevailing at the execution of the contract, but in no event shall the adjusted payment be at a rate of less than 2X dollars per cord.

The company is required, at its own expense, at all times during the term of the contract, to manage and operate the land and timber thereon in accordance with good forestry practices in such manner that the average annual growth of timber shall not be less than the amount of timber cut and removed or otherwise utilized annually. The contract provides for the assumption by the company of ad valorem taxes, the use by the company of existing improvements, the right to construct additional improvements, and the right of the company to the full beneficial possession of the surface to an extent not detrimental to timber growth.

Title to the timber was to pass to the purchaser as cut. In the event of fire beyond a specified magnitude, the permissible annual cut could, at the seller's option, be reduced in proportion to the acreage affected, but purchaser was obligated to continue paying under the original schedule. In the event performance of any part of the agreement was prevented by specified factors beyond the control of the parties (including infestation of timber but not including fire) purchaser's obligation to pay was to be reduced in proportion to the extent and duration of such factors.

The fair market value of the timber existing at the date of the contract (merchantable timber of cutting size and smaller young growth of appraisable value) exceeds the landowner's adjusted basis for such timber.

Capital gain treatment of any portion of the landowner's receipts under the contract would be available to the landowner only to the extent that the transaction constituted either (1) a "sale" of timber, within the purview of sections 1221 or 1231 of the Internal Revenue Code of 1954, or (2) a "disposal" of timber within the purview of section 631(b). If the timber is held by the landowner "primarily for sale to customers in the ordinary course of trade or business," the provisions of sections 1221 or 1231 are not applicable. However, the fact that the timber is so held does not preclude the application of section 631(b). *Ah Pah Redwood Company v. Commissioner*, 251 Fed. (2d) 163 (1957); and Rev. Rul. 57-90, C.B. 1957-1, 199.

A "disposal of timber," to qualify under section 631(b), must be under a contract by virtue of which the owner retains an economic interest in such timber. An essential condition is that recovery of the capital investment of the owner must be conditioned upon severance of the timber. *Estate of James M. Lawton v. Commissioner*, 33 T.C. 47 (1959). See also section 1.611-1(b) (1) of the Income Tax Regulations; *Joe S. Ray v. Commissioner*, 32 T.C. 1244 (1959), affirmed 283 Fed. (2d) 337 (1960); and Rev. Rul. 56-542, C.B. 1956-2, 327.

The fact that the original unit price is subject to periodic adjustment for changes in the Wholesale Commodity Price Index of all commodities does not give the landowner a retained economic interest

in the timber. The provision merely assures the landowner a return which will reflect changes in the general purchasing value of the dollar.

The possibility of a reduction of the purchaser's obligation to pay, to the extent that performance is prevented by specified factors other than fire does not create a retained economic interest in the timber; despite such possibility, the landowner still looks to payments which are not conditioned upon the severance of timber for the recovery of his investment.

By the contract the landowner is to be paid stipulated amounts which are not conditioned on the quantities of timber which the paper company cuts. The landowner is assured of a fixed return, and the paper company is committed to a fixed obligation, neither of which is dependent upon, or governed by, the time or degree of severance of the timber. Thus, the landowner does not possess a "retained economic interest" in the timber. Accordingly, the transaction is not a "disposal" of timber under section 631(b) of the Code.

The contract, however, accomplishes a "sale" of the timber existing at the time of its execution. The contract shifts to the paper company the significant benefits and burdens incident to beneficial ownership of the timber during its term. The retention by the landowner of legal title to the timber until cut is merely a security device.

The agreement can accomplish a "sale" only of timber existing at the date of the contract since only timber in existence can be the subject of a present sale. See Williston on Sales (Rev'd Ed.), sections 62 and 258.

The landowner has parted with all control of the timber and of the land itself so far as it pertains to timber growth; growth occurring during the term of the contract is attributable to the possession and management of the property by the paper company. This would apply both to the subsequent growth of trees existing at the making of the contract and to timber grown in its entirety during the contract term. Payments under the contract not attributable to timber existing at the execution of the contract are not proceeds of sale of timber by the landowner but are consideration for the use of the land by the paper company and, therefore, constitute ordinary income. *Estate of James M. Lawton*.

Accordingly, payments under the contract equal to the fair market value of the timber existing at the execution of the contract constitute proceeds of sale of timber. Any gain included in the above amount is capital gain, provided the conditions specified in section 1221 or 1231 of the Code are met. Any excess of such payments over the fair market value of the timber existing at the execution of the contract is ordinary income.

(Also Section 631, 1231; 1.631-1, 1.1231-1.)

Rev. Rul. 62-82¹

Lump sum payment under a contract for the lease of land and the grant of the right to cut timber therefrom constitutes proceeds of the sale of timber to the extent of the fair market value of the timber then existing; the resulting gain or loss is subject to the treat-

¹ Also released as Technical Information Release 383, dated May 11, 1962.

ment described in subchapter P of the Internal Revenue Code of 1954, provided the provisions thereof are met. Any excess of such payments over the fair market value of the existing timber is ordinary income.

Advice has been requested as to the treatment for Federal income tax purposes of income received by an owner, or lessor, pursuant to a long-term contract under the circumstances described below.

In the case under consideration, the owner (taxpayer) of timberland, in consideration of 2 $\times$ dollars per acre per year or a total of 198 $\times$ dollars (received in a lump sum upon the execution of the contract), leased, let and rented to a paper company for 99 years the surface rights, the rights of future operation and the right to cut and remove any and all timber, trees, wood and other forest products standing, growing or being situated and to be situated during the life of the contract on the described land.

The taxpayer retained ownership of all mineral rights and remained liable for taxes on such retained rights. The paper company was obligated to pay all taxes assessed against the leased property, including severance tax on the timber. The paper company may relieve itself of future liability for taxes with respect to such acreage as it may designate, but there is no provision for the rebate under such circumstances of any of the consideration originally paid for the use of such acreage.

The paper company has the exclusive right to recover for damages to the timber caused by mineral operations of the taxpayer or his lessees. The paper company is reimbursed for any land used in sand and gravel operations at a specified rate and for any damage to timber from such operation.

The taxpayer warrants title to the property, including timber thereon. In the event of loss of title by the taxpayer, or loss of possession by the paper company, the taxpayer will refund to the paper company the original consideration paid per acre for the lands so affected. The paper company has the right to recover and keep any awards, or damage payments resulting from trespasses or from condemnation of the property for public use, with respect to the value of the timber and the value of its rights with reference to future operations under the contract.

For reasons more fully set forth in Revenue Ruling 62-81, page 153, there has been under this contract, no "disposal" of timber within the meaning of section 631(b) of the Internal Revenue Code of 1954.

The question remains whether any portion of the lump-sum payment under the instant contract is consideration for a transfer of property in a transaction amounting to a present sale of timber. The transaction could properly be such only if some portion of the consideration was paid for timber having, at the time of the execution of the contract, a determinable fair market value (merchantable timber of cutting size and smaller young growth of appraisable value). Timber that is not in existence at the time of the contract cannot be the subject of a present sale. See Williston on Sales (Rev'd Ed.), sections 62 and 258.

The rights and privileges conferred upon the paper company comprehended both the possession of land and the disposition of timber. There is no provision of the contract which relates any portion of the

payment specifically to timber. Despite the absence of such a reference, however, some portion of the payment received by the landowner may, in fact, be attributable to timber. This would be true if the timber existing on the tract at the execution of the contract possessed a determinable fair market value. If the taxpayer establishes the fair market value of such existing timber, the payment to the extent of such fair market value constitutes proceeds from the sale of timber. The portion of the payment in excess of the value so established is in the nature of consideration for the use of land over a period of time and, therefore, ordinary income.

The position here is consistent with the conclusion by the Tax Court of the United States in *Estate of James M. Lawton v. Commissioner*, 33 T.C. 47 (1959), dealing with the tax treatment of receipts under a lease agreement. In that case, capital gain treatment had been allowed by the Commissioner of Internal Revenue with respect to receipts by the taxpayer, the landowner, for a described quantity of existing timber. The controversy related to succeeding receipts by the taxpayer which, from the evidence before the court, could not be identified as attributable to timber existing at the execution of the lease contract. The court held that such succeeding receipts were ordinary income to the landowner, describing these receipts as "in the nature of rent for the right to use and occupy acreage for 'pine tree farming' and other independent forestry activities." In the instant case, the taxpayer may establish that there was an existing stand of timber to which a determinable portion of the consideration could be attributed.

Accordingly, it is held that the lump sum payment received under the instant contract constitutes proceeds from the sale of timber to the extent of the fair market value of the timber existing at the execution of the contract; that the resulting gain or loss is subject to the treatment described in Subchapter P of the Code, provided the provisions thereof are met; and that any excess of the payment over the amount of such fair market value is ordinary income.

PART IV.—SPECIAL RULES FOR DETERMINING CAPITAL GAINS AND LOSSES

SECTION 1231.—PROPERTY USED IN THE TRADE OR BUSINESS AND INVOLUNTARY CONVERSIONS

26 CFR 1.1231-1: Gains and losses from the sale or exchange of certain property used in the trade or business.

Treatment of income received by the owner of timber lands under a long-term agreement for the sale of all timber and timber rights growing and to be grown on such lands. See Rev. Rul. 62-81, page 153.

Lump sum payment for lease of land and the right to cut timber. See Rev. Rul. 62-82, page 155.

SECTION 1242.—LOSSES ON SMALL BUSINESS INVESTMENT COMPANY STOCK

26 CFR 1.1242-1: Losses on small business investment company stock.
(Also Section 1243; 1.1243-1.)

Rev. Rul. 62-58¹

The benefits of sections 1242 and 1243 of the Internal Revenue Code of 1954, relating to losses on small business investment companies securities, may not be claimed by a small business investment company or its stockholders during a period in which the company's license to operate under the Small Business Investment Act of 1958, as amended, has been suspended by the Small Business Administration.

Advice has been requested whether a small business investment company or its stockholders may claim the benefits of sections 1242 and 1243 of the Internal Revenue Code of 1954 during a period in which the company's license to operate under the provisions of the Small Business Investment Act of 1958, Public Law 85-699, August 21, 1958, as amended by the Small Business Investment Amendments Act of 1961, Public Law 87-341, October 3, 1961, 75 Stat. 752-757, has been suspended by the Small Business Administration.

Section 1242 of the Code provides, in effect, that any loss sustained as the result of the worthlessness or sale or exchange of stock in a small business investment company operating under the Small Business Investment Act of 1958 shall, under certain circumstances, be treated as a loss from the sale or exchange of property which is not a capital asset.

Under the provisions of section 1243 of the Code, it is provided that, in the case of a small business investment company operating under the Small Business Investment Act of 1958, a loss on convertible debentures (including stock received pursuant to the conversion privilege) acquired pursuant to section 304 of the Small Business Investment Act of 1958 shall, under certain circumstances, be treated as a loss from the sale or exchange of property which is not a capital asset.

Under section 309 of the Small Business Investment Act of 1958, as amended, the Small Business Administration is authorized to suspend the license of a company operating under the Act, under certain specific circumstances, involving violations of the provisions and intent of the Act. The seriousness of the circumstances under which such action may be taken points to the conclusion that a suspension is intended to serve as a denial of all the privileges and advantages which would otherwise accrue to a licensee and that, during the period of suspension, a license is rendered inoperative.

In conformity with this view, the Income Tax Regulations promulgated under sections 1242 and 1243 of the Code permit a loss sustained by an investor in the stock of a small business investment company, or a loss sustained by a small business investment company on the stock and debentures of a small business concern, to be treated as a loss from the sale or exchange of property which is not a capital asset only if, at the time of such loss, the company was licensed to operate as a small business investment company pursuant to regulations of the Small Business Administration. See sections 1.1242-1(a) and 1.1243-1(a) of the regulations.

¹ Released as Technical Information Release 378, dated April 10, 1962.

Therefore, where the license of a company, previously licensed to operate under the provisions of the Small Business Investment Act of 1958, as amended, has been suspended, such company is not considered as "operating" under the Act within the meaning of sections 1242 and 1243 of the Code during the period of suspension.

Accordingly, it is held that the benefits provided by sections 1242 and 1243 of the Code are not available to a small business investment company or its stockholders during the period in which the company's license to operate under the Small Business Investment Act of 1958, as amended, has been suspended by the Small Business Administration.

SECTION 1243.—LOSS OF SMALL BUSINESS INVESTMENT COMPANY

26 CFR 1.1243-1: Loss of small business investment company.

Losses on small business investment company securities during a period of suspension of the license to operate under the Small Business Investment Act of 1958, as amended. See Rev. Rul. 62-58, page 158.

SUBCHAPTER Q.—READJUSTMENT OF TAX BETWEEN YEARS AND SPECIAL LIMITATIONS

PART V.—CLAIM OF RIGHT

SECTION 1341.—COMPUTATION OF TAX WHERE TAX-PAYER RESTORES SUBSTANTIAL AMOUNT HELD UNDER CLAIM OF RIGHT

26 CFR 1.1341-1: Restoration of amounts received or accrued under claim of right.

Repayment of regular Army retirement pay in order to receive nontaxable disability compensation from the Veterans' Administration. See Rev. Rul. 62-14, page 11.

CHAPTER 2.—TAX ON SELF-EMPLOYMENT INCOME

SECTION 1402.—DEFINITIONS

26 CFR 1.1402(c)-1: Trade or business.

Distributing and selling automobile license plates and club membership for an automobile club. See Rev. Rul. 62-79, page 184.

CHAPTER 3.—WITHHOLDING OF TAX ON NONRESIDENT ALIENS AND FOREIGN CORPORATIONS AND TAX-FREE COVENANT BONDS

SUBCHAPTER A.—NONRESIDENT ALIENS AND FOREIGN CORPORATIONS

SECTION 1441.—WITHHOLDING OF TAX ON NONRESIDENT ALIENS

26 CFR 1.1441: Statutory provisions; withholding of tax on nonresident aliens. T.D. 6592¹

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

Amendment of the Income Tax Regulations under section 1441 of the Internal Revenue Code of 1954 to conform to section 110(d) of the Mutual Educational and Cultural Exchange Act of 1961.

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

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

In order to conform the Income Tax Regulations (26 CFR Part 1) under section 1441 of the Internal Revenue Code of 1954 to section 110(d) of the Mutual Educational and Cultural Exchange Act of 1961 (Public Law 87-256, 75 Stat. 536 [C.B. 1961-2, 322]), such regulations are amended as follows:

PARAGRAPH 1. Section 1.1441 is amended by inserting a phrase before the period at the end of section 1441(a), by adding a sentence at the end of section 1441(b), by revising section 1441(c)(4), and by revising the historical note. These amended and added provisions read as follows:

§ 1.1441 STATUTORY PROVISIONS; WITHHOLDING OF TAX ON NONRESIDENT ALIENS.

SEC. 1441. WITHHOLDING OF TAX ON NONRESIDENT ALIENS.

(a) GENERAL RULE.—Except as otherwise provided in subsection (c), all persons, in whatever capacity acting (including lessees or mortgagors of real or personal property, fiduciaries, employers, and all officers and employees of the United States) having the control, receipt, custody, disposal, or payment of any of the items of income specified in subsection (b) (to the extent that any of such items constitutes gross income from sources within the United States), of any nonresident alien individual, or of any partnership not engaged in trade or business within the United States and composed in whole or in part of nonresident aliens, shall (except in the cases provided for in section 1451 and except as otherwise provided in regulations prescribed by the Secretary or his delegate under section 874) deduct and withhold from such items a tax equal to 30 percent thereof, except that in the case of any item of income specified in the second sentence of subsection (b), the tax shall be equal to 18 percent of such item.

¹ 27 F.R. 1888.

(b) **INCOME ITEMS.**—The items of income referred to in subsection (a) are interest (except interest on deposits with persons carrying on the banking business paid to persons not engaged in business in the United States), dividends, rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable annual or periodical gains, profits, and income, and amounts described in section 402(a)(2), section 403(a)(2), section 631(b) and (c), and section 1235, which are considered to be gains from the sale or exchange of capital assets. The items of income referred to in subsection (a) from which tax shall be deducted and withheld at the rate of 18 percent are—

(1) That portion of any scholarship or fellowship grant which is received by a nonresident alien individual who is temporarily present in the United States as a nonimmigrant under subparagraph (F) or (J) of section 101(a)(15) of the Immigration and Nationality Act, as amended, and which is not excluded from gross income under section 117(a)(1) solely by reason of section 117(b)(2)(B); and

(2) Amounts described in subparagraphs (A), (B), (C), and (D) of section 117(a)(2) which are received by any such nonresident alien individual and which are incident to a scholarship or fellowship grant to which section 117(a)(1) applies, but only to the extent such amounts are includible in gross income.

(c) **EXCEPTIONS.** * * *

(4) **COMPENSATION OF CERTAIN ALIENS.**—Under regulations prescribed by the Secretary or his delegate, there may be exempted from deduction and withholding under subsection (a) the compensation for personal services of—

(A) Nonresident alien individuals who enter and leave the United States at frequent intervals, and

(B) A nonresident alien individual for the period he is temporarily present in the United States as a nonimmigrant under subparagraph (F) or (J) of section 101(a)(15) of the Immigration and Nationality Act, as amended.

* * * * *

[Sec. 1441 as amended by sec. 544(f), Mutual Security Act 1954 (added by sec. 11(a), Mutual Security Act 1956 (70 Stat. 563 [C.B. 1956-2, 1170])); sec. 40(b), Technical Amendments Act 1958 (72 Stat. 1638 [C.B. 1958-3, 254]); sec. 110(d), Mutual Educational and Cultural Exchange Act 1961 (Pub. Law 87-256, 75 Stat. 536 [C.B. 1961-2, 322]). (Sec. 544(f), Mutual Security Act 1954, was repealed by sec. 11(b)(1), Mutual Security Act 1957 (71 Stat. 365), with the proviso that sec. 1441 was not affected by the repeal.)]

PAR. 2. Section 1.1441-1 is amended to read as follows:

§ 1.1441-1 **REQUIREMENT FOR WITHHOLDING OF TAX ON NON-RESIDENT ALIENS AND FOREIGN CORPORATIONS.**—Except as otherwise provided in §§ 1.1441-3 and 1.1441-4, to the extent that the items specified in § 1.1441-2 constitute gross income from sources within the United States, withholding of a tax of 30 percent is required in the case of items of income specified in paragraphs (a) and (b) of § 1.1441-2 when such income is paid to a nonresident alien individual, a nonresident partnership composed in whole or in part of nonresident alien individuals, or a nonresident foreign corporation, except that with respect to payments made after December 31, 1961, withholding of a tax of 18 percent is required in the case of items of income specified in paragraph (c) of § 1.1441-2. The rate of 30 percent or 18 percent shall be reduced as may be provided by treaty with any country. See section 894, relating to income exempt under treaty. For purposes of this section, the term "nonresident alien individual" includes an alien resident of Puerto Rico.

PAR. 3. Section 1.1441-2 is amended by adding a paragraph (c) at the end thereof. The added provision reads as follows:

§ 1.1441-2 **INCOME SUBJECT TO WITHHOLDING.**

* * * * *

(c) *Amounts received by participants in certain exchange or training programs.*—(1) Withholding of tax shall be at the rate of 18 percent (rather than 30 percent) on that portion of a scholarship or fellowship grant received by a

nonresident alien individual who is temporarily present in the United States as a nonimmigrant under subparagraph (F) or (J) of section 101(a)(15) of the Immigration and Nationality Act, as amended, which is not excludable from such nonresident alien's gross income under section 117(a)(1) and paragraph (a) of § 1.117-1 because it exceeds the limitations set forth by section 117(b)(2)(B) and paragraph (b)(2) of § 1.117-2. Thus, if a nonresident alien scientist who was admitted to the United States under subparagraph (J) of section 101(a)(15) of the Immigration and Nationality Act, as amended, to engage in post-doctoral scientific studies received a fellowship grant from a grantor specified in section 117(b)(2)(A) which exceeded the \$300-per-month-for-36-months limitation determined under paragraph (b)(2) and (3) of § 1.117-2, a tax at the rate of 18 percent rather than 30 percent should be withheld from the amount of the grant includible in the scientist's income.

(2) Withholding shall also be at the rate of 18 percent on amounts received by nonresident alien individuals described in subparagraph (1) of this paragraph to cover expenses for travel, research, clerical help, or equipment which are incident to a scholarship or fellowship grant to which section 117(a)(1) applies, but only to the extent that such amounts are not excludable from gross income under paragraph (b)(1) of § 1.117-1 because they pertain to a portion of a scholarship or fellowship grant which is not excludable, or because the amount received is not specifically designated to cover such expenses under paragraph (b)(2)(i) of § 1.117-1.

(3) A nonresident alien individual who is temporarily present in the United States as a nonimmigrant under subparagraph (J) of section 101(a)(15) of the Immigration and Nationality Act, as amended, includes a nonresident alien individual admitted to the United States as an "exchange visitor" under section 201 of the United States Information and Educational Exchange Act of 1948, as amended (22 U.S.C. 1446), which section was repealed by section 111 of the Mutual Educational and Cultural Exchange Act of 1961 (Pub. Law 87-256, 75 Stat. 538).

PAR. 4. Section 1.1441-3 is amended by revising subparagraph (2) of paragraph (e). This amended provision reads as follows:

§ 1.1441-3 EXCEPTIONS AND RULES OF SPECIAL APPLICATION.

* * * * *

(e) *Personal exemption.* * * *

(2) In the determination of the tax to be withheld at the source under § 1.1441-1 from remuneration paid for labor or personal services performed within the United States by a nonresident alien, the benefit of the deduction for one personal exemption provided in section 151 shall be allowed, prorated upon a daily basis for the period of employment during any portion of which labor or personal services are performed within the United States by the alien. The benefit of the deduction for one personal exemption provided in section 151 shall also be allowed in the determination of the tax of 18 percent to be withheld at the source under § 1.1441-1 and paragraph (c) of § 1.1441-2 from amounts paid after December 31, 1961, to nonresident alien individuals who are temporarily present in the United States as nonimmigrants under subparagraph (F) or (J) of section 101(a)(15) of the Immigration and Nationality Act, as amended, and such personal exemption shall be prorated upon a daily basis for the period during which the described nonresident alien student or scholar receives the payments. The proration is on the basis of \$1.70 per day. Thus, if A, a nonresident alien seaman employed by X Shipping Corporation, is paid in 1955 upon the termination of a voyage covering 100 days and A performs personal services within the United States during, or incident to, the voyage, the amount of \$170 will be allocated as the portion of the deduction to be allowed against the remuneration for personal services performed within the United States during that voyage; and withholding at 30 percent shall be applied against the balance, if any, of the remuneration. If, for example, the total remuneration paid to A for that voyage is \$2,000, of which the amount of \$800 is allocable to sources within the United States, a tax in the amount of \$189 is required to be withheld under § 1.1441-1. As to what constitutes remuneration for labor or personal services performed within the United States, see section 861(a)(3) and the regulations thereunder.

PAR. 5. Paragraph (b) of § 1.1441-4 is amended to read as follows:

§ 1.1441-4 EXEMPTIONS FROM WITHHOLDING.

* * * * *

(b) *Compensation for personal services.*—(1) *Residents of contiguous countries.*—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 withholding of tax under § 1.1441-1 if—

(i) The nonresident alien is a resident of Canada or Mexico, or

(ii) The nonresident alien is engaged in agricultural labor as defined in section 3121(g) and the regulations thereunder.

(2) *Participants in certain exchange or training programs.*—(i) The salary or other compensation for personal services performed by a nonresident alien individual as an employee within the meaning of section 3401 for the period he is temporarily present in the United States as a nonimmigrant under subparagraph (F) or (J) of section 101(a)(15) of the Immigration and Nationality Act, as amended, shall not be subject to withholding of tax under § 1.1441-1. This subparagraph shall be effective with respect to compensation paid after December 31, 1961.

(ii) If United States tax at a rate greater than 18 percent has been withheld under § 1.1441-1 after December 31, 1961, from compensation for personal services entitled to the exemption provided for by subdivision (i) of this subparagraph, the withholding agent is authorized to release and pay over to the nonresident alien individual from whom the tax was withheld an amount which is equal to the difference between the tax so withheld and the tax required to be withheld from such compensation pursuant to section 3402 and the regulations thereunder. The provisions of this subdivision do not apply to excess tax withheld from compensation for personal services which has been paid by the withholding agent to the Director of International Operations, Internal Revenue Service.

(iii) See paragraph (c)(3) of § 1.1441-2 for the treatment of nonresident alien individuals admitted to the United States as "exchange visitors".

(3) *Withholding of tax under section 3402.*—For collection of the income tax at source under section 3402 upon remuneration paid for services performed by a nonresident alien individual who is a resident of Canada or Mexico and who enters and leaves the United States at frequent intervals, see section 3401(a)(7) and the regulations thereunder. For collection of the income tax at source under section 3402 upon remuneration paid for services performed by a nonresident alien individual who is a nonimmigrant under subparagraph (F) or (J) of section 101(a)(15) of the Immigration and Nationality Act, as amended, see sections 3401(a)(6) and 3402(f)(6) and the regulations under such sections.

(4) *Proration of personal exemption.*—For provisions allowing the benefit of the deduction for the personal exemption on a prorated basis, see paragraph (e) of § 1.1441-3.

Because it is necessary to bring into effect at the earliest practicable date the rules of this Treasury Decision respecting exemption from withholding of tax and release of excess tax withheld, it is hereby found that it is impracticable to issue this Treasury Decision with notice and public procedure thereon under section 4(a) of the Administrative Procedure Act, approved June 11, 1946, or subject to the effective date limitation of section 4(c) of said Act.

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

MORTIMER M. CAPLIN,
Commissioner of Internal Revenue.

Approved February 23, 1962.

STANLEY S. SURREY,
Assistant Secretary of the Treasury.

(Filed by the Division of the Federal Register on February 27, 1962, 8:48 a.m., and published in the issue of the Federal Register for February 28, 1962, 27 F.R. 1888)

SUBTITLE B.—ESTATE AND GIFT TAXES

CHAPTER 11.—ESTATE TAX

SUBCHAPTER A.—ESTATES OF CITIZENS OR RESIDENTS

PART II.—CREDITS AGAINST TAX

SECTION 2014.—CREDIT FOR FOREIGN DEATH TAXES

26 CFR 20.2014: Statutory provisions; credit for foreign death taxes. T.D. 6600¹
(Also Sections 2038, 2053, 6061, 6091; 20.2038, 20.2053, 20.6061, 20.6091, 25.6061, 25.6091.)

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER B, PARTS 20 AND 25.—ESTATE AND GIFT TAXES

Estate and Gift Tax Regulations amended to prescribe regulations as to signing and verification of returns and Estate Tax Regulations amended to conform to Public Laws 86-141 and 86-175.

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

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

On January 9, 1962, a notice of proposed rulemaking was published in the Federal Register (27 F.R. 232), with respect to conforming the Estate Tax Regulations (26 CFR Part 20) to Act of August 7, 1959 (Public Law 86-141, 73 Stat. 288 [C.B. 1959-2, 685]) and Act of August 21, 1959 (Public Law 86-175, 73 Stat. 396 [C.B. 1959-2, 686]); to prescribe Estate Tax Regulations and Gift Tax Regulations under section 6165 of the Internal Revenue Code relating to bonds, and under sections 6061, 6065, and 6091 relating to signing, verification, and place for filing of returns and other documents; and to change cross references. After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the following regulations are hereby adopted.

ESTATE TAX REGULATIONS

(26 CFR Part 20)

PARAGRAPH 1. Section 20.2011 is amended by revising section 2011(e) and the historical note to read as follows:

§ 20.2011 STATUTORY PROVISIONS; CREDIT FOR STATE DEATH TAXES.

SEC. 2011. CREDIT FOR STATE DEATH TAXES * * *

(e) LIMITATION IN CASES INVOLVING DEDUCTION UNDER SECTION 2053(d).—In any case where a deduction is allowed under section 2053(d) for an estate, succession, legacy, or inheritance tax imposed by a State or Territory or the District of Columbia upon a transfer for public, charitable, or religious uses described in section 2055 or 2106(a)(2), the allowance of the credit under this section shall be subject to the following conditions and limitations:

¹ 27 F.R. 4983.

(1) The taxes described in subsection (a) shall not include any estate, succession, legacy, or inheritance tax for which such deduction is allowed under section 2053(d).

(2) The credit shall not exceed the lesser of—

(A) The amount stated in subsection (b) on a taxable estate determined by allowing such deduction authorized by section 2053(d), or

(B) That proportion of the amount stated in subsection (b) on a taxable estate determined without regard to such deduction authorized by section 2053(d) as (i) the amount of the taxes described in subsection (a), as limited by the provisions of paragraph (1) of this subsection, bears to (ii) the amount of the taxes described in subsection (a) before applying the limitation contained in paragraph (1) of this subsection.

(3) If the amount determined under subparagraph (B) of paragraph (2) is less than the amount determined under subparagraph (A) of that paragraph, then for purposes of subsection (d) such lesser amount shall be the maximum credit provided by subsection (b).

[Sec. 2011 as amended by sec. 3, Act of Feb. 20, 1956 (Pub. Law 414, 84th Cong., 70 Stat. 24 [C.B. 1956-1, 855]); secs. 65(a) and 102(c) (1), Technical Amendments Act 1958 (72 Stat. 1657, 1674) [Pub. Law 85-866, C.B. 1958-3, 254]; sec. 3, Act of Aug. 21, 1959 (Pub. Law 86-175, 73 Stat. 397) [C.B. 1959-2, 686]]

PAR. 2. Section 20.2011-2 is revised to read as follows:

§ 20.2011-2 LIMITATION ON CREDIT IF A DEDUCTION FOR STATE DEATH TAXES IS ALLOWED UNDER SECTION 2053(d).—If a deduction is allowed under section 2053(d) for State death taxes paid with respect to a charitable gift, the credit for State death taxes is subject to special limitations. Under these limitations, the credit cannot exceed the least of the following:

(a) The amount of State death taxes paid other than those for which a deduction is allowed under section 2053(d);

(b) The amount indicated in section 2011(b) to be the maximum credit allowable with respect to the decedent's taxable estate; or

(c) An amount, A, which bears the same ratio to B (the amount which would be the maximum credit allowable under section 2011(b) if the deduction under section 2053(d) for State death taxes were not allowed in computing the decedent's taxable estate) as C (the amount of State death taxes paid other than those for which a deduction is allowed under section 2053(d)) bears to D (the total amount of State death taxes paid). For the purpose of this computation, in determining what the decedent's taxable estate would be if the deduction for State death taxes under section 2053(d) were not allowed, adjustment must be made for the decrease in the deduction for charitable gifts under section 2055 or 2106(a) (2) (for estates of nonresidents not citizens) by reason of any increase in Federal estate tax which would be charged against the charitable gifts.

The application of this section may be illustrated by the following example:

Example. The decedent died January 1, 1955, leaving a gross estate of \$925,000. Expenses, indebtedness, etc., amounted to \$25,000. The decedent bequeathed \$400,000 to his son with the direction that the son bear the State death taxes on the bequest. The residuary estate was left to a charitable organization. Except as noted above, all Federal and State death taxes were payable out of the residuary estate. The State imposed death taxes of \$60,000 on the son's bequest and death taxes of \$75,000 on the bequest to charity. No death taxes were imposed by a foreign country with respect to any property in the gross estate. The decedent's taxable estate (determined without regard to the limitation imposed by section 2011(e) (2) (B)) is computed as follows:

* * * * *

PAR. 3. In § 20.2014 section 2014 is revised by deleting subsection (f) and the historical note and by substituting the following:

§ 20.2014 STATUTORY PROVISIONS; CREDIT FOR FOREIGN DEATH TAXES.

SEC. 2014. CREDIT FOR FOREIGN DEATH TAXES * * *

(f) ADDITIONAL LIMITATION IN CASES INVOLVING A DEDUCTION UNDER SECTION 2053(d).—In any case where a deduction is allowed under sec-

tion 2053(d) for an estate, succession, legacy, or inheritance tax imposed by and actually paid to any foreign country upon a transfer by the decedent for public, charitable, or religious uses described in section 2055, the property described in subparagraphs (A), (B), and (C) of paragraphs (1) and (2) of subsection (b) of this section shall not include any property in respect of which such deduction is allowed under section 2053(d).

(g) POSSESSION OF UNITED STATES DEEMED A FOREIGN COUNTRY.—For purposes of the credits authorized by this section, each possession of the United States shall be deemed to be a foreign country.

[Sec. 2014 as amended by sec. 102(c)(2), Technical Amendments Act 1958 (72 Stat. 1674 [Pub. Law 85-886, C.B. 1958-3, 254]); sec. 2, Act of Aug. 21, 1959 (Pub. Law 86-175, 73 Stat. 397 [C.B. 1959-2, 686])]]

PAR. 4. Paragraph (a) of § 20.2014-1 is amended by inserting new subparagraph (4) to read as follows:

§ 20.2014-1 CREDIT FOR FOREIGN DEATH TAXES.—(a) *In general.* * * *

(4) Where a deduction is allowed under section 2053(d) for foreign death taxes paid with respect to a charitable gift, the credit for foreign death taxes is subject to further limitations as explained in § 20.2014-7.

PAR. 5. Paragraph (a) of § 20.2014-2 is amended to read as follows :

§ 20.2014-2 "FIRST LIMITATION".—(a) The amount of a particular foreign death tax attributable to property situated in the country imposing the tax and included in the decedent's gross estate for Federal estate tax purposes is the "first limitation." Thus, the credit for any foreign death tax is limited to an amount, A, which bears the same ratio to B (the amount of the foreign death tax without allowance of credit, if any, for Federal estate tax) as C (the value of the property situated in the country imposing the foreign death tax, subjected to the foreign death tax, included in the gross estate and for which a deduction is not allowed under section 2053(d)) bears to D (the value of all property subjected to the foreign death tax). Stated algebraically, the "first limitation" (A) equals

$$\frac{\text{value of property in foreign country subjected to foreign death tax, included in gross estate and for which a deduction is not allowed under section 2053(d) (C)}}{\text{value of all property subjected to foreign death tax (D)}} \times \text{amount of foreign death tax (B).}$$

The values used in this proportion are the values determined for the purpose of the foreign death tax. The amount of the foreign death tax for which credit is allowable must be converted into United States money. The application of this paragraph may be illustrated by the following example:

* * * * *

PAR. 6. Paragraph (b) of § 20.2014-3 is amended to read as follows:

§ 20.2014-3 "SECOND LIMITATION".

* * * * *

(b) Adjustment is required to factor "G" of the ratio stated in paragraph (a) of this section if a deduction for foreign death taxes under section 2053(d), a charitable deduction under section 2055, or a marital deduction under section 2056 is allowed with respect to the foreign property. If a deduction for foreign death taxes is allowed, the value of the property situated in the foreign country, subjected to foreign death tax, and included in the gross estate does not include the value of any property in respect of which the deduction for foreign death taxes is allowed. See § 20.2014-7. If a charitable deduction or a marital deduction is allowed, the value of such foreign property (after exclusion of the value of

any property in respect of which the deduction for foreign death taxes is allowed) is reduced as follows:

(1) If a charitable deduction or a marital deduction is allowed to a decedent's estate with respect to any part of the foreign property, except foreign property in respect of which a deduction for foreign death taxes is allowed, specifically bequeathed, devised, or otherwise specifically passing to a charitable organization or to the decedent's spouse, the value of the foreign property is reduced by the amount of the charitable deduction or marital deduction allowed with respect to such specific transfer. See example (1) of paragraph (c) of this section.

(2) If a charitable deduction or a marital deduction is allowed to a decedent's estate with respect to a bequest, devise or other transfer of an interest in a group of assets including both the foreign property and other property, the value of the foreign property is reduced by an amount, I, which bears the same ratio to J (the amount of the charitable deduction or marital deduction allowed with respect to such transfer of an interest in a group of assets) as K (the value of the foreign property, except foreign property in respect of which a deduction for foreign death taxes is allowed, included in the group of assets) bears to L (the value of the entire group of assets). As used in this subparagraph, the term "group of assets" has reference to those assets which, under applicable law, are chargeable with the charitable or marital transfer. See example (2) of paragraph (c) of this section.

Any reduction described in subparagraph (1) or (2) of this paragraph on account of the marital deduction must proportionately take into account the 50-percent limitation on the aggregate amount of the marital deduction contained in section 2056(c), if applicable. See example (3) of paragraph (c) of this section.

PAR. 7. Immediately after § 20.2014-6 insert the following new section:

§ 20.2014-7 LIMITATION ON CREDIT IF A DEDUCTION FOR FOREIGN DEATH TAXES IS ALLOWED UNDER SECTION 2053(d).—If a deduction is allowed under section 2053(d) for foreign death taxes paid with respect to a charitable gift, the credit for foreign death taxes is subject to special limitations. In such a case the property described in subparagraphs (A), (B), and (C) of paragraphs (1) and (2) of section 2014(b) shall not include any property with respect to which a deduction is allowed under section 2053(d). The application of this section may be illustrated by the following example:

Example. The decedent, a citizen of the United States, died July 1, 1955, leaving a gross estate of \$1,200,000 consisting of: Shares of stock issued by United States corporations, valued at \$600,000; bonds issued by the United States Government physically located in the United States, valued at \$300,000; and shares of stock issued by a Country X corporation, valued at \$300,000. Expenses, indebtedness, etc., amounted to \$40,000. The decedent made specific bequests of \$400,000 of the United States corporation stock to a niece and \$100,000 of the Country X corporation stock to a nephew. The residue of his estate was left to charity. There is no death tax convention in existence between the United States and Country X. The Country X tax imposed was at a 50-percent rate on all beneficiaries. A State inheritance tax of \$20,000 was imposed on the niece and nephew. The decedent did not provide in his will for the payment of the death taxes, and under local law the Federal estate tax is payable from the general estate, the same as administration expenses.

Distribution of the Estate

Gross estate.....		\$1, 200, 000. 00
Debts and charges.....	\$40, 000. 00	
Bequest of United States corporation stock to niece	400, 000. 00	
Bequest of Country X corporation stock to nephew.....	100, 000. 00	
Net Federal estate tax.....	136, 917. 88	676, 917. 88
Residue before Country X tax.....		523, 082. 12
Country X succession tax on charity.....		100, 000. 00
Charitable deduction.....		423, 082. 12

Taxable Estate and Federal Estate Tax

Gross estate.....		\$1,200,000.00
Debts and charges.....	\$40,000.00	
Deduction of foreign death tax under section 2053(d).....	100,000.00	
Charitable deduction.....	423,082.12	
Exemption.....	60,000.00	623,082.12
Taxable estate.....		576,917.88
Gross estate tax.....		172,621.26
Credit for State death taxes.....		15,476.72
Gross estate tax less credit for State death taxes...		157,144.54
Credit for foreign death taxes.....		20,226.66
Net Federal estate tax.....		136,917.88

*Credit for Foreign Death Taxes**Country X tax*

Succession tax on nephew:

Value of stock of Country X corporation.....	\$100,000.00
Tax (50% rate).....	50,000.00

Succession tax on charity:

Value of stock of Country X corporation.....	200,000.00
Tax (50% rate).....	100,000.00

Computation of exclusion under section 2014(b)

Value of property situated in Country X-----	\$300,000.00
Value of property in respect of which a deduction is allowed under section 2053(d)-----	200,000.00
Value of property situated within Country X, subjected to tax, and included in gross estate as limited by section 2014(f)---	100,000.00

First limitation, § 20.2014-2(a)

\$100,000 (factor C of the ratio stated at § 20.2014-2(a))	
\$100,000 + \$200,000 (factor D of the ratio stated at § 20.2014-2(a))	× (\$50,000 + \$100,000) (factor B of the ratio stated at § 20.2014-2(a)) = \$50,000.00

Second limitation, § 20.2014-3(a)

\$100,000 (factor G of the ratio stated at § 20.2014-3(a)) (as limited by section 2014(f))	
\$1,200,000 - \$423,082.12 (factor H of the ratio stated at § 20.2014-3(a))	× (\$172,621.26 - \$15,476.72) (factor F of the ratio stated at § 20.2014-3(a)) = \$20,226.66

PAR. 8. Section 20.2038 is amended by adding at the end of section 2038 new subsection (c) and a historical note to read as follows:

§ 20.2038 STATUTORY PROVISIONS; REVOCABLE TRANSFERS.

SEC. 2038. REVOCABLE TRANSFERS * * *

(c) EFFECT OF DISABILITY IN CERTAIN CASES.—For purposes of this section, in the case of a decedent who was (for a continuous period beginning not less than 3 months before December 31, 1947, and ending with his death) under a mental disability to relinquish a power, the term "power" shall not include a power the relinquishment of which on or after January 1, 1940, and on or before December 31, 1947, would, by reason of section 1000(e) of the Internal Revenue Code of 1939, be deemed not to be a transfer of property for purposes of chapter 4 of the Internal Revenue Code of 1939.

[Sec. 2038 as amended by Act of Aug. 7, 1959 (Pub. Law 86-141, 73 Stat. 288) [C.B. 1959-2, 685]]

PAR. 9. Section 20.2038-1 is amended by adding at the end thereof new paragraph (f) as follows:

§ 20.2038-1 REVOCABLE TRANSFERS.

* * * * *

(f) *Effect of disability to relinquish power in certain cases.* Notwithstanding anything to the contrary in paragraphs (a) through (e) of this section the provisions of this section do not apply to a transfer if—

(1) The relinquishment on or after January 1, 1940, and on or before December 31, 1947, of the power would, by reason of section 1000(e), of the Internal Revenue Code of 1939, be deemed not a transfer of property for the purpose of the gift tax under chapter 4 of the Internal Revenue Code of 1939 and

(2) The decedent was, for a continuous period beginning on or before September 30, 1947, and ending with his death, after August 16, 1954, under a mental disability to relinquish a power.

For the purpose of the foregoing provision, the term "mental disability" means mental incompetence, in fact, to release the power whether or not there was an adjudication of incompetence. Such provision shall apply even though a guardian could have released the power for the decedent. No interest shall be allowed or paid on any overpayment allowable under section 2038(c) with respect to amounts paid before August 7, 1959.

PAR. 10. Section 20.2053 is amended by revising section 2053 (d) and the historical note to read as follows:

§ 20.2053 STATUTORY PROVISIONS; EXPENSES, INDEBTEDNESS, AND TAXES.

SEC. 2053. EXPENSES, INDEBTEDNESS, AND TAXES * * *

(d) CERTAIN STATE AND FOREIGN DEATH TAXES.—

(1) GENERAL RULE.—Notwithstanding the provisions of subsection (c) (1) (B) of this section, for purposes of the tax imposed by section 2001 the value of the taxable estate may be determined, if the executor so elects before the expiration of the period of limitation for assessment provided in section 6501, by deducting from the value of the gross estate the amount (as determined in accordance with regulations prescribed by the Secretary or his delegate) of—

(A) Any estate, succession, legacy, or inheritance tax imposed by a State or Territory or the District of Columbia upon a transfer by the decedent for public, charitable, or religious uses described in section 2055 or 2106(a) (2), and

(B) Any estate, succession, legacy, or inheritance tax imposed by and actually paid to any foreign country, in respect of any property situated within such foreign country and included in the gross estate of a citizen or resident of the United States, upon a transfer by the decedent for public, charitable, or religious uses described in section 2055.

The determination under subparagraph (B) of the country within which property is situated shall be made in accordance with the rules applicable under subchapter B (sec. 2101 and following) in determining whether property is situated within or without the United States. Any election under this paragraph shall be exercised in accordance with regulations prescribed by the Secretary or his delegate.

(2) CONDITION FOR ALLOWANCE OF DEDUCTION.—No deduction shall be allowed under paragraph (1) for a State death tax or a foreign death tax specified therein unless the decrease in the tax imposed by section 2001 which results from the deduction provided in paragraph (1) will inure solely for the benefit of the public, charitable, or religious transferees described in section 2055 or section 2106(a) (2). In any case where the tax imposed by section 2001 is equitably apportioned among all the transferees of property included in the gross estate, including those described in sections 2055 and 2106(a) (2) (taking into account any exemptions, credits, or deductions allowed by this chapter), in determining such decrease, there shall be disregarded any decrease in the Federal estate tax

which any transferees other than those described in sections 2055 and 2106(a) (2) are required to pay.

(3) EFFECT ON CREDITS FOR STATE AND FOREIGN DEATH TAXES OF DEDUCTION UNDER THIS SUBSECTION.—

(A) ELECTION.—An election under this subsection shall be deemed a waiver of the right to claim a credit, against the Federal estate tax, under a death tax convention with any foreign country for any tax or portion thereof in respect of which a deduction is taken under this subsection.

(B) CROSS REFERENCES.—See section 2011(e) for the effect of a deduction taken under this subsection on the credit for state death taxes, and see section 2014(f) for the effect of a deduction taken under this subsection on the credit for foreign death taxes.

[Sec. 2053 as amended by sec. 2, Act of Feb. 20, 1956 (Pub. Law 414, 84th Cong., 70 Stat. 23 [C.B. 1956-1, 855]) ; sec. 102(c) (3), Technical Amendments Act 1958 (72 Stat. 1674) [Pub. Law 85-860, C.B. 1958-3, 254] ; sec. 1, Act of Aug. 21, 1959, Pub. Law 86-175 (73 Stat. 396) [C.B. 1959-2, 686]]

PAR. 11. Immediately after § 20.2053-9 the following new section is added:

§ 20.2053-10 DEDUCTION FOR CERTAIN FOREIGN DEATH TAXES.—(a) *General rule.*—A deduction is allowed the estate of a decedent dying on or after July 1, 1955, under section 2053(d) for the amount of any estate, succession, legacy, or inheritance tax imposed by and actually paid to any foreign country, in respect of any property situated within such foreign country and included in the gross estate of a citizen or resident of the United States, upon a transfer by the decedent for charitable, etc., uses described in section 2055, but only if (1) the conditions stated in paragraph (b) of this section are met, and (2) an election is made in accordance with the provisions of paragraph (c) of this section. The determination of the country within which property is situated is made in accordance with the rules contained in §§ 20.2104 and 20.2105 in determining whether property is situated within or without the United States. See section 2014(f) and § 20.2014-7 for the effect which the allowance of this deduction has upon the credit for foreign death taxes.

(b) Condition for allowance of deduction.—(1) The deduction is not allowed unless either—

(i) The entire decrease in the Federal estate tax resulting from the allowance of the deduction inures solely to the benefit of a charitable, etc., transferee described in section 2055, or

(ii) The Federal estate tax is equitably apportioned among all the transferees (including the decedent's surviving spouse and the charitable, etc., transferees) of property included in the decedent's gross estate.

For allowance of the deduction, it is sufficient if either of these conditions is satisfied. Thus, in a case where the entire decrease in Federal estate tax inures to the benefit of a charitable transferee, the deduction is allowable even though the Federal estate tax is not equitably apportioned among all the transferees of property included in the decedent's gross estate. Similarly, if the Federal estate tax is equitably apportioned among all the transferees of property included in the decedent's gross estate, the deduction is allowable even though a noncharitable transferee receives some benefit from the allowance of the deduction.

(2) For purposes of this paragraph, the Federal estate tax is considered to be equitably apportioned among all the transferees (including the decedent's surviving spouse and the charitable, etc., transferees) of property included in the decedent's gross estate only if each transferee's share of the tax is based upon the net amount of his transfer subjected to the tax (taking into account any exemptions, credits, or deductions allowed by chapter 11). See examples (2) through (5) of paragraph (e) of § 20.2053-9.

(c) Exercise of election.—The election to take a deduction for a foreign death tax imposed upon a transfer for charitable, etc., uses shall be exercised by the executor by the filing of a written notification to that effect with the district director of internal revenue in whose district the estate tax return for the decedent's estate was filed. An election to take the deduction for foreign death taxes is deemed to be a waiver of the right to claim a credit under a treaty

with any foreign country for any tax or portion thereof claimed as a deduction under this section. The notification shall be filed before the expiration of the period of limitation for assessment provided in section 6501 (usually 3 years from the last day for filing the return). The election may be revoked by the executor by the filing of a written notification to that effect with the district director at any time before the expiration of such period.

(d) *Amount of foreign death tax imposed upon a transfer.*—If a foreign death tax is imposed upon the transfer of the entire part of the decedent's estate subject to such tax and not upon the transfer of a particular share thereof, the foreign death tax imposed upon a transfer for charitable, etc., uses is deemed to be an amount, J, which bears the same ratio to K (the amount of the foreign death tax imposed with respect to the transfer of the entire part of the decedent's estate subject to such tax) as M (the value of the charitable, etc., transfer, reduced as provided in the next sentence) bears to N (the total value of the properties, interests, and benefits subjected to the foreign death tax received by all persons interested in the estate, reduced as provided in the last sentence of this paragraph). In arriving at amount M of the ratio, the value of the charitable, etc., transfer is reduced by the amount of any deduction or exclusion allowed with respect to such property in determining the amount of the foreign death tax. In arriving at amount N of the ratio, the total value of the properties, interests, and benefits subjected to foreign death tax received by all persons interested in the estate is reduced by the amount of all deductions and exclusions allowed in determining the amount of the foreign death tax on account of the nature of a beneficiary or a beneficiary's relationship to the decedent.

PAR. 12. Immediately after § 20.6036-1 insert the following new sections:

§ 20.6061 STATUTORY PROVISIONS; SIGNING OF RETURNS AND OTHER DOCUMENTS.

SEC. 6061. SIGNING OF RETURNS AND OTHER DOCUMENTS.

* * * any return, statement, or other document required to be made under any provision of the internal revenue laws or regulations shall be signed in accordance with forms or regulations prescribed by the Secretary or his delegate.

§ 20.6061-1 SIGNING OF RETURNS AND OTHER DOCUMENTS.—Any return, statement, or other document required to be made under any provision of chapter 11 or subtitle F of the Code or regulations prescribed thereunder with respect to any tax imposed by chapter 11 of the Code shall be signed by the executor, administrator or other person required or duly authorized to sign in accordance with the regulations, forms or instructions prescribed with respect to such return, statement, or other document. See § 20.2203 for definition of executor, administrator, etc. The person required or duly authorized to make the return may incur liability for the penalties provided for erroneous, false, or fraudulent returns. For criminal penalties see sections 7201, 7203, 7206, 7207, and 7269.

§ 20.6065 STATUTORY PROVISIONS; VERIFICATION OF RETURNS.

SEC. 6065. VERIFICATION OF RETURNS.

(a) *PENALTIES OF PERJURY.*—Except as otherwise provided by the Secretary or his delegate, any return, declaration, statement, or other document required to be made under any provision of the internal revenue laws or regulations shall contain or be verified by a written declaration that it is made under the penalties of perjury.

(b) *OATH.*—The Secretary or his delegate may by regulations require that any return, statement, or other document required to be made under any provision of the internal revenue laws or regulations shall be verified by an oath. * * *

§ 20.6065-1 VERIFICATION OF RETURNS.—(a) *Penalties of perjury.*—If a return, statement, or other document made under the provisions of chapter 11 or subtitle F of the Code or the regulations thereunder with respect to any tax imposed by chapter 11 of the Code, or the form and instructions issued with respect to such return, statement, or other document, requires that it shall contain or be verified by a written declaration that it is made under the penalties of perjury, it must be so verified by the person or persons required

to sign such return, statement or other document. In addition, any other statement or document submitted under any provision of chapter 11 or subtitle F of the Code or regulations thereunder with respect to any tax imposed by chapter 11 of the Code may be required to contain or be verified by a written declaration that it is made under the penalties of perjury.

(b) *Oath*.—Any return, statement, or other document required to be submitted under chapter 11 or subtitle F of the Code or regulations prescribed thereunder with respect to any tax imposed by chapter 11 of the Code may be required to be verified by an oath.

PAR. 13. Section 20.6091 is amended to read as follows:

§ 20.6091 STATUTORY PROVISIONS; PLACE FOR FILING RETURNS OR OTHER DOCUMENTS.

SEC. 6091. PLACE FOR FILING RETURNS OR OTHER DOCUMENTS.

(a) *GENERAL RULE*.—When not otherwise provided for by this title, the Secretary or his delegate shall by regulations prescribe the place for the filing of any return, declaration, statement, or other document, or copies thereof, required by this title or by regulations.

(b) *TAX RETURNS*.—In the case of returns of tax required under authority of part II of this subchapter—

* * * * *

(3) *ESTATE TAX RETURNS*.—Returns of estate tax required under section 6018 shall be made to the Secretary or his delegate in the internal revenue district in which was the domicile of the decedent at the time of his death or, if there was no such domicile in an internal revenue district, then at such place as the Secretary or his delegate may by regulations prescribe.

(4) *EXCEPTIONAL CASES*.—Notwithstanding paragraph * * * (3) of this subsection, the Secretary or his delegate may permit a return to be filed in any internal revenue district, and may require the return of any officer or employee of the Treasury Department to be filed in any internal revenue district selected by the Secretary or his delegate.

PAR. 14. Section 20.6091-1 is revised to read as follows:

§ 20.6091-1 PLACE FOR FILING RETURNS OR OTHER DOCUMENTS.—If the decedent was a resident of the United States, the preliminary notice required by § 20.6036-1 and the estate tax return required by § 20.6018-1 shall be filed with the district director in whose district the decedent had his domicile at the time of death. If the decedent was a nonresident (whether a citizen or not a citizen), the notice and the return shall be filed with the Director of International Operations, Internal Revenue Service, Washington 25, D.C.

PAR. 15. Immediately after § 20.6091-1 the following new section is added:

§ 20.6091-2 EXCEPTIONAL CASES.—Notwithstanding the provisions of § 20.6091-1 the Commissioner may permit the filing of the preliminary notice required by § 20.6036-1 and the estate tax return required by § 20.6018-1 in any internal revenue district.

PAR. 16. Paragraph (b) of § 20.6165-1 is amended to read as follows:

§ 20.6165-1 BONDS WHERE TIME TO PAY TAX OR DEFICIENCY HAS BEEN EXTENDED.

* * * * *

(b) *Extensions under section 6163 of time to pay estate tax attributable to reversionary or remainder interests*.—As a prerequisite to the postponement of the payment of the tax attributable to a reversionary or remainder interest as provided in § 20.6163-1, a bond equal to double the amount of the tax and interest for the estimated duration of the precedent interest must be furnished conditioned upon the payment of the tax and interest accrued thereon within six months after the termination of the precedent interest. If after the acceptance of a bond it is determined that the amount of the tax attributable to the rever-

sionary or remainder interest was understated in the bond, a new bond or a supplemental bond may be required, or the tax, to the extent of the understatement, may be collected. The bond must be conditioned upon the principal or surety promptly notifying the district director when the precedent interest terminates and upon the principal or surety notifying the district director during the month of September of each year as to the continuance of the precedent interest, if the duration of the precedent interest is dependent upon the life or lives of any person or persons, or is otherwise indefinite. For other provisions relating to bonds where an extension of time has been granted for paying the tax, see the regulations under section 7101 contained in Part 301 of this chapter (Regulations on Procedure and Administration).

PAR. 17. Section 20.7101-1 is amended to read as follows:

§ 20.7101-1 **FORM OF BONDS.**—See paragraph (b) of § 20.6165-1 for provisions relating to the bond required in any case in which the payment of the tax attributable to a reversionary or remainder interest has been postponed under the provisions of § 20.6163-1. For further provisions relating to bonds, see § 20.6165-1 of these regulations and the regulations under section 7101 contained in Part 301 of this chapter (Regulations on Procedure and Administration).

GIFT TAX REGULATIONS

(26 CFR Part 25)

PAR. 18. Immediately after § 25.6019-4 insert the following new sections:

§ 25.6061 **STATUTORY PROVISIONS; SIGNING OF RETURNS AND OTHER DOCUMENTS.**

SEC. 6061. **SIGNING OF RETURNS AND OTHER DOCUMENTS.**

* * * any return, statement, or other document required to be made under any provision of the internal revenue laws or regulations shall be signed in accordance with forms or regulations prescribed by the Secretary or his delegate.

§ 25.6061-1 **SIGNING OF RETURNS AND OTHER DOCUMENTS.**—Any return, statement, or other document required to be made under any provision of chapter 12 or subtitle F of the Code or regulations prescribed thereunder with respect to any tax imposed by chapter 12 of the Code shall be signed by the donor or other person required or duly authorized to sign in accordance with the regulations, forms or instructions prescribed with respect to such return, statement, or other document. The person required or duly authorized to make the return may incur liability for the penalties provided for erroneous, false, or fraudulent returns. For criminal penalties see sections 7201, 7203, 7206, 7207, and 7269.

§ 25.6065 **STATUTORY PROVISIONS; VERIFICATION OF RETURNS.**

SEC. 6065. **VERIFICATION OF RETURNS.**

(a) **PENALTIES OF PERJURY.**—Except as otherwise provided by the Secretary or his delegate, any return, declaration, statement, or other document required to be made under any provision of the internal revenue laws or regulations shall contain or be verified by a written declaration that it is made under the penalties of perjury.

(b) **OATH.**—The Secretary or his delegate may by regulations require that any return, statement, or other document required to be made under any provision of the internal revenue laws or regulations shall be verified by an oath. * * *

§ 25.6065-1. **VERIFICATION OF RETURNS.**—(a) *Penalties of perjury.*—If a return, statement, or other document made under the provisions of chapter 12 or subtitle F of the Code or the regulations thereunder with respect to any tax imposed by chapter 12 of the Code, or the form and instructions issued with respect to such return, statement, or other document, requires that it shall contain or be verified by a written declaration that it is made under the penalties of perjury, it must be so verified by the person or persons required to sign such return, statement, or other document. In addition, any other statement or document submitted under any provision of chapter 12 or subtitle F of the Code or regulations thereunder with respect to any tax imposed by chapter 12 of the Code may be required to contain or be verified by a written declaration that it is made under the penalties of perjury.

(b) *Oath*.—Any return, statement, or other document required to be submitted under chapter 12 or subtitle F of the Code or regulations prescribed thereunder with respect to any tax imposed by chapter 12 of the Code may be required to be verified by an oath.

PAR. 19. Section 25.6091 is amended to read as follows:

§ 25.6091 STATUTORY PROVISIONS; PLACE FOR FILING RETURNS OR OTHER DOCUMENTS.

SEC. 6091. PLACE FOR FILING RETURNS OR OTHER DOCUMENTS.

(a) GENERAL RULE.—When not otherwise provided for by this title, the Secretary or his delegate shall by regulations prescribe the place for the filing of any return, declaration, statement, or other document, or copies thereof, required by this title or by regulations.

(b) TAX RETURNS.—In the case of returns of tax required under authority of part II of this subchapter—

(1) INDIVIDUALS.—Returns (other than corporation returns) shall be made to the Secretary or his delegate in the internal revenue district in which is located the legal residence or principal place of business of the person making the return, or, if he has no legal residence or principal place of business in any internal revenue district, then at such place as the Secretary or his delegate may by regulations prescribe.

(4) EXCEPTIONAL CASES.—Notwithstanding paragraph (1) * * * of this subsection, the Secretary or his delegate may permit a return to be filed in any internal revenue district, and may require the return of any officer or employee of the Treasury Department to be filed in any internal revenue district selected by the Secretary or his delegate.

PAR. 20. Immediately after § 25.6091-1 the following new section is added:

§ 25.6091-2 EXCEPTIONAL CASES.—Notwithstanding the provisions of § 25.6091-1 the Commissioner may permit the filing of the gift tax return required by section 6019 in any internal revenue district.

PAR. 21. Section 25.6165-1 is amended to read as follows:

§ 25.6165-1 BONDS WHERE TIME TO PAY TAX OR DEFICIENCY HAS BEEN EXTENDED.—If an extension of time for payment of tax or deficiency is granted under section 6161, the district director may, if he deems it necessary, require a bond for the payment of the amount in respect of which the extension is granted in accordance with the terms of the extension. However, such bond shall not exceed double the amount with respect to which the extension is granted. For provisions relating to form of bonds, see the regulations under section 7101 contained in Part 301 of this chapter (Regulations on Procedure and Administration).

PAR. 22. Section 25.7101-1 is amended to read as follows:

§ 25.7101-1 FORM OF BONDS.—For provisions relating to form of bonds, see the regulations under section 7101 contained in Part 301 of this chapter (Regulations on Procedure and Administration).

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

BERTRAND M. HARDING,
Acting Commissioner of Internal Revenue.

Approved May 23, 1962.

STANLEY S. SURREY,
Assistant Secretary of the Treasury.

(Filed by the Division of the Federal Register on May 28, 1962, 8:51 a.m., and published in the issue of the Federal Register for May 29, 1962, 27 F.R. 4983)

PART III.—GROSS ESTATE

SECTION 2033.—PROPERTY IN WHICH DECEDENT HAD AN INTEREST

26 CFR 20.2033-1: Property in which the decedent had an interest.

Rev. Rul. 62-83

The value of all real estate owned by an Osage Indian at the date of his death is includible in his gross estate for Federal estate tax purposes with the exception of one exemption for a homestead allotment not in excess of 160 acres, pursuant to the Act of June 28, 1906, 34 Stat. 539, and, in addition, another exemption for either agricultural lands not in excess of 160 acres or city property not exceeding \$5,000 in cost, pursuant to the Act of June 20, 1936, 49 Stat. 1542, as amended by the Act of May 19, 1937, 50 Stat. 188.

Revenue Ruling 55-418, C.B. 1955-1, 445, revoked; Revenue Ruling 54-168, C.B. 1954-1, 182, distinguished.

In view of the decision of the United States District Court for the Northern District of Oklahoma, in the case of *Hazel Fair Daniels, et al. v. United States*, 6 American Federal Tax Reports (2d) 6139, 60-2 U.S. Tax Cases 11,966, reconsideration has been given to Revenue Ruling 55-418, C.B. 1955-1, 445.

That ruling holds that the estate of a deceased Osage Indian is entitled to exclude the value of only one homestead allotment of either agricultural land of not more than 160 acres or village, town, or city property not exceeding in cost \$5,000 in determining the value of the decedent's gross estate for Federal estate tax purposes.

The conclusion reached in Revenue Ruling 55-418 is based on certain United States statutes which provide for the exemption from Federal taxation for homestead allotments of Osage Indians. These statutes read as follows:

Act of June 28, 1906, 34 Stat. 539, at 541.

* * * Each member of said tribe shall be permitted to designate which of his three selections shall be a homestead, and his certificate of allotment and deed shall designate the same as a homestead, and the same shall be inalienable and nontaxable until otherwise provided by Act of Congress. * * *

Act of March 2, 1929, 45 Stat. 1478-1479.

* * * Homestead allotments of Osage Indians not having a certificate of competency shall remain exempt from taxation while the title remains in the original allottee of one-half or more of Osage Indian blood and in his unallotted heirs or devisees of one-half or more of 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 one hundred and sixty acres. * * *

Act of June 24, 1938, 52 Stat. 1034-1036.

* * * Homestead allotments of Osage Indians not having a certificate of competency shall remain exempt from taxation while the title remains in the original allottee of one-half or more of Osage Indian blood and in his unallotted heirs or devisees of one-half or more of Osage Indian blood until January 1, 1984: *Provided*, That the tax-exempt land of any such Indian allottee, heir, or devisee shall not at any time exceed one hundred and sixty acres. * * *

The Act of June 20, 1936, 49 Stat. 1542, which applied to Indians generally, including Osage Indians, provided, in part, as follows:

Sec. 2. All lands the title to which is now held by an Indian subject to restrictions against alienation or encumbrance except with the consent or approval

of the Secretary of the Interior, heretofore purchased out of trust or restricted funds of said Indian, are hereby declared to be instrumentalities of the Federal Government and shall be nontaxable until otherwise directed by Congress.

Section 2 of the Act of June 20, 1936, was amended by the Act of May 19, 1937, 50 Stat. 188, to read as follows:

All homesteads, heretofore purchased out of the trust or restricted funds of individual Indians, are hereby declared to be instrumentalities of the Federal Government and shall be nontaxable until otherwise directed by Congress: *Provided*, That the title to such homesteads shall be held subject to restrictions against alienation or encumbrance except with the approval of the Secretary of the Interior: *And provided further*, That the Indian owner or owners shall select, with the approval of the Secretary of the Interior, *either* the agricultural and grazing lands, not exceeding a total of one hundred and sixty acres, *or* the village, town, or city property, not exceeding in cost \$5,000, to be designated as a homestead. [Emphasis added.]

In the *Daniels* case, the United States District Court for the Northern District of Oklahoma decided that there is one exemption from the Federal estate tax for a homestead of up to 160 acres allotted under the Act of June 28, 1906 and, in addition, another exemption under the Act of June 20, 1936, as amended by the Act of May 19, 1937, for either agricultural lands not in excess of 160 acres or city property not exceeding \$5,000 in cost. The court based its conclusion upon the interpretation that the latter acts are cumulative upon the former act and that, therefore, such members of the Osage Tribe, as may have received tax-exempt homesteads under prior land allotment acts, become entitled to another tax-exempt homestead of either agricultural lands not in excess of 160 acres or city lands costing \$5,000, such lands to have been purchased with restricted trust funds. See also like decisions handed down by the same court in similar cases of *Russel Wagoshie, et al. v. U.S.*, 7 American Federal Tax Reports (2d) 1767, 61-1 U.S. Tax cases 12,001, and *El Reno West, et al. v. U.S.*, 7 American Federal Tax Reports (2d) 1770, 61-1 U.S. Tax cases 12,000.

The Act of June 28, 1906, allotted to enrolled members of the Osage Tribe certain parcels of land. Of the lands so allotted, each Indian was entitled to designate one selection, not to exceed 160 acres, as a tax-exempt homestead. By virtue of the Act of March 2, 1929, the tax exemption was to extend to January 1, 1959. The Act of June 24, 1938, extended the period until January 1, 1984.

The Act of June 20, 1936, as amended by the Act of May 19, 1937, differed from the Osage Allotment Act of 1906 in two important respects. First, this Act applied to all Indians. There is no language to indicate that those Indians previously provided for under the various tribal allotment acts are not covered by the 1936 and 1937 legislation. Second, the lands therein referred to are lands which were purchased by the Bureau of Indian Affairs, Department of the Interior, with restricted funds held in trust for the Indians.

Accordingly, it is held that the estate of a deceased Osage Indian not having a certificate of competency is entitled to one exemption for a homestead of up to 160 acres set aside and designated under the Act of June 28, 1906, and, in addition, another exemption for either agricultural lands not in excess of 160 acres or city property not exceeding in cost \$5,000, under the Act of June 20, 1936, as amended by the Act of May 19, 1937.

Accordingly, Revenue Ruling 55-418, C.B. 1955-1, 445, is hereby revoked.

Revenue Ruling 54-168, C.B. 1954-1, 182, states that the value of restricted allotted lands of an Indian of the Quapaw Tribe is includible in the deceased Indian's gross estate for Federal estate tax purposes. The validity of Revenue Ruling 55-418 for the reason that the treaty with the Quapaw Tribe contained no tax-exemption provision such as was included in the treaty between the United States and the Osage Tribe. Moreover, since the Act of June 20, 1936, as amended by the Act of May 19, 1937, applies only to lands purchased out of restricted trust funds, it would not create a tax-exempt status with respect to lands allotted to members of the Quapaw Tribe pursuant to treaty.

Accordingly, Revenue Ruling 54-168, C.B. 1954-1, 182, is distinguished.

SECTION 2038.—REVOCABLE TRANSFERS

26 CFR 20.2038: Statutory provisions; revocable transfers.

Exclusion of trust property from gross estate in cases where the decedent was under a mental disability to relinquish a power with respect to a trust. See T.D. 6600, page 164.

SECTION 2041.—POWERS OF APPOINTMENT

26 CFR 20.2041-1: Powers of appointment; T. D. 6582¹
in general.
(Also Section 2514; 25.2514-1.)

TITLE 26—INTERNAL REVENUE.—CHAPTER 1

SUBCHAPTER B, PART 20.—ESTATE TAX; ESTATES OF DECEDENTS DYING AFTER
AUGUST 16, 1954—PART 25.—GIFT TAX; GIFTS MADE AFTER DECEMBER 31,
1954

SUBCHAPTER D, PART 45.—MISCELLANEOUS STAMP TAXES

Estate and Gift Tax Regulations amended with regard to general powers of appointment.

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

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

In order to conform the Estate Tax Regulations (26 CFR Part 20) and the Gift Tax Regulations (26 CFR Part 25) to the decision of the United States Court of Appeals for the Eighth Circuit in *United States v. Winifred H. Turner, Exec.*, 287 F. 2d 821, filed March 8, 1961, relating to general powers of appointment, and in order to correct a typographical error in paragraph (f) (7) of § 45.4894-1 of the Miscellaneous Stamp Tax Regulations (26 CFR Part 45), the following regulations are prescribed:

¹ 26 F.R. 11861.

ESTATE TAX REGULATIONS
(26 CFR Part 20)

PARAGRAPH 1. Paragraph (e) of § 20.2041-1 is amended to read as follows:

§ 20.2041-1 POWERS OF APPOINTMENT; IN GENERAL.

* * * * *

(e) *Time of creation of power.*—A power of appointment created by will is, in general, considered as created on the date of the testator's death. However, section 2041(b)(3) provides that a power of appointment created by a will executed on or before October 21, 1942, is considered a power created on or before that date if the testator dies before July 1, 1949, without having republished the will, by codicil or otherwise, after October 21, 1942. A power of appointment created by an inter vivos instrument is considered as created on the date the instrument takes effect. Such a power is not considered as created at some future date merely because it is not exercisable on the date the instrument takes effect, or because it is revocable, or because the identity of its holders is not ascertainable until after the date the instrument takes effect. However, if the holder of a power exercises it by creating a second power, the second power is considered as created at the time of the exercise of the first. The application of this paragraph may be illustrated by the following examples:

Example (1). A created a revocable trust before October 22, 1942, providing for payment of income to B for life with remainder as B shall appoint by will. Even though A dies after October 21, 1942, without having exercised his power of revocation, B's power of appointment is considered a power created before October 22, 1942.

Example (2). C created an irrevocable inter vivos trust before October 22, 1942, naming T as trustee and providing for payment of income to D for life with remainder to E. T was given the power to pay corpus to D and the power to appoint a successor trustee. If T resigns after October 21, 1942, and appoints D as successor trustee, D is considered to have a power of appointment created before October 22, 1942.

Example (3). F created an irrevocable inter vivos trust before October 22, 1942, providing for payment of income to G for life with remainder as G shall appoint by will, but in default of appointment income to H for life with remainder as H shall appoint by will. If G died after October 21, 1942, without having exercised his power of appointment, H's power of appointment is considered a power created before October 22, 1942, even though it was only a contingent interest until G's death.

Example (4). If in example (3) above G had exercised his power of appointment by creating a similar power in J, J's power of appointment would be considered a power created after October 21, 1942.

GIFT TAX REGULATIONS
(26 CFR Part 25)

PAR. 2. Paragraph (e) of § 25.2514-1 is amended to read as follows:

§ 25.2514-1 TRANSFERS UNDER POWER OF APPOINTMENT.

* * * * *

(e) *Time of creation of power.*—A power of appointment created by will is, in general, considered as created on the date of the testator's death. However, section 2514(f) provides that a power of appointment created by a will executed on or before October 21, 1942, is considered a power created on or before that date if the testator dies before July 1, 1949, without having republished the will, by codicil or otherwise, after October 21, 1942. A power of appointment created by an inter vivos instrument is considered as created on the date the instrument takes effect. Such a power is not considered as created at some future date merely because it is not exercisable on the date the instrument takes effect, or because it is revocable, or because the identity of its holders is not ascertainable until after the date the instrument takes effect. However, if the holder of a power exercises it by creating a second power, the second power is considered as created at the time of the exercise of the first. The application of this paragraph may be illustrated by the following examples:

Example (1). A created a revocable trust before October 22, 1942, providing for payment of income to B for life with remainder as B shall appoint by deed

or will. Even though A dies after October 21, 1942, without having exercised his power of revocation, B's power of appointment is considered a power created before October 22, 1942.

Example (2). C created an irrevocable inter vivos trust before October 22, 1942, naming T as trustee and providing for payment of income to D for life with remainder to E. T was given the power to pay corpus to D and the power to appoint a successor trustee. If T resigns after October 21, 1942, and appoints D as successor trustee, D is considered to have a power of appointment created before October 22, 1942.

Example (3). F created an irrevocable inter vivos trust before October 22, 1942, providing for payment of income to G for life with remainder as G shall appoint by deed or will, but in default of appointment income to H for life with remainder as H shall appoint by deed or will. If G died after October 21, 1942, without having exercised his power of appointment, H's power of appointment is considered a power created before October 22, 1942, even though it was only a contingent interest until G's death.

Example (4). If in example (3) above G had exercised by will his power of appointment, by creating a similar power in J, J's power of appointment would be considered a power created after October 21, 1942.

MISCELLANEOUS STAMP TAX REGULATIONS (26 CFR Part 45)

PAR. 3. Paragraph (f)(7) of § 45.4894-1 is amended to read as follows:

§ 45.4894-1 ABATEMENT OR REFUND OF TAX ATTRIBUTABLE TO PROFITS REALIZED IN COURSE OF REGULAR BUSINESS.

* * * * *

(f) *Hedges against sales from necessary inventory.*— * * *

(7) *Rules applicable to foreign corporate subsidiary or affiliate.*—Silver owned by a foreign corporation subsidiary to or affiliated with the taxpayer may at the option of the taxpayer (with the written consent of such foreign corporation) be included in the inventory of the taxpayer; in which case all transfers by such foreign corporation shall be deemed to be transfers by the taxpayer, and as such shall be taxable to the taxpayer, and replacement silver acquired by such foreign corporation shall be included as replacement silver acquired by the taxpayer, but transfers as between the corporations shall not be deemed to be transfers of interests in silver bullion, within the meaning of § 45.4892 and paragraph (b) of § 45.4892-1; and the silver so transferred shall be deemed to have been acquired by the transferee otherwise than for a valuable consideration, within the meaning of paragraph (a)(3) of § 45.4892-1. The election to include a foreign corporate subsidiary or affiliate may be revoked by an instrument in writing signed by the taxpayer and by such foreign corporation and filed with the district director, in accordance with the provisions of § 45.6091-2, and shall be effective as of the close of the calendar month in which it is filed. Any silver acquired by such foreign corporation after the effective date of the revocation provided in the preceding sentence shall not be deemed to be replacement silver. If, on the effective date of the revocation, the amount of silver owned by such foreign corporation which formed a part of the necessary inventory, does not exceed the amount so owned by it at the time of the election to include such foreign corporation, transfers by the foreign corporation after such revocation are taxable only in accordance with §§ 45.4891-1 and 45.4896-1; and if it does exceed the amount so owned by it at the time of the election to include the foreign corporation, the next succeeding transfers aggregating the amount of such excess shall be deemed to be transfers from the inventory of the taxpayer and as such shall be taxable to the taxpayer. In determining such amounts, transfers between the taxpayer and the foreign corporate subsidiary or affiliate, whether for spot or future delivery, shall be considered as transfers, but the cost of silver so transferred shall be determined in accordance with paragraph (a) of § 45.4892-1.

Because this Treasury Decision prescribes rules favorable to taxpayers, and because it merely corrects a typographical error, it is deemed unnecessary to issue it with notice and public procedure thereon under section 4(a) of the Administrative Procedure Act, approved June 11, 1946, or subject to the effective date limitation of section 4(c) of such Act.

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

MORTIMER M. CAPLIN,
Commissioner of Internal Revenue.

Approved December 6, 1961.

STANLEY S. SURREY,
Assistant Secretary of the Treasury.

(Filed by the Division of the Federal Register on December 11, 1961, 8:47 a.m. and published in the issue of the Federal Register for December 12, 1961, 26 F.R. 11861)

PART IV.—TAXABLE ESTATE

SECTION 2053.—EXPENSES, INDEBTEDNESS, AND TAXES

26 CFR 20.2053: Statutory provisions; expenses, indebtedness, and taxes.

Deduction for estate tax purposes of foreign death taxes paid upon a transfer for charitable, etc., uses. See T.D. 6600, page 164.

SECTION 2055.—TRANSFERS FOR PUBLIC, CHARITABLE, AND RELIGIOUS USES

26 CFR 20.2055-1: Deductions for transfers for public, charitable, and religious uses; in general.

Transfers to or for the use of a State agency for exclusively public purposes. See Rev. Rul. 62-66, page 83.

SUBCHAPTER B.—ESTATES OF NONRESIDENTS NOT CITIZENS

SECTION 2106.—TAXABLE ESTATE

26 CFR 20.2106: Statutory provisions; taxable estate.

Transfers to or for the use of a State activity for exclusively public purposes. See Rev. Rul. 62-66, page 83.

CHAPTER 12.—GIFT TAX

SUBCHAPTER B.—TRANSFERS

SECTION 2511.—TRANSFERS IN GENERAL

26 CFR 25.2511-2: Cessation of donor's dominion
and control.

Rev. Rul. 62-13

Where property is transferred to a trust, under the terms of which the trustee is given very broad discretionary powers over the distribution to the grantor of income, and corpus, and where, even though the value of the property transferred is large in amount, under the circumstances there appears to be no assurance at the time of creating the trust that anything of value will be paid to a beneficiary (or class of beneficiaries) other than the grantor, such transfer constitutes, for purposes of the Federal gift tax statute, an incomplete transfer and, hence, does not result in a taxable gift.

Revenue Ruling 54-538, C.B. 1954-2, 316, modified.

Advice has been requested whether the Internal Revenue Service will follow the decision in *Commissioner v. Sarah Gilkey Vander Weele*, 254 Fed. (2d) 895 (1958), in a situation where a grantor conveys in trust a substantial amount of property, providing for complete discretion in the trustee with respect to distributions of income and corpus to the grantor, and where there is no assurance that anything of value will be paid to a beneficiary (or class of beneficiaries) other than the grantor.

The general rule is that the value of a gift is the value of the property transferred, reduced by the value of any interest therein retained by the donor. See section 25.2511-1(e) of the Gift Tax Regulations. However, where the donor transfers property retaining a reversionary interest which is not susceptible of valuation by recognized actuarial methods, the entire gift is complete. The position stated above is in accord with the decisions in *Hulburt W. Smith v. Shaughnessy*, 318 U.S. 176 (1943), Ct. D. 1575, C.B. 1943, 1144, and *Meta Biddle Robinette et al. v. Helvering*, 318 U.S. 184 (1943), Ct. D. 1574, C.B. 1943, 1141. The facts in those two cases are, however, distinguishable from those in the *Vander Weele* case.

In the *Smith* case, the donor made an irrevocable transfer in trust providing for payment of income to his wife for life, with remainder to him at her death if he were then living and, if not, to specified third parties. The donor in that case lost all possibility of economic benefit except to the extent that he would recapture the corpus in the event he survived his wife. The value of such a reversionary interest was, concededly, capable of computation by recognized actuarial methods and, hence, deductible in computing the value of the gift subject to tax.

The irrevocable trusts involved in the *Robinette* case provided for life incomes to the three grantors and subsequent life incomes to others, with remainders to the issue of one of the grantors upon such issue's reaching 21. In default of such issue, remainders were to be subject to testamentary disposition by the last survivor of the three

grantors. Here again, the grantors lost all possibility of economic benefit as to the corpus, except as to the contingent reversionary interests. Such interests were, however, conditioned not only upon survivorship but also upon the death of one of the grantors (then unmarried) without issue who should reach the age of 21. It was held that the value of the reversionary interests could not be computed by recognized actuarial methods and, hence, was not deductible from the value of the property transferred in determining the value of the gift for gift tax purposes.

In the *Vander Weele* case, the grantor created an irrevocable trust to which she transferred certain securities and a contingent interest of substantial value in a large testamentary trust of her grandfather. The trustees were to pay her for life the income from the securities, at least until the falling in of the contingent interest. After that time, the trustees were empowered to pay her such reasonable and substantial portions of the income of the trust as, in their sole judgment and discretion, should seem desirable and ample for her comfortable well-being and enjoyment. They were also empowered to pay her the entire income or to accumulate undisbursed income for the benefit of her children during minority. In addition, the trustees were given sweeping powers to encroach upon corpus for the benefit of the grantor. Such powers were almost unrestricted and surrounding circumstances indicated that the trust had been created primarily for the benefit of the grantor.

The Court of Appeals for the Sixth Circuit, affirming the decision of the Tax Court of the United States, held that under such circumstances there was no actual taxable gift inasmuch as there was no assurance that anything of value would ever pass to the remaindermen. There was only a transfer which, upon contingencies, might become a gift at some future date.

In view of the foregoing, it is held that where property is transferred to a trust under the terms of which the trustee is given very broad discretionary powers over the distribution to the grantor of income and corpus, and where, even though the value of the property transferred is large in amount, under the circumstances there appears to be no assurance at the time of creating the trust that anything of value will be paid to a beneficiary (or class of beneficiaries) other than the grantor, such transfer constitutes, for purposes of the Federal gift tax statute, an incomplete transfer and, hence, does not result in a taxable gift.

The non-acquiescence, C.B. 1957-2, 8, in *Sarah Gilkey Vander Weele v. Commissioner*, 27 T.C. 340, is withdrawn and acquiescence substituted therefor. See page 3 of this Bulletin.

The rule, stated in Revenue Ruling 54-538, C.B. 1954-2, 316, to the effect that, although a retained interest capable of valuation by recognized actuarial methods should be excluded from the value of the gift, the entire gift is complete where the retained interest is not susceptible of such computation, is considered applicable only to cases where it has already been determined that a gift has been made and the issue concerns the valuation of an interest retained by the donor, as in the *Smith* and *Robinette* cases. In that ruling, the Service indicated that it did not consider the decision of the Tax Court in *Christianna K.*

Gramm v. Commissioner, 17 T.C. 1063, holding the gift incomplete, as contrary to the holdings in the *Smith* and *Robinette* cases, inasmuch as the terms of the trust with respect to the powers of the trustee, considered together with the fact that the corpus of the trust was relatively small and comprised the entire property of the grantor, indicated the possibility of total depletion of the corpus in the lifetime of the grantor. The same principle is deemed applicable in a case like *Vander Weele*, which involves such sweeping powers to invade income and corpus for the benefit of the grantor that there is no assurance under the circumstances that anything of value will be paid to any beneficiary other than the grantor, and the question of whether or not a transfer is complete for Federal gift tax purposes in such a case does not depend on whether the value of the property transferred is large or small. Accordingly, the nonacquiescence in the *Gramm* decision published in C.B. 1957-2, 8, is withdrawn and acquiescence is substituted therefor. See page 3 of this Bulletin.

Revenue Ruling 54-538, C.B. 1954-2, 316, is hereby modified to remove any implication that a transfer may be considered a completed gift for Federal gift tax purposes where a power to invade income and corpus for the benefit of the grantor is so great that under the circumstances there is no assurance that anything of value will be paid to any beneficiary other than the grantor.

SECTION 2514.—POWERS OF APPOINTMENT

26 CFR 25.2514: Transfers under power of appointment.

Amended regulations with respect to the determination of time of creation of general power of appointment. See T.D. 6582, page 177.

SUBCHAPTER C.—DEDUCTIONS

SECTION 2522.—CHARITABLE AND SIMILAR GIFTS

26 CFR 25.2522(a)-1: Charitable and similar gifts; citizens or resident.

Gifts to or for the use of a State activity for exclusively public purposes. See Rev. Rul. 62-66, page 83.

SUBTITLE C.—EMPLOYMENT TAXES

CHAPTER 21.—FEDERAL INSURANCE CONTRIBUTIONS ACT

SUBCHAPTER C.—GENERAL PROVISIONS

SECTION 3121.—DEFINITIONS

26 CFR 31.3121(d)-1: Who are employees.
(Also Section 1402; 1.1402(c)-1.)

Rev. Rul. 62-79

An individual is engaged by an automobile club to distribute automobile license plates and to sell club memberships. He maintains and operates his own office, engages and pays his own assistants, and bears all expenses incurred in connection with his activities for the club. He receives a fixed fee for each license plate issued and a commission on each club membership sold. He may engage in other work and his services may be terminated by either party upon proper notice. *Held*, the individual is not an employee of the club for Federal employment tax purposes.

The individual's activities constitute a "trade or business" the income from which is includible in computing his net earnings from self-employment for purposes of the Self-Employment Contributions Act of 1954.

An inquiry has been received relative to the status, for purposes of the Federal Insurance Contributions Act and the Self-Employment Contributions Act of 1954 (chapter 21, subtitle C, and chapter 2, subtitle A, respectively, Internal Revenue Code of 1954), of an individual engaged in distributing automobile license plates and selling club memberships under the terms of an agreement with an automobile club.

The automobile club has a contract with the commissioner of motor vehicles of the state involved under which it is authorized to sell and distribute automobile license plates in the state and to engage agents to carry out the contract. It receives a fee for each sale made by agents under the contract. The club has engaged several agents, one of whom is the individual who is the subject of this ruling.

The automobile club has granted the individual the authority to sell and distribute automobile license plates and to sell automobile club memberships. The club pays him a fixed fee for each set of license plates issued and a commission on each club membership sold by him. In addition, the club pays him a fixed fee for the transfer of title where there is no license issued and a like fee for a transfer of license where there is no transfer of title.

It is mutually understood and agreed that the individual will accept full responsibility for safeguarding all automobile license plates and other property received from the state; that he will conduct the affairs of his office according to his good judgment and in keeping with proper business ethics and practices; that he will be responsible for all of his own expenses; that he will distribute and properly account for all automobile license plates sold in a manner required by the laws and regulations of the state; that he will be responsible for all moneys

received for the accounts of the state and the club; and that all his accounting records with respect to the sale of license plates and club memberships shall be subject to inspection by a representative of the club or of the state. It is further understood and agreed that the individual may engage in any other work or business. The agreement may be terminated by either party upon proper notice.

The relationship between the state and the motor club is not one contemplated by section 3121(b)(7) of the Federal Insurance Contributions Act. Therefore, agents engaged by the club may not be considered as assistants of state officials for purposes of that section. See Rev. Rul. 61-21, C.B. 1961-1, 431, particularly case 2 on page 433.

Section 3121(d) of the Federal Insurance Contributions Act provides, among other things, that the term "employee" means any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee. The guides for determining whether, under such rules, an employer-employee relationship exists, are found in section 31.3121(d)-1(c) of the Employment Tax Regulations.

Whether an individual is an independent contractor or an employee is largely a question to be determined upon the consideration of the particular facts in each case. In the instant case, it is concluded that in the performance of services for the club in compliance with the agreement referred to above, the individual is not subject to the control and direction by the club which is necessary, under the usual common law rules, to establish an employer-employee relationship for Federal employment tax purposes. Therefore, the individual here involved is not an employee of the motor club for Federal employment tax purposes.

Section 1402 of the Self-Employment Contributions Act of 1954 provides in part as follows:

(a) **NET EARNINGS FROM SELF-EMPLOYMENT.**—The term "net earnings from self-employment" means the gross income derived by an individual from any trade or business carried on by such individual, less the deductions allowed by this subtitle [subtitle A] which are attributable to such trade or business, * * *

(c) **TRADE OR BUSINESS.**—The term "trade or business", when used with reference to self-employment income or net earnings from self-employment, shall have the same meaning as when used in section 162 (relating to trade or business expenses), * * *.

As a general rule, when a person is engaged in an occupation or profession for profit which constitutes, in whole or in part, his livelihood and, as to such occupation or profession, is not regarded as an employee for purposes of the taxes imposed by the Federal Insurance Contributions Act or otherwise excluded from the self-employment provisions, he is engaged in a "trade or business."

In the instant case, it is held that the individual is engaged in a "trade or business" with respect to the services performed in selling automobile license plates and club memberships under the circumstances herein involved. The income derived from such services should be taken into consideration in computing net earnings from self-employment for purposes of the Self-Employment Contributions Act of 1954.

26 CFR 31.3121(d)-2: Who are employers.

In a statutory merger, the resultant entity is regarded as the same taxpayer and employer as the absorbed corporation. See Rev. Rul. 62-60, below.

CHAPTER 23.—FEDERAL UNEMPLOYMENT TAX ACT

SECTION 3301.—RATE OF TAX

26 CFR 31.3301-1: Persons liable for tax. Rev. Rul. 62-60
(Also Sections 3121, 3302, 3401; 31.3121(d)-2,
31.3302(a)-1, 31.3401(d)-1.)

Where a corporation is absorbed by another corporation in a statutory merger or consolidation, the resultant entity is regarded as the same taxpayer and same employer as the absorbed corporation for Federal Unemployment Tax Act purposes. Thus, if the required 20-week period of employment exists, the resultant corporation is subject to the Federal unemployment tax with respect to the premerger or preconsolidation employment of individuals by the absorbed corporation. Similarly, the resultant corporation is entitled to the credits against such tax provided by section 3302 of the Act with respect to such employment.

S.S.T. 188 and S.S.T. 199, C.B. 1937-2, 377 and 405, respectively, modified.

Advice has been requested as to the effect of a statutory merger or consolidation upon an absorbed corporation and the resultant entity with respect to liability for the tax imposed under the Federal Unemployment Tax Act (Chapter 23, subtitle C, Internal Revenue Code of 1954).

In the past, in cases involving a statutory merger or consolidation, the Internal Revenue Service has treated the absorbed corporation as distinct from the resultant entity for Federal employment tax purposes. See S.S.T. 199, C.B. 1937-2, 405, at 406, Question 6 and the answer thereto. See also S.S.T. 188, C.B. 1937-2, 377.

Upon reconsideration, the Service has concluded that where a corporation is absorbed by another corporation in a statutory merger or consolidation the resultant corporation should be regarded as the same taxpayer and the same employer for Federal unemployment tax purposes. In this regard see Senate Report No. 868, dated September 5, 1961, 87th Congress, 1st Session, C.B. 1961-2, 447, and Congressional Record for August 31, 1961, Vol. 107, No. 152, at page 16656. Also see Revenue Ruling 54-31, C.B. 1954-1, 212, modifying S.S.T. 199, *supra*, as to the continuation of a partnership as the same taxpayer and employer notwithstanding a change in its membership.

Accordingly, it is held that in the case of a statutory merger or consolidation the resultant entity is subject to the tax imposed by the Federal Unemployment Tax Act by reason of the premerger or preconsolidation employment of individuals by the corporation or corporations absorbed. That is to say, if individuals are employed in the business for the appropriate 20-week period during the calendar year, liability for the Federal unemployment tax is incurred by the resultant

corporation whether it employed them for 20 weeks or that period was divided between the absorbed corporation and the resultant corporation.

The effect of the foregoing is to impute the employment, by the absorbed corporation, to the resultant corporation, in which the corporate life of the absorbed corporation is deemed to continue. Accordingly, the credits against the Federal unemployment tax provided by section 3302 of the 1954 Code for contributions made by the absorbed corporation into State unemployment funds with respect to such employment are allowable to the resultant corporation.

The above conclusion that the continuing corporation resulting from a statutory merger or consolidation is the same employer and taxpayer as the absorbed corporation, is also applicable for purposes of the taxes imposed under the Federal Insurance Contributions Act and the Withholding of Income Tax at Source on Wages (chapters 21 and 24, respectively, subtitle C of the 1954 Code).

In cases involving employment taxes, the resultant corporation should furnish one Form W-2, Withholding Tax Statement, to each employee showing as one total the wages paid in the year of the merger by one or both corporations. A single Form W-3, Reconciliation of Income Tax Withheld from Wages, should be filed by the resultant corporation; the amount of income tax withheld by each corporation need not be separately identified. One Form 941, Employer's Quarterly Federal Tax Return, for the quarter in which the merger occurred and one Form 940, Employer's Annual Federal Unemployment Tax Return, for the calendar year in which the merger occurred should be filed by the resultant corporation covering the wages paid by both corporations during those periods.

The first return filed by the resultant corporation subsequent to the merger or consolidation should be accompanied by information indicating the change which has taken place, the date of the change, the name and address of the absorbed corporation and the identification number assigned to the absorbed corporation.

For calendar years beginning after 1960, a successor employer who acquires the business and employees of a predecessor, who is not an "employer" for purposes of the Federal unemployment tax, is permitted, under section 3302(e) of the Federal Unemployment Tax Act, to credit against his Federal unemployment tax the credits for State contributions which would have been allowable to the predecessor with respect to the acquired employees if the predecessor had qualified as an "employer" during the calendar year. Section 3302(e) does not apply to a corporation acquiring the trade or business and employees of another corporation in a statutory merger or consolidation since, as indicated herein, there is no predecessor-successor relationship in a statutory merger or consolidation but one continuing taxpayer or employer.

S.S.T. 188, C.B. 1937-2, 377, is modified to remove the conclusions that the provisions thereof are applicable to statutory mergers or consolidations.

S.S.T. 199, C.B. 1937-2, 405, is modified to remove the inference that Question 6 and the answer thereto is applicable in the case of a statutory merger or consolidation.

SECTION 3302.—CREDITS AGAINST TAX

26 CFR 31.3302(a)-1: Credit against tax for contributions paid.

In a statutory merger, the resultant entity is regarded as the same taxpayer and employer as the absorbed corporation for purposes of the Federal Unemployment Tax Act. See Rev. Rul. 62-60, page 186.

CHAPTER 24.—COLLECTION OF INCOME TAX AT SOURCE ON WAGES

SECTION 3401.—DEFINITIONS

26 CFR 31.3401(d)-1: Employer.

In a statutory merger, the resultant entity is regarded as the same taxpayer and employer as the absorbed corporation. See Rev. Rul. 62-60, page 186.

SUBTITLE D.—MISCELLANEOUS EXCISE TAXES**CHAPTER 31.—RETAILERS EXCISE TAXES**

SUBCHAPTER A.—JEWELRY AND RELATED ITEMS

SECTION 4001.—IMPOSITION OF TAX

26 CFR 48.4001-1: Imposition of tax.

Rev. Rul. 62-55

Also Sections 4011, 4021, 4031, 4041, 4061, 4071, 4081, 4091, 4111, 4121, 4131, 4141, 4151, 4161, 4171, 4181, 4191, 4201, 4211; 48.4011-1, 48.4031-1, 48.4041-1, 40.4061(a)-1, 40.4061(b)-1, 48.4071-1, 48.4081-1, 48.4091-1, 48.4111-1, 48.4121-1, 48.4131-1, 48.4141-1, 48.4151-1, 48.4161-1, 48.4171-1, 48.4181-1, 48.4191-1, 48.4201-1, 48.4211-1.)

The "Articles of Agreement of the International Bank for Reconstruction and Development" provide that the Bank's "transactions" shall be immune from all taxation. The Bretton Woods Agreements Act, under which the United States accepted membership in the Bank, provides that this immunity shall have full force and effect in the United States. Consequently, the retailers excise tax does not apply to an otherwise taxable sale at retail to the Bank, and the manufacturers excise tax does not apply to an otherwise taxable sale by a manufacturer, producer, or importer directly to the Bank.

Advice has been requested whether the retailers and the manufacturers excise taxes apply to sales of taxable articles to the International Bank for Reconstruction and Development (hereinafter referred to as the Bank).

The Bank is an international organization established for the general purpose of facilitating the financing of the reconstruction and development of productive facilities in the territories of the member nations. The Bank was created pursuant to an agreement signed by the member nations in 1944, which is known as the "Articles of Agreement of the International Bank for Reconstruction and Development" (hereinafter referred to as the Agreement). Section 9(a) of Article VII of the Agreement reads as follows:

The Bank, its assets, property, income and its operations and transactions authorized by this Agreement, shall be immune from all taxation, and from all customs duties. The Bank shall also be immune from liability for the collection or payment of any tax or duty.

The United States accepted membership in the Bank under the authority of the "Bretton Woods Agreements Act," 22 U.S.C. 286. Section 11 of the Bretton Woods Agreements Act reads, in part, as follows:

The provisions of * * * Article VII, sections 2-9, both inclusive, of the Articles of Agreement of the Bank shall have full force and effect in the United States * * * upon the acceptance of membership by the United States in, and the establishment of, the * * * Bank.

The specific question to be resolved is whether sales of taxable articles to the Bank by retailers or by manufacturers are immune from tax by virtue of the provision in the Agreement that the Bank's *transactions* shall be immune from all taxation.

Where an article is sold to the Bank, the vendor's *sale* and the Bank's *purchase* of that article constitute a single transaction in which the Bank is an essential participant. Accordingly, in view of the immunity from all taxation provided for the Bank's *transactions*, which are carried out pursuant to the Agreement, it is held (1) that the retailers excise tax does not apply to an otherwise taxable sale at retail to the Bank and (2) that the manufacturers excise tax does not apply to an otherwise taxable sale by a manufacturer, producer, or importer directly to the Bank, when the purchases are made pursuant to carrying out the purposes of the Bank as established by the Agreement. See Revenue Ruling 62-56, page 272, this Bulletin, for a related conclusion with respect to the documentary stamp taxes.

This ruling applies with equal effect to the transactions of certain other organizations, as follows:

Inter-American Development Bank
International Development Association
International Finance Corporation
International Monetary Fund

The agreements establishing these organizations contain provisions substantially similar to section 9(a) of Article VII of the Agreement in the instant case, and the agreements have been made part of the statutory law of the United States.

To support the exempt character of a sale to the International Bank for Reconstruction and Development, or to one of the other

international organizations enumerated above, a manufacturer or retailer should obtain from the vendee a written statement in substantially the following form:

-----, 19-----
(Date)

The undersigned states that he is ----- of -----;
(Title of position) (Name of organization);
that he is authorized to execute this statement; and that the article or articles
specified in the accompanying order, or on the reverse side hereof, are pur-
chased from ----- for use exclusively in carrying out the pro-
(Name of vendor)
visions of the "-----"
(Title of agreement establishing organization)

(Signature)

Where only occasional sales are made by a retailer or manufacturer to one of these international organizations, a separate exemption certificate should be furnished for each order. However, where sales by the retailer or manufacturer to such an organization are regularly or frequently made, a certificate covering all orders for a specified period not to exceed four calendar quarters will be acceptable.

(Also Sections 4011, 4021, 4031; 48.4011-1, 48.4031-1.)

Rev. Rul. 62-90

A company is engaged in the business of selling, at wholesale and at retail, products which are not subject to the retailers excise taxes. The company distributes coupons with the sale of its products to retail customers. The customers may redeem the coupons by presenting them to the company in exchange for certain other merchandise, including articles which are subject to the retailers excise taxes imposed by sections 4001, 4011, 4021, and 4031 of the Internal Revenue Code of 1954. *Held*, the company is liable for the retailers excise tax on its transfer of taxable articles to customers in exchange for the coupons, and the basis upon which the tax is to be computed is the *fair market value* of the articles at the time of transfer.

Advice has been requested concerning the application of the retailers excise tax to the exchange of taxable articles for coupons under the circumstances described below. If the tax applies, further advice has been requested concerning the proper basis for computing the tax.

A company is engaged in the business of selling, at wholesale and at retail, products which are not subject to the retailers excise taxes. When a retail customer purchases the company's products, the customer is given coupons that he may redeem by presenting them to the company in exchange for certain other merchandise, including articles which are subject to the retailers excise taxes imposed by sections 4001, 4011, 4021, and 4031 of the Internal Revenue Code of 1954.

The coupons may not be redeemed for cash or for the products normally sold by the company. Occasionally, when a customer wants a particular article but has not accumulated a sufficient number of coupons therefor, the company will exchange the article upon the presentation of a combination of coupons and cash. In such cases, the customer must present at least 75 percent of the total number

of coupons allotted to the particular article. The customer substitutes cash in lieu of the remaining number of coupons allotted to the article, on the basis of one cent for each coupon.

Sections 4001, 4011, 4021, and 4031 of the Code impose upon jewelry and related items, furs, toilet preparations, and luggage, handbags, etc., respectively, sold at retail, a tax equivalent to ten percent of the price for which so sold.

Section 320.5(d) of Regulations 51, made applicable to the 1954 Code by Treasury Decision 6091, C.B. 1954-2, 47, provides that the giving of a premium in consideration of the return of wrappers, labels, coupons, trading stamps, or other scrip, delivered or sold in connection with the sale of a commodity, constitutes a taxable transaction, and the person so giving the premium is considered to be one who sells at retail.

In the case of *Southern Premium Stamp Co. v. United States*, 289 Fed. (2d) 319 (1961), the United States Court of Appeals for the Fifth Circuit affirmed the decision of the District Court, 191 Fed. Supp. 158 (1961), which held that the transfer of articles (such as jewelry and luggage) by the stamp company to the ultimate consumer in exchange for trading stamps is a sale at retail which is subject to tax. The court further held that the *fair market value* of the taxable articles (at the time of transfer to the ultimate consumer in exchange for the trading stamps) is the "price for which so sold" for purposes of computing the retailers excise tax.

The applicability to the instant case of the position approved by the court in the *Southern Premium Stamp Co.* decision is not affected by the fact that the taxable articles are exchanged for "coupons" rather than for "trading stamps" or by the fact that the coupons are accepted in exchange by the company which issued them rather than by a "trading stamp" company.

Accordingly, it is held that the retailers excise tax applies to the exchange of taxable articles for coupons under the circumstances described in the instant case and that the company is liable for the retailers excise tax with respect to its transfer of taxable articles. It is further held that the basis upon which the tax is to be computed is the fair market value of the taxable articles at the time the articles are transferred to the customers.

26 CFR 48.4001-2: Jewelry.

Rev. Rul. 62-32

The retailers excise tax imposed by section 4001 of the Internal Revenue Code of 1954 does not apply to the sale at retail of a glove holder which is made entirely of nonprecious metal and which is not ornamented with any of the stones enumerated in that section of the Code.

Advice has been requested whether the retailers excise tax on jewelry and related items applies to sales at retail of the article described below.

A retailer sells a "glove holder" which is designed to hold ladies' gloves to keep them from being lost. It consists of a clip made of nonprecious metal in the form of a miniature glove with a small chain attached. The chain is used to fasten the article to a handbag. Neither

the clip nor the chain is made of, or ornamented, mounted or fitted with precious metals or imitations thereof. Moreover, the article is not ornamented with any of the stones enumerated in section 4001 of the Internal Revenue Code of 1954.

Section 4001 of the Code imposes a tax upon the sale at retail of "all articles commonly or commercially known as jewelry, whether real or imitation." That section also imposes a tax upon the sale at retail of "articles made of, or ornamented, mounted or fitted with precious metals or imitations thereof."

Section 48.4001-2(a) of the Manufacturers and Retailers Excise Tax Regulations provides that jewelry in general includes articles designed to be worn on the person or on apparel for the purpose of adornment and which in accordance with custom or ordinary usage are worn so as to be displayed. Sections 48.4001-2(b) of the regulations provides that jewelry also includes certain other articles if they are made of, or ornamented, mounted or fitted with, any of the stones enumerated in section 4001 whether such stones are real or synthetic.

Section 48.4001-4(a) of the regulations provides that the tax imposed by section 4001 of the Code applies to the sale at retail of articles (as distinguished from those articles commonly or commercially known as jewelry as described in section 48.4001-2) which are made of, or ornamented, mounted or fitted with, precious metals or imitations thereof. Section 48.4001-4(b) of the regulations provides that the term "precious metals" includes platinum, gold, silver, and other metals of similar or greater value. The term "imitations thereof" includes (i) alloys of precious metals, and (ii) platings of precious metals and platings of alloys of such metals, provided such platings are one one-hundred-thousandth of an inch or more in thickness.

Glove holders are not considered to be "articles commonly or commercially known as jewelry," within the meaning of section 48.4001-2(a) of the regulations. However, glove holders which are made of, or ornamented, mounted or fitted with precious metals or imitations thereof are subject to the retailers excise tax under the provisions of section 48.4001-4(a) of the regulations. Since the glove holder in the instant case is made entirely of nonprecious metal, it does not come within the scope of section 48.4001-4(a) of the regulations.

Accordingly, it is held that the retailers excise tax imposed by section 4001 of the Code does not apply to the sale at retail of the glove holder which is described above.

Rev. Rul. 62-72

Retailers' sales of "necktie knot supports" which are designed for the purpose of keeping the knot in place and which are worn hidden from view are not subject to the retailers excise tax on jewelry and related items imposed by section 4001 of the Internal Revenue Code of 1954, unless they are made of, or ornamented, mounted or fitted with precious metals or imitations thereof.

Advice has been requested concerning the applicability of the retailers excise tax on jewelry and related items to sales at retail of a certain so-called "necktie knot support."

A retailer sells a so-called "necktie knot support" which is made of nonprecious metals. The support consists of a hook with a long

shank and two removable clips. One clip is used with neckties made of heavy fabrics and the other clip is used with neckties made of lighter fabrics. The necktie knot support is designed to be worn inserted in the knot of a necktie for the purpose of keeping the knot straight and preventing it from slipping. The support is worn in such a manner as to be hidden from view.

Section 4001 of the Internal Revenue Code of 1954 imposes a tax upon the sale at retail of certain articles, including "all articles commonly or commercially known as jewelry, whether real or imitation." That section also imposes a tax upon the sale at retail of "articles made of, or ornamented, mounted or fitted with precious metals or imitations thereof."

Section 48.4001-2(a) of the Manufacturers and Retailers Excise Tax Regulations provides, in part, that jewelry in general includes articles designed to be worn on the person or on apparel for the purpose of adornment and which in accordance with custom or ordinary usage are worn so as to be displayed, such as rings, chains, brooches, bracelets, cuff buttons, necklaces, earrings, beads, charms, pendants, etc. The tax is imposed on the sale of any of such articles at retail, regardless of the substance of which made and without reference to their utilitarian value or purpose, unless for a purpose specifically exempted by law.

Necktie supports which are designed to be worn within the knot of a necktie for the purpose of keeping the knot in place and which are worn hidden from view are not considered to be articles designed to be worn for the purpose of adornment or customarily worn so as to be displayed. Therefore, the supports described above do not come within the scope of the statutory term "articles commonly or commercially known as jewelry."

Accordingly, it is held that the retailer's sales of these supports made of nonprecious metals are not subject to the retailers excise tax imposed by section 4001 of the Code.

However, the retailers excise tax imposed by section 4001 of the Code would apply to the retailer's sales of any necktie knot supports which are made of, or ornamented, mounted or fitted with precious metals or imitations thereof.

SUBCHAPTER B.—FURS

SECTION 4011.—IMPOSITION OF TAX

26 CFR 48.4011-1: Imposition of tax.

Whether sales of articles to the International Bank for Reconstruction and Development, and similar organizations, are immune from the retailers excise tax. See Rev. Rul. 62-55, page 188.

The application of the retailers excise tax to the exchange of taxable articles for coupons issued in connection with the sale of other products. See Rev. Rul. 62-90, page 190.

SUBCHAPTER C.—TOILET PREPARATIONS

SECTION 4021.—IMPOSITION OF TAX

Whether sales of articles to the International Bank for Reconstruction and Development, and similar organizations, are immune from the retailers excise tax. See Rev. Rul. 62-55, page 188.

The application of the retailers excise tax to the exchange of taxable articles for coupons issued in connection with the sale of other products. See Rev. Rul. 62-90, page 190.

SUBCHAPTER D.—LUGGAGE, HANDBAGS, ETC.

SECTION 4031.—IMPOSITION OF TAX

26 CFR 48.4031-1: Imposition of tax.

Rev. Rul. 62-41

Where a manufacturer, pursuant to a contract, produces luggage for a customer's use from material furnished by the customer who retains title thereto throughout the transaction and bills the customer for the labor, incidental materials, and a profit, the transaction is a contract for labor and materials rather than a sale of the luggage produced. Accordingly, any charge made by the manufacturer incident to producing luggage under these circumstances is not subject to the retailers excise tax imposed by section 4031 of the Internal Revenue Code of 1954.

Advice has been requested concerning the applicability of the retailers excise tax on luggage, handbags, etc., to a transaction whereby a manufacturer produces luggage from material furnished by a customer under the circumstances described below. Specifically, advice has been requested whether the applicability of the tax in this situation is affected by the provisions of section 4012(a) of the Internal Revenue Code of 1954.

A customer engages a manufacturer to produce, from the customer's own material, luggage for the customer's own use. Pursuant to a contract, the customer furnishes the basic material used in the manufacture of the luggage and retains title thereto throughout the transaction. The manufacturer produces the luggage and bills the customer, on the basis of the contract, for the labor, incidental materials, and a profit.

Section 4031 of the Code imposes a tax upon the sale at retail of certain enumerated articles, generally referred to as luggage, handbags, etc.

Section 4012(a) of the Code provides that where a person, who is engaged in the business of dressing or dyeing fur skins or of manufacturing, selling, or repairing fur articles, produces an article of the kind described in section 4011 from fur on the hide or pelt furnished, directly or indirectly, by a customer and the article is for use of, and not for resale by, such customer, the transaction shall be deemed to be a sale at retail and the person producing the article shall be deemed

to be the person selling such article at retail for the purposes of such section. The tax on such a transaction shall be computed and paid by such person upon the fair retail market value, as determined by the Secretary of the Treasury or his delegate, of the finished article.

The provisions of section 4012(a) of the Code are relevant only to the fur articles upon which a retailers excise tax is imposed by section 4011 of the Code. There is no similar provision in the law or regulations with respect to the tax on luggage, handbags, etc.

Accordingly, the transaction described above is a contract for labor and materials rather than a sale of the luggage produced. Therefore, it is held that any charge made by the manufacturer incident to producing luggage from material owned by the customer under the circumstances stated is not subject to the retailers excise tax imposed by section 4031 of the Code.

It should be noted that this conclusion would not apply to any situation in which all of the circumstances (including the manner in which the customer acquired the materials) indicate that the substance of the transaction is the sale at retail of the luggage produced.

Rev. Rul. 62-84

A "writing portfolio" which is capable of being closed on all four sides and which is designed for carrying "social" stationery is considered to be a briefcase within the meaning of section 4031 of the Internal Revenue Code of 1954. Therefore, the retailer's sales of this briefcase are subject to the retailers excise tax on luggage, handbags, etc., imposed by that section.

Advice has been requested whether the retailers excise tax on the sale of luggage, handbags, etc., applies to the sale of the portfolio described below.

A retailer sells a so-called "writing portfolio" which is made of plastic. This portfolio may be closed on all four sides by means of a zipper. When it is closed, the outside measurements are approximately 9 inches by 11¾ inches. One side of the portfolio is equipped with a full length gusset pocket, with a divider for carrying correspondence and stationery. The pocket measures approximately 7½ inches by 11 inches. It is designed for carrying "social" stationery and is not suitable for carrying what is ordinary considered to be "business" stationery. On the outside of this pocket there are three small compartments which contain an address book, a calendar, and a postage stamp holder. The other side of the portfolio is equipped with a blotter pad.

Section 4031 of the Internal Revenue Code of 1954 imposes a tax upon certain enumerated articles, by whatever name called, when sold at retail. Among the enumerated articles are "briefcases."

Section 48.4031-1(b)(2) of the Manufacturers and Retailers Excise Tax Regulations provides that the term "briefcases" includes so-called "portfolios," "envelopes," etc., capable of being closed on all four sides which are designed and constructed for carrying or conveying unfolded legal-size or letter-size papers, documents, etc., but that it does not include "portfolios," "envelopes," etc., designed and constructed primarily for storage purposes.

The term "letter-size papers" as used in the regulations is not restricted in meaning to any standardized size of paper for either business or personal use. Hence, variable sized sheets of paper intended for use in writing letters, either social or business, are considered to be of letter size.

In view of the foregoing, it is held that the "writing portfolio" described above, which is capable of being closed on all four sides and is designed and constructed for carrying unfolded social stationery, is a briefcase within the meaning of section 4031 of the Code. Therefore, the retailers excise tax imposed by that section applies to the retail sale of that article.

Rev. Rul. 62-87

The retailers excise tax on luggage, handbags, etc., imposed by section 4031 of the Internal Revenue Code of 1954, applies to the sale at retail of certain so-called "shoppers" which by reason of their features of design, size, etc., are considered to be handbags. On the other hand, the tax does not apply to sales of certain other "shoppers," which are considered to be shopping bags, because they do not have the features of design, etc., which would bring them within the scope of shopping bags which are "suitable for use as purses or handbags."

Advice has been requested whether the retailers excise tax on luggage, handbags, etc., applies to the sale at retail of the articles described below.

A retailer sells certain articles which are advertised as "shoppers." These articles fall within two general groups. In the first group are articles of various sizes ranging from 10 to 17 inches in length, 5 to 8 inches in width, and 10 to 11 inches in depth. Each of the articles within this group is lined and is equipped with handles at the top for carrying and a top-center closure. They are made of reed or straw materials and are either painted or otherwise decorated on the outside. These articles are made in various shapes which closely resemble the shapes of other articles commonly marketed as "handbags."

In the second group are articles all of which are approximately 16 inches in length, 5 inches in width, and 9 inches in depth. Each of the articles in this group has handles at the top for carrying and is designed so as to provide a full-length top opening with no closure. They are unlined and have no inside or outside pockets or compartments. These articles are made of rush grass or maize grass materials.

Section 4031 of the Internal Revenue Code of 1954 imposes a tax upon certain articles, by whatever name called, sold at retail. Among those enumerated are "purses and handbags" and "knitting or shopping bags (suitable for use as purses or handbags)."

Section 48.4031-1(b) of the Manufacturers and Retailers Excise Tax Regulations provides, in part, as follows:

Meaning of terms.—(1) *In general.*—For purposes of the tax imposed by section 4031, the articles listed in such section include all receptacles commonly or commercially known and sold as such regardless of design, size, or materials from which made or the purpose for which they are to be used. If there is doubt as to whether an article is taxable, the manner in which the article is advertised or otherwise held out for sale shall be considered. The articles listed in section 4031 include any such articles regardless of the name attached to, or associated with, the articles for merchandising or other reasons. * * *

* * * * *

(3) *Knitting or shopping bags.*—A knitting or shopping bag shall be considered suitable for use as a purse or handbag, for purposes of the tax imposed by section 4031, if it is capable of being carried in the hand, or hung on the arm or across the shoulder, and if—

(i) The bag has a secure closure, or

(ii) The bag has a built-in purse, side pocket, or compartment closed by a zipper, snap fastener, or other secure closure, provided the bag, or the built-in purse, side pocket, or compartment, is capable, when open, of holding the normal contents of a purse or handbag.

The articles in the first group described above have the same features of design, etc., and are within the same size ranges as many bag-type and basket-type articles made of reed, straw, rattan, wood, rush grass, maize grass, and similar materials which are advertised and sold as “handbags.” They also have the required characteristics as to suitability for use as a purse or handbag. Therefore, in view of the quoted provisions of the regulations, the articles in the first group are considered to be handbags for purposes of section 4031 of the Code.

The articles in the second group have features of design, etc., of shopping bags. However, because they do not have, among other things, inside or outside purses, pockets, or compartments, and have no closures for the full-length top openings, they are not considered to be shopping bags which are “suitable for use as purses or handbags” for purposes of section 4031 of the Code.

Accordingly, it is held that (1) the retailers excise tax on luggage, handbags, etc., applies to the sale at retail of the handbags in the first group described in the instant case and (2) the tax does not apply to the sale of the articles included in the second group.

Whether sales of articles to the International Bank for Reconstruction and Development, and similar organizations, are immune from the retailers excise tax. See Rev. Rul. 62-55, page 188.

The application of the retailers excise tax to the exchange of taxable articles for coupons issued in connection with the sale of other products. See Rev. Rul. 62-90, page 190.

SUBCHAPTER E.—SPECIAL FUELS

SECTION 4041.—IMPOSITION OF TAX

26 CFR 48.4041-1: Tax on diesel fuel and special motor fuel.

Whether sales of articles to the International Bank for Reconstruction and Development, and similar organizations, are immune from the retailers excise tax. See Rev. Rul. 62-55, page 188.

SUBCHAPTER F.—SPECIAL PROVISIONS APPLICABLE TO
RETAILERS TAXSECTION 4057.—EXEMPTION FOR NONPROFIT
EDUCATIONAL ORGANIZATIONS

26 CFR 148.1-4: Tax-free sales or services
to certain nonprofit educational organiza-
tions.

Rev. Rul. 62-6

(Also Sections 4221, 4294.)

A nonprofit organization which was established for the training, educating, and rehabilitating of mentally handicapped children and which meets the prescribed requirements concerning formal instruction, faculty, curriculum, and student body enrollment comes within the scope of the term "nonprofit educational organization" for purposes of the exemptions from the retailers excise taxes, the manufacturers excise taxes, and the communications and transportation taxes, provided by sections 4057(a), 4221(a)(5), and 4294(a), respectively, of the Internal Revenue Code of 1954. However, another nonprofit organization which is operated primarily as a residential facility for handicapped children does not come within the scope of the term "nonprofit educational organization."

Advice has been requested whether the two organizations referred to below as "*M*" and "*N*" come within the scope of the term "nonprofit educational organization" for purposes of the exemptions from the retailers excise taxes, the manufacturers excise taxes, and the communications and transportation taxes, provided by sections 4057(a), 4221(a)(5), and 4294(a), respectively, of the Internal Revenue Code of 1954.

M is a nonprofit organization established for the training, educating, and rehabilitating of mentally handicapped children. It operates on a 5-day-week basis and has an enrollment of approximately 75 students. It maintains a staff of nine, consisting of a director, five teachers (one of whom is a nurse and one a speech therapist), a bus driver, a maid, and a clerk-typist. In order to develop each child to his potential, the school offers a complete academic program which includes the teaching of numbers, colors, music, arithmetic, weaving, woodworking, ceramics, and homemaking. The curriculum is basically the same as that provided in public schools for retarded children, in which the curriculum is geared to the level of competence of the students. Organized play and socialization are also offered, and social events are held periodically to round out each child's education and experience.

N, a residential facility for mentally handicapped children, is located in the same general area as *M*, except that *N* is situated in a rural section. *N* is operated by an association for retarded children, which is exempt from income tax under section 501(a) of the Code as a nonprofit organization described in section 501(c)(3). *N* has complete facilities for year around boarding as well as some facilities for educational and vocational training.

N maintains a staff of five, consisting of a director, a nurse who also serves as housemother, a cook, a maid, and a maintenance man. The

ten children who reside at *N* attend the *M* school in town during the regular school year. During the summer vacation, the children participate in a program of recreation, including outdoor play and swimming instruction. Some of them are given training in animal care, in gardening, or in special crafts. Transportation is provided so the children may take advantage of the nearby entertainment facilities and cultural opportunities.

During the summer, some of the students who attend *M* school, but who do not reside at *N*, come to *N* on a daily basis to participate in the athletic program and other activities.

Sections 4057(a) and 4221(a)(5) of the Code provide that, under regulations prescribed by the Secretary of the Treasury or his delegate, no retailers excise taxes or manufacturers excise taxes shall be imposed with respect to the sale of taxable articles to a nonprofit educational organization for its exclusive use, or in the case of a tax imposed by section 4041, with respect to the use by a nonprofit educational organization of any liquid as a fuel.

Section 4294(a) of the Code provides that, under regulations prescribed by the Secretary or his delegate, no tax shall be imposed under section 4251 or 4261 on any amount paid by a nonprofit educational organization for services or facilities furnished to such organization.

Under the provisions of sections 4057(b), 4221(d)(5), and 4294(b) of the Code, the term "nonprofit educational organization" means an educational organization which is exempt from income tax under section 501(a) and which normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on. The term also includes a school operated as an activity of an organization described in section 501(c)(3) which is exempt from income tax under 501(a), if such school normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on.

Section 148.1-4(b) of the temporary rules relating to registration and exemption for nonprofit educational organizations, T.D. 6344, C.B. 1959-1, 776, provides, in part, that the term "nonprofit educational organization" means an organization exempt from income tax under section 501(a) of the Code whose primary function is the presentation of formal instruction and which normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on.

The fact that an organization may have been granted exemption from Federal income tax as an organization described in section 501(c)(3) of the Code does not, of itself, determine whether that organization (or an activity of that organization) comes within the scope of the term "nonprofit educational organization" for purposes of the excise tax exemptions involved here. Whether an organization (or an activity of an organization) comes within the scope of the term "nonprofit educational organization" depends upon whether the organization (or the activity of an organization) meets the requirements of normally maintaining a regular faculty and curriculum, normally having a regularly enrolled body of pupils or students, and

having as its primary function the presentation of formal instruction, in accordance with the definition in the statute and in section 148.1-4(b) of the temporary rules. These requirements are consistent with the Congressional intent to provide exemptions covering articles sold to, or services or facilities furnished to, nonprofit private schools which are set up and operated primarily for the same basic purposes as public schools. See II. Rept. 481, 85th Cong., 2d sess., C.B. 1958-3, 372, at 385.

In view of the foregoing, it is held that *M* is a "nonprofit educational organization" within the meaning of sections 4057(b), 4221(d)(5), and 4294(b) of the Code and section 148.1-4(b) of the temporary rules. Accordingly, articles which otherwise would be subject to the retailers excise taxes may be sold to *M* on a tax exempt basis, subject to the exemption certificate requirements of section 148.1-4(c) of the temporary rules. Likewise, articles which otherwise would be subject to the manufacturers excise taxes may be sold to *M* on a tax-exempt basis, subject to the registration and evidence provisions of section 148.1-3 of the temporary rules. Furthermore, communications and transportation services and facilities may be furnished to *M* on a tax-exempt basis, subject to the exemption certificate requirements of sections 148.1-4(e) and 148.1-4(f) of the temporary rules.

However, *N* is primarily a residential facility and is not a "nonprofit educational organization" within the meaning of the aforementioned sections of the Code and temporary rules. Accordingly, articles sold to, or services and facilities furnished to, *N* do not come within the scope of the exemptions from the retailers excise taxes, the manufacturers excise taxes, and the communications and transportation taxes.

(Also Sections 4221, 4294.)

Rev. Rul. 62-23

As a part of its over-all program of varied activities, a boys' club offers to its members, on an optional basis, numerous courses which are not related as parts of any planned continuity of study. *Held*, the club does not come within the scope of the term "nonprofit educational organization" for purposes of the exemptions from retailers excise taxes, the manufacturers excise taxes, and the communications and transportation taxes, provided by sections 4057(a), 4221(a)(5), and 4294(a), respectively, of the Internal Revenue Code of 1954.

Advice has been requested whether the boys' club described below comes within the scope of the term "nonprofit educational organization" for purposes of the exemptions from the retailers excise taxes, the manufacturers excise taxes, and the communications and transportation taxes, provided by sections 4057(a), 4221(a)(5), and 4294(a), respectively, of the Internal Revenue Code of 1954.

A boys' club was organized in a certain city for the purpose of elevating and advancing the moral, intellectual, and social conditions of boys and training and educating them for the duties of citizenship. Membership in the club is open to boys between the ages of seven and one-half to 20 years.

The club provides an extensive physical education program and also conducts regular classes in such subjects as model building, art.

woodwork, metalwork, printing, handicraft, radio, photography, toy repair, auto mechanics, music, and industrial arts. All classes meet daily during club hours on Monday through Saturday and are under the guidance of specially trained instructors. The courses are made available to the members of the club as part of the club's over-all program, and the boys are encouraged to study as many subjects as they can. No prescribed number of courses is required, and the courses are not related to each other as part of any planned continuity of study.

The club also promotes a variety of other activities and events, such as hobby groups, day camping, resident camping, awards night, parents' night, sports night, honor night, and a special night devoted to the presentation of a variety show. The club is open to the boys in the late afternoons and evenings on school days and all day on Saturdays.

The club has been granted exemption from Federal income tax under section 501(a) of the Code as an organization described in section 501(c)(3) of the Code.

Sections 4057(a) and 4221(a)(5) of the Code provide that, under regulations prescribed by the Secretary of the Treasury or his delegate, no retailers excise taxes or manufacturers excise taxes shall be imposed with respect to the sale of any article to a nonprofit educational organization for its exclusive use.

Section 4294(a) of the Code provides that, under regulations prescribed by the Secretary or his delegate, no tax shall be imposed under section 4251 or 4261 on any amount paid by a nonprofit educational organization for services or facilities furnished to such organization.

Under the provisions of sections 4057(b), 4221(d)(5), and 4294(b) of the Code, the term "nonprofit educational organization" means an educational organization which is exempt from income tax under section 501(a) of the Code and which normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on. The term also includes a school operated as an activity of an organization described in section 501(c)(3) of the Code which is exempt from income tax under section 501(a), if such school normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on.

Section 148.1-4(b) of the temporary rules relating to registration requirements and exemption for nonprofit educational organizations, Treasury Decision 6344, C.B. 1959-1, 776, provides, in part, that the term "nonprofit educational organization" means an organization exempt from income tax under section 501(a) of the Code whose primary function is the presentation of formal instruction and which normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on.

The fact that an organization may have been granted exemption from Federal income tax as an organization described in section 501(c)(3) of the Code does not, alone, determine the applicability of the exemptions from the retailers excise taxes, the manufacturers

excise taxes, and the communications and transportation taxes. In order for those exemptions to apply, an organization (or a school operated as an activity of such organization) must meet the requirements of a "nonprofit educational organization" as defined in sections 4057(b), 4221(d)(5), and 4294(b) of the Code and in section 148.1-4(b) of the temporary rules.

Although the boys' club here considered offers classes of instruction in various subjects to members of the club on an optional basis, the courses do not represent a "curriculum" within the meaning of the Code. This heterogeneous collection of courses is not "formal instruction" within the meaning of section 148.1-4(b) of the temporary rules. The classes primarily serve to implement the other activities of the club rather than to represent an activity which would be a "school" of the type referred to in the statute.

Accordingly, it is held that this boys' club does not come within the scope of the term "nonprofit educational organization" as defined in sections 4057(b), 4221(d)(5), and 4294(b) of the Code and in section 148.1-4(b) of the temporary rules. Therefore, the exemptions from the retailers excise taxes and the manufacturers excise taxes, provided by sections 4057(a) and 4221(a)(5) of the Code, do not apply to sales of taxable articles to the club. Furthermore, the exemption from the communications and transportation taxes, provided by section 4294(a) of the Code, does not apply to any amount paid by the club for services or facilities furnished to the club.

CHAPTER 32.—MANUFACTURERS EXCISE TAXES

SUBCHAPTER A.—AUTOMOTIVE AND RELATED ITEMS

PART I.—MOTOR VEHICLES

SECTION 4061.—IMPOSITION OF TAX

26 CFR 40.4061(a)-1: Imposition of tax.

Whether, for purposes of the manufacturers excise tax on motor vehicle articles, an automobile truck tank body manufacturer's separate charges for a "finish" coat of paint and special lettering are part of the price for which his tank body is sold. See Rev. Rul. 62-4, page 214.

Whether sales of articles to the International Bank for Reconstruction and Development, and similar organizations, are immune from the manufacturers excise tax. See Rev. Rul. 62-55, page 188.

26 CFR 40.4061(b)-1: Imposition of tax.

Rev. Rul. 62-33

At the request of purchasers, a manufacturer of taxable automobile batteries, modifies such batteries by cutting or removing the

standard "S.A.E. type taper" terminals and "burning on" special terminals. Such modifications do not change the basic characteristics of the batteries, which are still considered to be "suitable for use" with taxable motor vehicles. Accordingly, the manufacturer's sales of these modified batteries are subject to the manufacturers excise tax on automobile parts or accessories imposed by section 4061(b) of the Internal Revenue Code of 1954.

Advice has been requested concerning the applicability of the manufacturers excise tax on automobile parts or accessories under the circumstances described below.

A company manufactures six-volt and 12-volt electric storage batteries of the lead acid type which are advertised and sold for use with automobiles, trucks, and buses. These batteries are equipped with standard "S.A.E. type taper" terminals, and the battery casings are embossed with words or symbols which indicate that the batteries are for use with automotive vehicles.

At the request of a purchaser, the company will, without extra charge, cut or remove the standard terminals and "burn on" special terminals. With these special terminals the batteries may be used conveniently with inter-communication systems, "stand-by" emergency lighting, laboratory and hospital equipment, various types of generating plants, etc.

Section 4061(b) of the Code imposes a tax on the sale by the manufacturer, producer, or importer of parts or accessories (other than tires and inner tubes and other than automobile radio and television receiving sets) for any of the articles enumerated in section 4061(a) of the Code.

Section 4062(a) of the Code provides that, for purposes of section 4061, certain articles, which are suitable for use on or in connection with, or as component parts of, any of the articles enumerated in section 4061(a), shall be considered parts or accessories for such articles, whether or not primarily adapted for such use. Storage batteries are included among the articles for which this special definition is provided in the statute.

Prior to their modification, the electric storage batteries in the instant case are "suitable for use" with taxable motor vehicles and are considered to be parts or accessories for such vehicles within the meaning of section 4062(a) of the Code.

The fact that batteries are equipped with terminals other than the standard "S.A.E. type taper" terminals does not, in and of itself, provide an adequate basis for concluding that the batteries are not "suitable for use" with taxable motor vehicles. See Revenue Ruling 61-94, C.B. 1961-1, 475, which also states that a battery which is produced by the manufacturer for automotive vehicle use or held out and sold for such use will be assumed to be "suitable for use" with automotive vehicles. A battery will be deemed to be held out and sold for use with automotive vehicles if the battery case itself contains any wording, emblem, symbol, etc., which indicates or denotes that the battery is for use in such a vehicle.

In the instant case, the fact that the manufacturer cuts or removes the standard terminals from batteries which, when sold by the manufacturer, are otherwise "suitable for use" with taxable motor vehicles and "burns on" special terminals does not change the basic characteristics of the batteries. Accordingly, it is held that sales by the man-

ufacturer of these modified batteries are subject to the manufacturers excise tax imposed by section 4061(b) of the Code.

Whether sales of articles to the International Bank for Reconstruction and Development, and similar organizations, are immune from the manufacturers excise tax. See Rev. Rul. 62-55, page 188.

26 CFR 40.4061(b)-2: Definition of parts
or accessories.

Rev. Rul. 62-50

Various companies manufacture and sell so-called "telescopic clothes hanger bars" which are designed for use in hanging clothes over the rear seats of passenger automobiles. For purposes of temporary across-the-car installation, the ends of these bars are equipped with rings or other devices by which they can be attached to the clothes hanger hooks in most automobiles or wedged over the window frame or the trim. The length of these bars can be adjusted to fit the interior width of various automobiles. In addition to automotive use, these clothes hanger bars can be used in closets, storage rooms, etc., by fastening hooks or similar devices to the walls. Accordingly, they are advertised for both automotive and home use. However, it has been determined that such devices are used primarily in connection with automobiles. *Held*, since the clothes hanger bars described above are designed to be attached to automobiles and are primarily used in connection with automobiles, they are automobile "parts or accessories" for purposes of the manufacturers excise tax. Therefore, sales of the bars by the manufacturers thereof are subject to the manufacturers excise tax imposed by section 4061(b) of the Internal Revenue Code of 1954.

PART II.—TIRES AND TUBES

SECTION 4071.—IMPOSITION OF TAX

26 CFR 48.4071-1: Imposition and rates of tax.

Whether sales of articles to the International Bank for Reconstruction and Development, and similar organizations, are immune from the manufacturers excise tax. See Rev. Rul. 62-55, page 188.

PART III.—PETROLEUM PRODUCTS

Subpart A.—Gasoline

SECTION 4081.—IMPOSITION OF TAX

26 CFR 48.4081-1: Imposition and rates of tax.

Whether sales of gasoline to the International Bank for Reconstruction and Development, and similar organizations, are immune from the manufacturers excise tax. See Rev. Rul. 62-55, page 188.

Subpart B.—Lubricating Oil

SECTION 4091.—IMPOSITION OF TAX

26 CFR 48.4091-1: Tax on lubricating oil.

Whether sales of lubricating oil to the International Bank for Reconstruction and Development, and similar organizations, are immune from the manufacturers excise tax. See Rev. Rul. 62-55, page 188.

26 CFR 48.4091-2: Definitions.

Applicability of the manufacturers excise tax to the use of lubricating oil in producing nontaxable grease or nontaxable lubricating oil. See Rev. Rul. 62-51, page 218.

SUBCHAPTER B.—HOUSEHOLD TYPE EQUIPMENT, ETC.**PART I.—REFRIGERATION EQUIPMENT**

SECTION 4111.—IMPOSITION OF TAX

26 CFR 48.4111-1: Imposition of tax.

Whether sales of articles to the International Bank for Reconstruction and Development, and similar organizations, are immune from the manufacturers excise tax. See Rev. Rul. 62-55, page 188.

PART II.—ELECTRIC, GAS, AND OIL APPLIANCES

SECTION 4121.—IMPOSITION OF TAX

26 CFR 48.4121-1: Imposition of tax.

Rev. Rul. 62-88

A gas clothes drier which is specifically designed and constructed for use in commercial and industrial installations is not an article of the household type within the meaning of section 4121 of the Internal Revenue Code of 1954 and the regulations thereunder. Therefore, sales of such articles by the manufacturer, producer, or importer thereof are not subject to the manufacturers excise tax imposed by that section of the Code.

Advice has been requested whether the manufacturers excise tax on certain electric, gas, and oil appliances applies to sales of the so-called “commercial gas clothes drier” described below.

The so-called “commercial gas clothes drier” measures approximately 73 inches high by 40 inches wide by 45 inches deep and weighs

approximately 570 pounds. It has a 38-inch by 30-inch cylinder which holds 50 pounds of clothes. Also, it is equipped with a one-half horsepower motor and has a total input rating of 130,000 B.T.U.'s. The drier is available with or without coin meter and timer mechanisms. It is stated to be specifically designed and constructed for use in industrial installations, motels, mobile home sites, and self-service laundries.

Section 4121 of the Internal Revenue Code of 1954 imposes a tax upon the sale by the manufacturer, producer, or importer of certain enumerated "articles of the household type," including electric or gas clothes driers. Section 48.4121-2(a) of the Manufacturers and Retailers Excise Tax Regulations provides that the term "articles of the household type" includes all articles enumerated in section 4121 which have an actual, practical, commercial fitness, or are specifically designed and constructed, for household use.

The features of design and construction of the gas clothes drier described above indicate it is for use in commercial and industrial installations rather than for domestic or household type use. Accordingly, this gas clothes drier is not an article of the household type within the meaning of section 4121 of the Code and the regulations thereunder. Therefore, it is held that the sale of this drier by its manufacturer, producer, or importer is not subject to the manufacturers excise tax imposed by that section of the Code.

Compare Revenue Ruling 56-699, C.B. 1956-2, 806, which relates to the taxability of certain household type clothes driers which are equipped with coin-operated switch mechanisms to facilitate their use in self-service laundries, etc.

Whether sales of articles to the International Bank for Reconstruction and Development, and similar organizations, are immune from the manufacturers excise tax. See Rev. Rul. 62-55, page 188.

PART III.—ELECTRIC LIGHT BULBS

SECTION 4131.—IMPOSITION OF TAX

26 CFR 48.4131-1: Imposition of tax.

Whether sales of articles to the International Bank for Reconstruction and Development, and similar organizations, are immune from the manufacturers excise tax. See Rev. Rul. 62-55, page 188.

26 CFR 48.4131-2: Definitions.

Rev. Rul. 62-34

The manufacturers excise tax imposed upon electric light bulbs and tubes by section 4131 of the Internal Revenue Code of 1954 applies to the manufacturer's sales of a so-called "electroluminescent nite lite" which comes within the scope of the definition set forth in section 48.4131-2 of the Manufacturers and Retailers Excise Tax Regulations.

Advice has been requested whether the manufacturers excise tax on electric light bulbs and tubes applies to the manufacturer's sales of the so-called "electroluminescent nite lite" described below.

The plastic night light fixture has a flat rectangular appearance. It measures approximately two and three-fourths inches by two and one-half inches and is about one-half inch thick. An electrical plug extends from the fixture for insertion in a standard electrical outlet.

The source of illumination in the night light is a so-called "electroluminescent lamp" which produces a relatively soft light. This element is a sheet-like material somewhat similar in thickness to a plasticized identification card. The electroluminescent lamp is constructed on a base of aluminum foil, which serves as a conductive surface. It also includes successive layers of organic dielectric, phosphor, and a transparent conductive outer surface. Suitable electrical contacts are made to the conductive layers. A plastic covering is added to the front and to the back for insulation.

The light source functions in much the same manner as a capacitor. That is, the electric field that exists between the conductive layers (or plates) energizes the phosphor sufficiently to cause it to radiate energy in the visible spectrum. The color of the light thus produced depends upon the color of the phosphor used.

Section 4131 of the Internal Revenue Code of 1954 imposes a tax upon the sale by the manufacturer, producer, or importer of electric light bulbs and tubes.

Section 48.4131-2 of the Manufacturers and Retailers Excise Tax Regulations provides that, for purposes of the tax imposed by section 4131, the term "electric light bulbs and tubes" includes any device designed for the diffusion of artificial light for illuminative or decorative purposes through the use of electricity.

It is immaterial, for purposes of that definition, whether the artificial light is produced by a process of incandescence, by fluorescence, or by luminescence. The "electroluminescent nite lite" described above is a device designed for the diffusion of artificial light for illuminative purposes through the use of electricity. Accordingly, it is held that this device is an "electric light bulb or tube" within the scope of the definition set forth in section 48.4131-2 of the regulations. Therefore, sales of these articles by manufacturers, producers, or importers thereof are subject to the manufacturers excise tax imposed by section 4131 of the Code.

Under the authority contained in section 7805(b) of the Code, this Revenue Ruling will be applied only to sales made by manufacturers, producers, or importers on and after May 1, 1962.

SUBCHAPTER C.—ENTERTAINMENT EQUIPMENT**PART L.—RADIO AND TELEVISION SETS, PHONOGRAPHS AND RECORDS, ETC.****SECTION 4141.—IMPOSITION OF TAX**

26 CFR 48.4141-1: Imposition and rate of tax.

Whether sales of articles to the International Bank for Reconstruction and Development, and similar organizations, are immune from the manufacturers excise tax. See Rev. Rul. 62-55, page 188.

SECTION 4142.—DEFINITION OF RADIO AND TELEVISION COMPONENT

26 CFR 48.4142-1: Radio and television components.

Rev. Rul. 62-62

Cabinets and so-called "stands" designed to enclose complete television receiving sets come within the scope of the term "radio and television components" as defined by section 4142 of the Internal Revenue Code of 1954. Therefore, sales of these articles by the manufacturer, producer, or importer thereof are subject to the manufacturers excise tax imposed by section 4141 of the Code.

Advice has been requested whether certain cabinets and so-called "stands," which are designed to enclose television receiving sets, are considered to be television components within the meaning of section 4142 of the Internal Revenue Code of 1954.

A manufacturer of television receiving sets also manufactures decorative cabinets of various styles, sizes, colors, and finishes, which are designed to match the decor or period style of the furniture in a particular room. They are built with doors, and they have no shelves. Although they also may be used as book cases, liquor cabinets, etc., they are designed, advertised, and sold as enclosures for table model television receiving sets. When such a cabinet is used to enclose a television receiving set, the set itself remains enclosed in its original cabinet and is a complete unit which operates independently of the decorative cabinet.

The company also manufactures a "stand" which is designed as a partial enclosure for a table model television receiving set. This article has four legs and is equipped with a bottom panel, a top panel, and two side panels, but it has no front or rear panel. When a television receiving set is placed in the stand, the set is enclosed except for the front and rear sections.

A television receiving set may be readily removed from the decorative cabinet or from the stand and used elsewhere.

Section 4141 of the Code imposes a tax upon the sale by the manufacturer, producer, or importer of certain articles, among which are "television receiving sets" and "radio and television components."

Section 4142 of the Code defines the term "radio and television components" to mean chassis, cabinets, tubes, speakers, amplifiers, power supply units, antennae of the "built-in" type, phonograph mecha-

nisms, and phonograph record-players, which are suitable for use on or in connection with, or as component parts of, any of the articles enumerated in section 4141, whether or not primarily adapted for such use.

Section 48.4142-1(a) of the Manufacturers and Retailers Excise Tax Regulations provides that, in general, the term "radio and television components" means, among other things, cabinets which are suitable for use on or in connection with, or as a component part of, any radio or television receiving set, phonograph, or combination of any of the foregoing. Section 48.4142-1(c) (2) of the regulations provides that the term "cabinets" includes containers suitable for housing a chassis for any radio or television receiving set, phonograph, or combination of any of the foregoing.

The Internal Revenue Service considers that the term "cabinet" for a television receiving set, as meant by section 4142 of the Code and section 48.4142-1 of the regulations, includes an enclosure which covers the sides and top of a table model television set as well as furnishing a support for such set.

Since the so-called "stand," which has bottom, top and side panels, and the decorative cabinets enclose television receiving sets, they are cabinets and are suitable for use on or in connection with television receiving sets. Therefore, it is held that they come within the scope of the term "radio and television components" as defined by section 4142 of the Code. Accordingly, the sale of such a cabinet or "stand" by the manufacturer, producer, or importer thereof is subject to the manufacturers excise tax imposed by section 4141 of the Code.

On the other hand, a table which merely supports a table model television receiving set without covering the sides and top of the set is not considered to be a cabinet within the meaning of the law and regulations. The sale of such a table is not subject to the manufacturers excise tax.

PART II.—MUSICAL INSTRUMENTS

SECTION 4151.—IMPOSITION OF TAX

26 CFR 48.4151-1: Imposition and rate of tax.

Rev. Rul. 62-44

A wind instrument consists of a plastic tube approximately 11 inches long. It has a removable plastic mouthpiece and has seven finger holes on one side and a thumb rest and finger hole on the other. Two musical scales may be played on it.

A percussion instrument consists of twelve metal tubes of the same diameter mounted in a frame. The tubes differ in length, graduating from approximately five inches to nine inches. The notes which they produce range from "middle C" to "G" above "high C." It is played by striking the tubes with a wooden mallet.

Held, because of the limitations on the use of the articles, they are not generally suitable for the rendition of musical compositions or adaptable for teaching music and are not subject to the manufacturers excise tax on musical instruments imposed by section 4151 of the Internal Revenue Code of 1954.

Advice has been requested concerning the applicability of the manufacturers excise tax on musical instruments, imposed by section 4151 of the Internal Revenue Code of 1954, to sales by the manufacturer of the articles described below.

(1) *A wind instrument.*—This article consists of a plastic tube approximately 11 inches long and a removable plastic mouthpiece. It has seven finger holes on one side of the tube and a thumb rest and a finger hole on the other side. Two complete musical scales may be played on the article by manipulating the fingers over these holes and blowing into the mouthpiece.

(2) *A percussion instrument.*—This article consists of 12 metal tubes of the same diameter mounted in a frame. The metal tubes are graduated in length from approximately five inches for the smallest to nine inches for the longest. The notes which they produce range from "middle C" to "G" above "high C." The article is played by striking the metal tubes with a wooden mallet.

The instruments are designed, advertised, and sold for use as tools to test musical potential and to develop and encourage interest in music for the purpose of preparing a student for the playing of a musical instrument. The selections that may be played on both the wind instrument and the percussion instrument by reason of the limitations in design and other characteristics of the devices are limited. Few musical compositions arranged for standard instruments can be played on these articles.

Section 4151 of the Code imposes a tax upon the sale of musical instruments by the manufacturer, producer, or importer thereof.

Under the provisions of section 48.4151-1(d) of the Manufacturers and Retailers Excise Tax Regulations, the term "musical instruments" includes all wind, reed, string, percussion or electronic instruments used to produce music, including but not limited to all types of pianos and organs, trombones, saxophones, violins, drums, xylophones, chimes, etc. The term does not include articles in the nature of toys or novelties which simulate musical instruments and which are unsuitable for use in playing musical compositions or in teaching music.

In determining whether a particular article is a musical instrument, consideration is given to a variety of factors. Among them are the primary purposes for which the article is designed; the quality of construction of the article; whether it is a type ordinarily used in the rendition of musical compositions, either in solo presentation or in connection with other musical instruments, or whether it is adaptable for teaching proficiency in the use of musical instruments. In considering the last two factors it is not essential that the article used in musical rendition or instruction be of a professional standard or quality. The aforementioned factors are not all inclusive, and no one of them is determinative of the taxability of a particular article.

The instruments here under consideration are widely used to test the musical potential of children and to encourage the instruction of music; they are of a design and quality comparable to toys or novelties which simulate musical instruments, and their relationship to the actual teaching of music is limited to determining whether children have sufficient natural musical ability to warrant the additional instruction required to teach them proficiency in the use of a standard

musical instrument. Thus, these instruments are not "musical instruments" as defined in section 48.4151-1(d) of the regulations.

Based upon the foregoing, it is held that the articles described are not musical instruments within the meaning and intent of the law and regulations. Accordingly, the manufacturers' sales of such articles are not subject to the tax imposed by section 4151 of the Code.

Whether sales of articles to the International Bank for Reconstruction and Development, and similar organizations, are immune from the manufacturers excise tax. See Rev. Rul. 62-55, page 188.

SUBCHAPTER D.—RECREATIONAL EQUIPMENT

PART I.—SPORTING GOODS

SECTION 4161.—IMPOSITION OF TAX

26 CFR 48.4161-1: Imposition and rate of tax. Rev. Rul. 62-19

The manufacturers excise tax on certain enumerated articles which are commonly referred to as "sporting goods," imposed by section 4161 of the Internal Revenue Code of 1954, applies to the sale by the manufacturer of croquet balls and mallets which are designed and constructed so as to be suitable for practical use by children in the conventional game of croquet, even though the balls and mallets are not of sufficient size to permit their use in adult competition under rules established by various national and international associations.

Advice has been requested whether sales of certain croquet balls and mallets designed for use by children are subject to the manufacturers excise tax on sporting goods.

A company manufactures and sells wooden balls and mallets for resale in a so-called "children's croquet set," which also contains other items, such as posts, wire wickets, and wicket bases. These articles, which are designed and constructed for use by children, are smaller in size than the articles which must be used in "regulation" croquet games under rules established by various national and international associations. For example, the balls have a diameter of two inches, whereas the "regulation" croquet balls, under most association rules, must have a diameter of three inches or more. The mallets are likewise of smaller size, the mallet head being one and one-half inches in diameter and five inches in length, whereas the "regulation" mallets usually have heads with a diameter of about three inches and a length of from six to nine inches.

The equipment described above is so constructed that the game may be played in the same manner as, and with the same essential features of, the "regulation" game of croquet. However, the equipment is designed for use in an area considerably smaller than that required for a "regulation" game. By using the wicket bases, a game can be played indoors.

Section 4161 of the Internal Revenue Code of 1954 imposes a tax upon the sale by the manufacturer, producer, or importer of certain

enumerated articles which are commonly referred to as "sporting goods." Included in the taxable articles enumerated are "croquet balls and mallets."

Section 48.4161-1(a)(2) of the Manufacturers and Retailers Excise Tax Regulations provides that the tax attaches to the sale of any articles specified in section 4161 of the Code which is designed or constructed for use in playing or participating in the conventional game or sport with which the particular article is associated. However, the tax does not attach to the sale of articles in the nature of toys or novelties which simulate sporting goods of the type referred to and which are not designed or constructed for use as provided in the preceding sentence.

The tax imposed by section 4161 of the Code is not limited to articles which are designed or constructed for use in games or sports as they are played under rules or regulations established by national or international associations for competition by adults. In addition to such "regulation" games or sports, the term "conventional game or sport" referred to above includes any game or sport which embodies the general character of the "regulation" game or sport but which may not be played according to all of the same rigid rules or regulations, such as those controlling the size of the equipment or the size of the playing area.

The tax is imposed on sporting goods enumerated in section 4161 if they are constructed so as to be fit for practical use in the sport to which they relate, irrespective of whether they are designed to be used by children or by adults. For example, see Revenue Ruling 58-202, C.B. 1958-1, 416, which relates to skis and ski poles designed for use by children.

The croquet balls and mallets described above are considered to be designed and constructed so as to be suitable for practical use by children in a game of croquet which parallels or has the essential features of the "regulation" game of croquet. Therefore, it is held that the manufacturers excise tax imposed by section 4161 of the Code applies to the price for which the balls and mallets are sold at wholesale by the manufacturer. See Revenue Ruling 60-259, C.B. 1960-2, 318, which sets forth the method of computing the tax liability on the sale of a croquet set which contains both taxable and nontaxable articles.

Whether sales of articles to the International Bank for Reconstruction and Development, and similar organizations, are immune from the manufacturers excise tax. See Rev. Rul. 62-55, page 188.

Whether billiard balls and cues may be sold tax-free to a manufacturer of billiard and pool tables who assembles a table, balls, and cues, and sells them in a package, some cues being sold without leather tips or fibre ferrules. See Rev. Rul. 62-61, page 221.

PART II.—PHOTOGRAPHIC EQUIPMENT

SECTION 4171.—IMPOSITION OF TAX

26 CFR 48.4171-1 : Imposition and rates of tax.

Whether sales of articles to the International Bank for Reconstruction and Development, and similar organizations, are immune from the manufacturers excise tax. See Rev. Rul. 62-55, page 188.

PART III.—FIREARMS

SECTION 4181.—IMPOSITION OF TAX

26 CFR 48.4181-1 : Imposition and rates of tax.

Whether sales of articles to the International Bank for Reconstruction and Development, and similar organizations, are immune from the manufacturers excise tax. See Rev. Rul. 62-55, page 188.

SUBCHAPTER E.—OTHER ITEMS**PART I.—BUSINESS MACHINES**

SECTION 4191.—IMPOSITION OF TAX

26 CFR 48.4191-1 : Imposition and rate of tax.

Whether sales of articles to the International Bank for Reconstruction and Development, and similar organizations, are immune from the manufacturers excise tax. See Rev. Rul. 62-55, page 188.

PART II.—PENS AND MECHANICAL PENCILS AND LIGHTERS

SECTION 4201.—IMPOSITION OF TAX

26 CFR 48.4201-1 : Imposition and rate of tax.

Whether sales of articles to the International Bank for Reconstruction and Development, and similar organizations, are immune from the manufacturers excise tax. See Rev. Rul. 62-55, page 188.

PART III.—MATCHES

SECTION 4211.—IMPOSITION OF TAX

26 CFR 48.4211-1: Imposition and rates of tax.

Whether sales of articles to the International Bank for Reconstruction and Development, and similar organizations, are immune from the manufacturers excise tax. See Rev. Rul. 62-55, page 188.

SUBCHAPTER F.—SPECIAL PROVISIONS APPLICABLE TO MANUFACTURERS TAX

SECTION 4216.—DEFINITION OF PRICE

(Also Section 4061; 26 CFR 40.4061(a)-1.)

Rev. Rul. 62-4

A company manufactures automobile truck tank bodies which it sells to oil jobbers for use in the delivery of liquid products. The "finish" coat of paint is applied to the bodies by the manufacturer at the time of sale in accordance with the specifications of the purchaser. For purposes of the manufacturers excise tax imposed by section 4061(a)(1) of the Internal Revenue Code of 1954, the manufacturer's separate charge for this "finish" coat of paint is a part of the price for which the bodies are sold. On the other hand, the tax does not apply to separate charges for special lettering painted over the "finish" coat in accordance with the purchaser's request.

Advice has been requested concerning the applicability of the manufacturers excise tax to amounts charged by the manufacturer of automobile truck tank bodies for the so-called "finish" coat of paint applied to the bodies by the manufacturer at the time of sale in accordance with the specifications of the purchasers of the bodies.

A company manufactures and sells automobile truck tank bodies, which are subject to the manufacturers excise tax imposed by section 4061(a)(1) of the Internal Revenue Code of 1954. These tank bodies are sold to oil jobbers for use in the delivery of liquid products. Ordinarily, upon completion of the assembly of the bodies, they are given a "prime" coat of paint and placed in a storage yard or warehouse awaiting sale.

When one of the bodies is sold to an oil jobber, that purchaser specifies the type and color of the paint to be used by the manufacturer for the "finish" coat. The color, or combination of colors, requested by the jobber usually is prescribed by the oil company which he represents. In addition to the "finish" coat of paint, the purchaser may request that the manufacturer also paint on the body such things as the name or trademark of the oil company, the name and address of the jobber, or the operating license or truck number.

The manufacturing company invoices separately its additional charges for the "finish" coat painting of the bodies and for the other painting done in accordance with the purchaser's specifications.

These amounts may be paid by the oil company rather than by the jobber. The question presented is whether any or all of these additional charges should be included in determining, for purposes of computing the manufacturers excise tax, the price for which the truck tank bodies are sold.

Section 4061(a)(1) of the Code imposes a tax on certain enumerated articles, including chassis and bodies for automobile trucks, sold by the manufacturer, producer, or importer. This tax is based on the price for which the articles are sold.

Section 4216(a) of the Code provides that in determining the price for which an article is sold, for purposes of the manufacturers excise tax, there shall be included any charge for coverings and containers of whatever nature, and any charge incident to placing the article in condition packed ready for shipment.

In accordance with the practice throughout the industry, automobile truck tank bodies in normal use are covered with both a "prime" coat and a "finish" coat of paint. The "finish" coat serves an important function in the protection of the body from deterioration and in the ornamentation of the body. In view of its significant function, the "finish" coat of paint is considered to be inherently a part of the tank body.

The "finish" coat of paint is no less a part of the body merely because the purchaser may have specified the type and colors of paint to be used or because the particular colors chosen may serve an additional function of customer advertising and product identification. Furthermore, it is of no significance that the "finish" coat of paint may not be applied by the manufacturer until the time of sale of the body, if the circumstances are such as to warrant the presumption that the painting in fact is merely a component element of the overall transaction which constitutes the sale of a taxable body by the manufacturer. This painting is merely another step in completing the manufacture of the taxable body which actually is sold to the purchaser.

Accordingly, under the circumstances in the instant case, it is held that any charge which is made by the body manufacturer for the "finish" coat of paint is to be included in determining the price for which the body is sold by the manufacturer. It is immaterial for this purpose whether this portion of the price is charged to the purchasing jobber or to the oil company which he represents.

On the other hand, special lettering painted over the "finish" coat in accordance with the purchaser's specifications, in the manner stated above, would not serve any significant function in connection with the body itself, and such lettering is not inherently a part of the body as it is sold by the manufacturer. Accordingly, any charges for painting the name or trademark of the oil company, the name and address of the jobber, or the operating license or truck number would not be considered to be a part of the price for which the body is sold, provided, of course, that the manufacturer has contracted separately for that work and has invoiced the charges therefor separately from the price for which the body is sold.

For a similar conclusion, see Revenue Ruling 60-80, C.B. 1960-1, 497, in which the "prime" coat and the "finish" coat of paint are referred to as "ordinary" painting and the additional lettering, etc., is referred to as "special" painting.

26 CFR 148.1-5: Constructive sale price.
(Also Section 6416; 330.1-2.)

Rev. Rul. 62-68¹

Computation of the manufacturers excise tax under section 4216(b)(1)(C) of the Internal Revenue Code of 1954, where an article is sold otherwise than through an arm's length transaction at less than the fair market price.

Advice has been requested concerning the method of computing the manufacturers excise tax under section 4216(b)(1)(C) of the Internal Revenue Code of 1954, where an article is sold otherwise than through an arm's length transaction at less than the fair market price.

Under an arrangement between *X* (hereinafter sometimes referred to as the "manufacturer"), a parent company, and *Y* (hereinafter sometimes referred to as the "selling company"), a wholly-owned subsidiary, *X* performs the engineering, product development, and manufacturing functions. *Y* is organized to perform the selling and distribution function. *X* sells its products to *Y* and *Y* resells to one or more independent wholesale distributors. In conducting its selling and distributing function, *Y* has its own employees, place of business, adequate working capital, and property. Under these circumstances, it is generally considered that *Y* has such substance and reality as to evidence that it operates separate and apart from *X*, and that the transactions between *X* and *Y* are actual sales. However, *Y* is wholly owned by *X*, and the sales between the related entities are not at arm's length. Further, it has been determined the intercompany price between *X* and *Y* is less than the fair market price. Therefore, the provisions of section 4216(b)(1)(C) of the Code are applicable.

Section 4216(b)(1)(C) relates to determination of a constructive sale price and provides, in general, that where an article is sold otherwise than through an arm's length transaction at less than the fair market price, the tax under Chapter 32 (if based on the price for which the article is sold) shall 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 Secretary of the Treasury or his delegate.

G.C.M. 21114, C.B. 1939-1 (Part 1), 351, outlines the position of the Service, relating to the authority of the Commissioner to determine constructive sale price. It states, in part, that there is a close relation between the terms of section 619(a) and (b) of the Revenue Act of 1932, comparable to section 4216(a) and (b)(1) of the 1954 Code. Thus, in determining constructive sale price under section 4216(b)(1), the Commissioner must necessarily take into consideration all elements, including those items which would be included or excluded under authority of the Code, but once the constructive sale price is determined, the tax must be based on that price and the statute does not contemplate any further adjustments.

It is the position of the Service that on intercompany sales at less than arm's length and less than the fair market price, a manufacturer of an article taxable under Chapter 32 of the Code (where tax is based on sale price) may elect to use as a basis for tax, pursuant to section 4216(b)(1)(C), a constructive sale price equal to 95 percent of its selling company's lowest established resale price for the article

¹ Also released as Technical Information Release 380, dated May 7, 1962.

to unrelated wholesale distributors in the ordinary course of trade. This 5 percent margin is an allowance for those exclusions from, and readjustments of, the selling company's resale price which, under sections 4216 and 6416, the law would allow a manufacturer selling in the ordinary course of trade to unrelated distributors. Where the selling company's resale price includes the tax and the rate of tax applicable is 10 percent, for example, the tax may be computed at $1/11$ ($10/110$) of the constructive sale price in order to exclude the amount of tax from the tax base as provided by law. No further exclusions from or readjustments to, this constructed tax base are to be made for any items under Code sections 4216(a), 4216(f), or 6416(b)(1), except as provided in the following sentence. Where a sale is rescinded and the manufacturer makes a readjustment in respect of the full selling price of the article, including tax, an overpayment of tax will be recognized under section 6416(b)(1).

In cases in which a manufacturer does not exercise the election provided in the preceding paragraph, his liability for tax shall be a constructive sale price based upon the actual selling price at which the taxable article leaves the corporate family in the ordinary course of trade. In other words, the basis for tax is the actual wholesale price at which the selling company sells to unrelated customers. If, however, the sale by the selling company is at retail, the basis for tax shall be the lower of (1) the actual price for which the article is sold, or (2) the highest price for which such articles are sold by the selling company to wholesale distributors. In the latter event, it must be shown that the selling company has an established bona fide practice of selling such articles in substantial quantities to wholesale distributors. If the selling company has no such sales to wholesale distributors, the fair market price for the retail sales shall be determined by the Commissioner.

The constructive sale price determined under the methods set forth in the preceding paragraph will be subject to the exclusions from and readjustments to, such price as provided in section 4216(a), section 4216(f) effective January 1, 1961, and section 6416(b)(1). These exclusions and readjustments may be taken into consideration only when made in connection with the sale of the article by the selling company and when they constitute items of expense or allowance actually incurred or made by the manufacturer in respect of the sale price of the article as herein determined.

In any case where the constructive sale price, determined either under the election method or by using the adjusted selling price at which the article leaves the corporate family, results in a basis for tax which is lower than the actual price between the related companies, the liability for tax shall be based on the intercompany price.

In selecting the method by which a manufacturer computes and pays tax due under Chapter 32 of the Code, pursuant to this ruling, he must follow the procedure outlined below:

- (1) Where a manufacturer desires to exercise an election to compute and pay tax based on 95 percent of the selling company's lowest established wholesale price, the manufacturer shall notify the District Director of such election by attaching a statement to the return, Form 720, filed for the quarter in which the election

is made. If the election is not made, no notice need be served upon the District Director.

(2) Where a manufacturer using the election method no longer wishes to use this optional basis for tax, he must notify the District Director of his intent to use the alternative tax base prescribed in this ruling by attaching a statement to this effect to the return filed for the quarter preceding the quarter in which the change is to be made.

Under the authority contained in section 7805(b) of the Code, this Revenue Ruling shall apply with respect to sales by the manufacturer made on and after July 1, 1962.

SECTION 4218.—USE BY MANUFACTURER OR IMPORTER CONSIDERED SALE

(Also Section 4091; 26 CFR 48.4091-2.)

Rev. Rul. 62-51

A company which produces "new" lubricating oil and uses it in the production of other products does not incur liability for the manufacturers excise tax on lubricating oils, under the provisions of section 4218(a) of the Internal Revenue Code of 1954, when it uses the oil, along with "reclaimed" lubricating oil, in compounding *nontaxable grease*, since such use is considered to be a nonlubricating use. On the other hand, the company does incur liability for the tax under the provisions of that section when it blends the "new" oil with "reclaimed" oil, the resulting product being a *nontaxable lubricating oil*, irrespective of the purpose for which the end product is sold.

Advice has been requested concerning the applicability of the manufacturers excise tax on lubricating oils under the circumstances described below.

A company produces "new" lubricating oil, hereinafter referred to as product "A," which is subject to the manufacturers excise tax imposed by section 4091 of the Internal Revenue Code of 1954. Some of that lubricating oil is used by the company, along with "reclaimed" lubricating oil and (in some instances) small quantities of other substances, in the production of two other products, hereinafter referred to as product "B" and product "C." For reasons which are set forth below, no manufacturers excise tax applies to the company's sales of either product "B" or product "C."

By a process of compounding certain quantities of product "A" with reclaimed lubricating oil, the company produces product "B." Although product "B" has lubricating properties, it is a "grease" under the provisions of section 48.4091-2(a) of the Manufacturers and Retailers Excise Tax Regulations. Accordingly, product "B" is not subject to the manufacturers excise tax on lubricating oils.

Also, the company blends or mixes certain quantities of product "A" with reclaimed lubricating oil, the resulting product being referred to here as product "C." Although product "C" is a lubricating oil under the definition set forth in section 48.4091-2(a) of the regulations, the company is not a "manufacturer" of that product under the provisions of section 48.4091-2(b) (2) (iii) of the regulations. Accordingly, no manufacturers excise tax applies to the company's sales of product "C."

Two specific questions have been presented. The first is whether the company incurs liability for the manufacturers excise tax with respect to its use of product "A" in the production of product "B" or product "C." The second question, which becomes pertinent only if there is an affirmative answer to the first question, is whether the company is entitled to a credit or refund of the tax paid on the use of product "A" if the resulting product "B" or product "C" is sold (1) to another company (which is a manufacturer or producer of lubricating oil) for resale, (2) to a State or local government for its exclusive use, or (3) to another customer (i) for export or (ii) for nonlubricating use.

Section 4091 of the Code imposes a tax on lubricating oils sold in the United States by the manufacturer or producer thereof.

Under the provisions of section 4218(a) of the Code, insofar as applicable to the situation presented here, if any person manufactures or produces an article and uses it (otherwise than as material in the manufacture or production of, or as a component part of, another taxable article to be manufactured or produced by him), then he shall be liable for the manufacturers excise tax in the same manner as if such article were sold by him.

Therefore, if a manufacturer or producer of lubricating oil "uses" that lubricating oil, within the meaning of section 4218(a) of the Code, that manufacturer or producer becomes liable for the manufacturers excise tax imposed by section 4091 of the Code in the same manner as if the lubricating oil were sold by him.

Section 48.4091-2(a) of the regulations provides that the term "lubricating oils" includes all oils, regardless of origin, which (1) are suitable for use as a lubricant or (2) are sold for use as a lubricant. However, the term does not include synthetic materials which possess lubricating properties, nor does it ordinarily include products of the type commonly known as grease. Oleaginous substances which are classed as grease and which contain oil are not subject to the tax when of a worked consistency of less than 390 penetration units, or an unworked consistency of less than 360 penetration units, by the method of test of the American Society for Testing Materials D-217-52-T.

Section 48.4091-2(b) of the regulations provides, in part, as follows:

(1) For purposes of the tax imposed under section 4091, the term "manufacturer" includes:

(i) Any person who produces lubricating oil by any process of manufacturing, refining, or compounding, or any manipulation involving substantially more than mere mixing of taxable oils, and

(ii) Any person who produces lubricating oil by mixing taxable oils with other substances.

(2) For purposes of the tax imposed under section 4091, the term "manufacturer" does not include:

(i) Any person who merely blends or mixes two or more taxable oils.

(ii) Any person who merely cleans, renovates, or refines used or waste lubricating oil, or

(iii) Any person who merely blends or mixes one or more taxable oils with used or waste lubricating oil which has been cleaned, renovated, or refined.

Section 48.4091-4(a)(1) of the regulations provides that the tax imposed by section 4091 of the Code does not attach to the sale by the manufacturer of lubricating oil direct to a purchaser for non-lubricating use by him, if such oil is actually so used by such purchaser.

The company's use of product "A" in producing either product "B" or product "C" constitutes a "use" of taxable lubricating oil within the meaning of section 4218(a) of the Code, since product "A" is being used otherwise than in the manufacture of products which are themselves subject to the manufacturers excise tax. Therefore, the applicability of the tax to the "use" of product "A" in producing either product "B" or product "C" depends upon whether the tax would apply if product "A" were *sold* for the same purpose.

The sale of lubricating oils for use as constituent materials in the manufacture of products which are not lubricating oils and which do not perform the function of a lubricating oil are considered to be sales for nonlubricating use within the meaning of section 48.4091-4(a) of the regulations. Although grease is a lubricant, it is not treated as a lubricating oil for tax purposes. The production of grease from any oils or other substances is a manufacturing process rather than mere blending. The "use" of product "A" in compounding the nontaxable product "B" is considered to be a nonlubricating use. Accordingly, the manufacturers excise tax does not apply to the company's "use" of product "A" in compounding product "B."

On the other hand, although product "C" is not taxable when sold by the company, it is a lubricating oil which performs a lubricating function. The use of product "A" in the blending or mixing of product "C" constitutes a lubricating use of product "A," even though such use of the oil is not considered to be a process of "manufacture" within the meaning and intent of section 48.4091-(2)(b)(2)(iii) of the regulations. Therefore, it is held that the manufacturers excise tax applies to the company's "use" of product "A" in the blending or mixing of product "C."

Since the answer to the first question presented in the instant case is affirmative to the extent that product "A" is used in blending product "C," the second question presented is pertinent. The answer to the second question depends upon the provisions of section 4093 and section 6416(b)(2) of the Code.

Section 4093 of the Code provides that, under regulations prescribed by the Secretary of the Treasury or his delegate, the tax on lubricating oils shall not apply to lubricating oils sold to a manufacturer or producer of lubricating oils for resale by him. However, under the provisions of section 4092(a) of the Code, a vendee who has purchased lubricating oils free of tax under section 4093 shall be considered the manufacturer or producer of such lubricating oils.

Under the provisions of section 6416(b)(2) of the Code, insofar as applicable to the instant case, the manufacturers excise tax paid in respect of any lubricating oil is deemed to be an overpayment if the lubricating oil was, by any person, exported, sold to a State or local government for the exclusive use of a State or local government, or used or sold for nonlubricating purposes.

Under the circumstances involved in this case, a taxable lubricating oil, product "A," is used by the company in such a manner that it loses its identity as a separate product for tax purposes. The provisions of section 4093 and section 6416(b)(2) of the Code would apply in this case only if the *taxable lubricating oil* had been used or sold for the purposes specified in those sections. The fact that the nontaxable product "C" may have been sold for one of those purposes pro-

vides no basis for a credit or refund of the tax paid on the "use" of product "A" in blending product "C." See Revenue Ruling 59-63, C.B. 1959-1, 356, for a similar conclusion which relates to sales of nontaxable articles, in the manufacture of which taxable electric light bulbs were used, to a political subdivision of a State.

SUBCHAPTER G.—EXEMPTIONS, REGISTRATION, ETC.

SECTION 4221.—CERTAIN TAX-FREE SALES

(Also Section 4161; 26 CFR 48.4161-1.)

Rev. Rul. 62-61

Billiard and pool balls and cues may not be sold tax-free to a manufacturer of billiard and pool tables who assembles a table, balls, and cues, and sells them together in a package. The manufacturer of the balls and cues is liable for the tax on sporting goods, imposed by section 4161 of the Internal Revenue Code of 1954, on his sale of the balls and cues. Furthermore, the manufacturer is liable for the tax regardless of whether the cues contain leather tips or fibre ferrules.

Advice has been requested whether billiard and pool balls and cues may be sold tax-free under the circumstances described below.

A manufacturer of billiard balls and cues sells balls and cues to a manufacturer of billiard and pool tables who assembles a table, balls, and cues, and sells them together in a package. Some of the cues, when sold by the cue manufacturer, do not have leather tips or fibre ferrules at the points.

Section 4161 of the Internal Revenue Code of 1954 imposes a tax upon the sale by the manufacturer, producer, or importer of certain enumerated articles of sporting goods, including in each case parts or accessories of such articles sold on or in connection therewith, or with the sale thereof. Included in the articles enumerated are "billiard and pool tables (measuring 45 inches overall or more in length) and balls and cues for such tables."

Under the provisions of section 4221(a)(1) of the Code, the manufacturers excise tax is not imposed on the sale by the manufacturer of taxable articles for use by the purchaser for further manufacture, or for resale by the purchaser to a second purchaser for use by such second purchaser in further manufacture, if such use is to occur before any other use. In accordance with section 4221(d)(6)(A) of the Code, articles taxable under Chapter 32 of the Code are to be treated as sold for use in further manufacture if such articles are sold for use by the purchaser as material in the manufacture or production of, or as a component part of, another article subject to the manufacturers excise tax, to be manufactured or produced by him.

Billiard and pool balls and cues taxable under section 4161 of the Code are not considered to be components used in the further manufacture of billiard and pool tables within the meaning of section 4221 of the Code. Under the circumstances described above, the balls and cues are merely purchased and resold by the table manufacturer in the form purchased.

Accordingly, it is held that billiard and pool balls and cues may not be sold tax-free to a manufacturer of billiard and pool tables who assembles a table, balls, and cues, and sells them together in a package. The manufacturer of the balls and cues is liable for the tax on sporting goods, imposed by section 4161 of the Code, on his sale of such balls and cues. Furthermore, the cue manufacturer is liable for the tax regardless of whether the cues contain leather tips or fibre ferrules.

The billiard or pool table manufacturer who sells tables of his manufacture and resells balls and cues, purchased taxpaid, in combination with his tables is liable for tax under section 4161 of the Code only on his sale of the tables. The portion of the price charged for the combination which is allocable to the tables for purposes of computing the tax is to be determined in each instance in accordance with the method described in Revenue Ruling 60-259, C.B. 1960-2, 318.

26 CFR 148.1-4: Tax-free sales or services
to certain nonprofit educational organizations.

Whether certain described nonprofit organizations which provide training for mentally handicapped children come within the scope of the term "nonprofit educational organization" for purposes of exemption from the manufacturers excise taxes. See Rev. Rul. 62-6, page 198.

Whether a boys' club comes within the scope of the exemption from the manufacturers excise taxes with respect to the sale of any article by the manufacturer to a nonprofit educational organization for its exclusive use. See Rev. Rul. 62-23, page 200.

CHAPTER 33.—FACILITIES AND SERVICES

SUBCHAPTER A.—ADMISSIONS AND DUES

PART II.—CLUB DUES

SECTION 4242.—DEFINITIONS

26 CFR 49.4242-1: Definition; dues
or membership fees.

Rev. Rul. 62-46

Amounts paid to a *social* club by its members for health treatments are not considered to be "dues" within the provisions of section 4242(a) of the Internal Revenue Code of 1954 and, therefore, are not subject to the excise tax on club dues.

Advice has been requested whether the excise tax on club dues applies to amounts paid to a social club by its members for the use of the facilities described below.

A club, which qualifies as a *social* club or organization (rather than an athletic or sporting club or organization) within the meaning of section 4241 of the Internal Revenue Code of 1954 and section 49.4241-1(e) of the Facilities and Services Excise Tax Regulations, maintains a health treatment department and offers health treatments to its members. The health treatment facilities include a hot room, steam room, electric cabinets, various kinds of baths, showers, hydrotherapy equipment, ultraviolet and infrared lamps, deep therapy equipment, and massage equipment. The equipment is operated by an attendant who accompanies the members through the course of treatment. A usual treatment includes a massage and the use of some or all of the available equipment. The members may pay a prescribed amount for each treatment, or they may pay a larger amount for a course of treatments extending over a period of several weeks.

No mandatory minimum charge is made against all members for the use of these facilities. Only the members who take the health treatments are required to make any payments for these facilities.

Section 4241(a)(1) of the Code imposes a tax on any amount paid as dues or membership fees to any social, athletic, or sporting club or organization, if the dues or fees of an active resident annual member are in excess of ten dollars per year.

Section 4242(a) of the Code provides that the term "dues" includes any assessment, irrespective of the purpose for which made, and any charges for social privileges or facilities, or for golf, tennis, polo, swimming, or other athletic or sporting privileges or facilities, for any period of more than six days.

Section 49.4242-1(a) of the regulations provides that, in addition to the charges made by a social, athletic, or sporting club or organization which are commonly understood to constitute dues or membership fees, as well as all other charges required to be paid to such a club or organization for the privilege of being a member of the club or organization or a member of a particular membership class, the term "dues or membership fees" also includes other amounts, as follows:

(1) Any assessment made by a social, athletic, or sporting club or organization, irrespective of the purpose for which made, and

(2) All charges made by a social, athletic, or sporting club or organization for (i) social privileges or facilities for any period of more than 6 days (whether or not consecutive), or (ii) golf, tennis, polo, swimming, or other athletic or sporting privileges or facilities for any period of more than 6 days (whether or not consecutive).

In determining whether a charge by such a club or organization constitutes dues or membership fees within the meaning of subparagraph (2) of this paragraph, the test is whether payment of the charge confers the right to use a social, athletic, or sporting privilege or facility of the club or organization for the prescribed period. It is immaterial whether the privilege or facility is one for which a charge is mandatory, even though the member chooses not to avail himself of the privilege or facility, or whether the privilege or facility is one for which a charge is made only if the member, at his own election, chooses to have the privilege or facility made available to him. Any privilege or facility offered by a social, athletic, or sporting club or organization which is so directly related to a social, athletic, or sporting activity in which the club is engaged, or for which it was created, as to partake of the nature of the activity itself is considered to be a social, athletic, or sporting privilege or facility. This is true even though such privilege or facility, if considered entirely apart from any social, athletic, or sporting activity, would not in and of itself constitute a social, athletic, or sporting privilege or facility.

The use of the health treatment facilities is not considered to constitute the use of social, athletic, or sporting privileges or facilities of the instant *social* club within the meaning of the regulations quoted above. Accordingly, it is held that amounts paid by the members to the *social* club for health treatments are not “dues” within the meaning of section 4242(a) of the Code and, therefore, are not subject to the excise tax on club dues.

SUBCHAPTER B.—COMMUNICATIONS

SECTION 4252.—DEFINITIONS

26 CFR 42.4252-6: Wire and equipment service.

Rev. Rul. 62-11

In view of the decision of the United States Court of Claims in the case of *Hampton Roads Industrial Electronics Corporation v. United States*, amounts paid for musical program services which are transmitted by means of radio circuits rather than wire lines will no longer be considered as being subject to the communications tax on “wire and equipment service.” However, under the provisions of section 4252(e) of the Internal Revenue Code of 1954 as amended by the Excise Tax Technical Changes Act of 1958, the tax on “wire mileage service” applies to amounts paid for such musical program services on or after January 1, 1959, subject to the exemption provided by section 4253(h) of the Code relating to station terminal equipment.

Revenue Ruling 56-527, C.B. 1956-2, 839, revoked.

Reconsideration has been given by the Internal Revenue Service to the position stated in Revenue Ruling 56-527, C.B. 1956-2, 839, in view of (1) the decision of the United States Court of Claims in the case of *Hampton Roads Industrial Electronics Corporation v. United States*, 178 Fed. Supp. 474, and (2) certain provisions of the Excise Tax Technical Changes Act of 1958, Public Law 85-859, C.B. 1958-3, 92.

Revenue Ruling 56-527 holds that the communications tax on “wire and equipment service” applies to amounts paid by subscribers for a musical program service where radio channels are used for transmission of the programs. That Revenue Ruling was issued under the provisions of sections 4251 and 4252 of the Internal Revenue Code of 1954 prior to the amendments made by the Excise Tax Technical Changes Act of 1958.

Prior to January 1, 1959, the effective date of those amendments, section 4252(e) of the Code provided, in pertinent part, that the term “wire and equipment service” shall include stock quotation and information services, burglar alarm or fire alarm service, and all other similar services.

It has been held that the definition provided by section 4252(e) of the Code includes all services of the type mentioned in that section, irrespective of the fact that technological advances permit variations in the method of transmission from the point of origin to the subscriber's premises. That position was the basis for the conclusion set forth in Revenue Ruling 56-527.

However, in the *Hampton Roads Industrial Electronics Corporation* decision, the court held that amounts paid by commercial sub-

scribers for a background music program service furnished by means of an FM radio transmission system known as "multiplex" were not subject to the tax on "wire and equipment service," because that system does not utilize "wire" in the transmission of the musical programs.

In view of that decision, musical program services which are furnished by means of radio circuits rather than wire lines will no longer be considered as coming within the scope of the term "wire and equipment service." Consequently, amounts paid before January 1, 1959, for such services are not subject to the tax imposed on "wire and equipment service" in effect prior to that date.

However, the taxability of amounts paid for such services on or after January 1, 1959, must be determined under the provisions of the statute as amended by the Excise Tax Technical Changes Act of 1958.

Section 4251 of the Code, as amended, imposes a tax upon enumerated communication services, including "wire mileage service" and "wire and equipment service." Those terms are defined by subsections (e) and (f) of section 4252 of the Code as follows:

(e) **WIRE MILEAGE SERVICE.**—For purposes of this subchapter, the term "wire mileage service" means—

(1) any telephone or radio telephone service, and

(2) any other wire or radio circuit service,

not included in any other subsection of this section; except that such term does not include service used exclusively in furnishing wire and equipment service.

(f) **WIRE AND EQUIPMENT SERVICE.**—For purposes of this subchapter, the term "wire and equipment service" includes stock quotation and information services, burglar alarm or fire alarm service, and all other similar services (whether or not oral transmission is involved). Such term does not include teletypewriter exchange service.

Since the musical program service described above is a radio circuit service which does not come within the scope of any other subsection of section 4252, it is held that it comes within the definition of "wire mileage service" provided in subsection (e). Accordingly, amounts paid on or after January 1, 1959, for such musical program services are subject to the tax on "wire mileage service."

It should be noted, however, that section 4253(h) of the Code, as amended, provides that no tax shall be imposed under section 4251 on so much of any amount paid for "wire mileage service" as is paid for, and properly attributable to, the use of any sending or receiving set or device which is station terminal equipment.

The portion of an amount paid for "wire mileage service" which is *properly attributable* to the station terminal equipment depends upon all of the pertinent facts relating to each case. However, under all of the circumstances relating to musical program services furnished by means of radio transmission, it will be deemed that 20 percent of the total amount paid for the service is properly attributable to the station terminal equipment. Therefore, the tax may be applied to only 80 percent of the total amount paid for the service. Any claimed allocation of more than 20 percent to the station terminal equipment must be properly supported by adequate evidence.

Revenue Ruling 56-527 is hereby revoked.

SECTION 4253.—EXEMPTIONS

Rev. Rul. 62-57

The exemption from the communications tax on "wire and equipment service" provided by section 4253(i) of the Internal Revenue Code of 1954, relating to "interior communication systems," is not applicable to amounts paid for background music furnished by a music network company to subscribers who are located in the same building as the music company but on separate and distinct premises.

Advice has been requested whether the exemption from communications tax on "wire and equipment service" with respect to "interior communication systems" is applicable to amounts paid for background music furnished under the circumstances described below.

A music network company furnishes background music to its subscribers, some of whom are tenants in the same building in which the company is located. The facilities and equipment employed in furnishing the service are located in the network company's offices in the building. The equipment for receiving the music is located in the offices and rooms of the various subscribers. The music is transmitted to the subscribers over wires running from the company's offices to the offices and rooms of the subscribers.

The service furnished by the company constitutes "wire and equipment service" for purposes of the communications tax imposed by section 4251 of the Internal Revenue Code of 1954. The specific question presented is whether the exemption provided by section 4253(i) of the Code, relating to "interior communication systems," is applicable to the amounts paid by the subscribers, inasmuch as the facilities and equipment used in furnishing the music service and the equipment for receiving the music are located entirely within the building in which both the music company and the subscribers are located.

Section 4253(i) of the Code provides an exemption from the tax on "wire and equipment service," imposed under section 4251, if such service is rendered through the use of an "interior communications system," which is defined to mean any system "no part of which is situated off the premises of the subscriber, and which may not be connected (directly or indirectly) with any communication system any part of which is situated off the premises of the subscriber."

In general, the term "premises," as used in section 4253(i) of the Code, means property owned, leased, or controlled by a subscriber to a communications service. The statutory reference to "premises" is to the subscriber's "premises." The language limits the exemption to any interior communications system "no part of which is situated off the premises of the subscriber." Therefore, where a subscriber leases only a room, or rooms, in a building, the exemption will apply only to communications systems wholly located in such room or rooms.

Since, in the instant case, the offices of the network company, where the facilities for transmitting background music are situated, are separate and distinct from the premises of the subscribers, where the facilities for receiving the music are located, the system is not considered to be an "interior communication system" within the meaning of section 4253(i) of the Code. Accordingly, it is held that the exemption provided by section 4253(i) of the Code is not applicable to the situation described. Therefore, amounts paid to the company by the subscribers for background music furnished by wire are subject to the tax on "wire and equipment service" imposed by section 4251 of the Code.

SUBCHAPTER E.—SPECIAL PROVISIONS APPLICABLE TO SERVICES AND FACILITIES TAXES

SECTION 4294.—EXEMPTION FOR NONPROFIT EDUCATIONAL ORGANIZATIONS

26 CFR 148.1-4: Tax-free sales or services to certain nonprofit educational organizations.

Whether certain described nonprofit organizations which provide training for mentally handicapped children come within the scope of the term "nonprofit educational organization" for purposes of exemption from the communication and transportation excise taxes. See Rev. Rul. 62-6, page 198.

Whether a boys' club comes within the scope of the exemption from certain Federal excise taxes with respect to amounts paid by a nonprofit educational organization for service or facilities furnished to exclusive use. See Rev. Rul. 62-23, page 200.

CHAPTER 34.—DOCUMENTARY STAMP TAXES

SUBCHAPTER A.—ISSUANCE OF CAPITAL STOCK AND CERTIFICATES OF INDEBTEDNESS BY A CORPORATION

PART I.—ISSUANCE OF CAPITAL STOCK AND SIMILAR INTERESTS

SECTION 4301.—IMPOSITION OF TAX

26 CFR 47.4301: Statutory provisions; T. D. 6589¹
imposition of tax.
(Also Sections 4311, 4321, 4331, 4341,
4361, 4371, 4381, 6001, 6801, 6802,
6804, 7209; 47.4311, 47.4321, 47.4331,
47.4341, 47.4361, 47.4371, 47.4381,
47.6001, 47.6801, 47.6802, 47.6804,
47.7209.)

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER D, PART 47.— DOCUMENTARY STAMP TAXES

Regulations under chapter 34 (documentary stamp taxes) of
the Internal Revenue Code of 1954.

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

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

On December 24, 1960, notice of proposed rulemaking with respect to regulations under chapter 34 of the Internal Revenue Code of 1954, as amended, and under those administrative provisions of subtitle F of the Code which have special application to the taxes imposed by such chapter 34 was published in the Federal Register (25 F.R. 13699). The regulations, except where otherwise specifically provided, are applicable in respect of transactions occurring on or after January 1, 1959, and supersede § 148.1-1 of the Regulations on Certain Excise Tax Matters under Excise Tax Technical Changes Act of 1958 [P.L. 85-859, C.B. 1958-3, 92] (26 CFR 148.1-1). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the following regulations are hereby adopted:

¹ The publication of this Treasury Decision in 27 F.R. 1088, dated February 7, 1962, contains (1) instructions for modifying the notice of proposed rulemaking published in 25 F.R. 13699, dated December 24, 1960, and (2) the full context of the regulations with such modifications. As here published, the Treasury Decision reflects the full context of such regulations, with modifications. The individual instructions have been omitted.

DOCUMENTARY STAMP TAX REGULATIONS

26 CFR Part 47

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Authority: §§ 47.0-1 to 47.7805-1, incl., issued under sec. 7805, I.R.C. 1954; 68A Stat. 917; 26 U.S.C. 7805.

DOCUMENTARY STAMP TAX REGULATIONS

Subpart A—Introductory Provisions

§ 47.0-1 Introduction.

(a) *In general.* The regulations in this part (Part 47, Subchapter D, Chapter I, Title 26 (1954) Code of Federal Regulations) are designated "Documentary Stamp Tax Regulations". The regulations relate to the taxes imposed by chapter 34 of the Internal Revenue Code of 1954, as amended, and to certain related administrative provisions of subtitle F of such Code. Chapter 34 of the Code imposes a tax on the issuance and on the sale or transfer of shares or certificates of stock or certificates of indebtedness, on conveyances of realty, and on policies issued by foreign insurers. References in these regulations to the "Internal Revenue Code" or the "Code" are references to the Internal Revenue Code of 1954, as amended, unless otherwise indicated. References to a section or other provision of law are references to a section or other provision of the Internal Revenue Code, as amended, unless otherwise indicated.

(b) *Division of regulations.* The regulations in this part are divided into 10 subparts. Subpart A contains provisions relating to the arrangement and numbering of the sections of the regulations in this part, general definitions and use of terms, scope of regulations, and the extent to which the regulations in this part supersede prior regulations relating to the excise taxes imposed by chapter 34 of the Internal Revenue Code. The other subparts of the regulations in this part and the subject matter to which they relate are as follows:

Subpart B—Tax on issuance of capital stock and similar interests

Subpart C—Tax on issuance of certificates of indebtedness

Subpart D—Tax on sales or transfers of capital stock and similar interests

Subpart E—Tax on sales or transfers of certificates of indebtedness

Subpart F—Provisions common to sales or transfers of capital stock and certificates of indebtedness

Subpart G—Tax on conveyances

Subpart H—Tax on policies issued by foreign insurers

Subpart I—Miscellaneous provisions applicable to documentary stamp taxes

Subpart J—Administrative provisions applicable to documentary stamp taxes

(c) *Arrangement and numbering.* Each section of the regulations in Subpart B through Subpart J is preceded by the section, subsection, or paragraph of the Internal Revenue Code which it interprets. The sections of the regulations can readily be distinguished from the sections of the Code since—

(1) The sections of the regulations are printed in larger type;

(2) The sections of the regulations are preceded by a section symbol and the part number, arabic numeral 47 followed by a decimal point (§ 47.); and

(3) The sections of the Code are preceded by "Sec."

Each section of the regulations setting forth law or regulation is designated by a number composed of the part number followed by a decimal point (47.) and the number of the corresponding provision of the Internal Revenue Code. In the case of a section setting forth regulations, this designation is followed by a hyphen (-) and a number identifying such section.

§ 47.0-2 General definitions and use of terms.

(a) *In general.* As used in the regulations in this part, unless otherwise expressly indicated—

(1) The terms defined in the provisions of law contained in the regula-

tions in this part shall have the meanings so assigned to them.

(2) The Internal Revenue Code of 1954 means the Act approved August 16, 1954 (68A Stat.), entitled "An Act to revise the internal revenue laws of the United States", as amended.

(3) District director means district director of internal revenue. The term also includes the Director of International Operations in all cases where the authority to perform the functions which may be performed by a district director has been delegated to the Director of International Operations.

(4) The terms "stamp tax" and "stamp taxes" generally mean any one or all of the stamp taxes which constitute the subject of the regulations in this part.

(5) The term "documentary stamps" means all stamps issued for use in payment of stamp taxes imposed by chapter 34 of the Internal Revenue Code, including stamps issued by authorized meter machines. See § 47.6801-1.

(6) The cross references in the regulations in this part to other portions of the regulations, when the word "see" is used, are made only for convenience and shall be given no legal effect.

(b) *Cross references.* For other definitions, see section 4381, § 47.4381-1, and section 7701 (§ 47.7701).

§ 47.0-3 Scope of regulations.

The regulations in this part relate to the documentary stamp taxes referred to in subparts B through H (see paragraph (b) of § 47.0-1) and, except where otherwise specifically provided, have application to transactions occurring on or after January 1, 1959. The provisions of the Internal Revenue Code set forth in the regulations in this part are, unless otherwise indicated, provisions of law in effect on January 1, 1959.

§ 47.0-4 Extent to which the regulations in this part supersede prior regulations.

The regulations in this part, with respect to the subject matter within the scope thereof, supersede the Documentary Stamp Tax Regulations contained in Part 43 of this chapter

Subpart B—Tax on Issuance of Capital Stock and Similar Interests

§ 47.4301 Statutory provisions; imposition of tax.

SEC. 4301 *Imposition of tax.* There is hereby imposed, on each original issue of shares or certificates of stock issued by a corporation (whether on organization or reorganization), a tax at the rate of 10 cents on each \$100 (or major fraction thereof) of the actual value of the certificates (or of the shares where no certificates are issued); except that such rate shall be 4 cents instead of 10 cents in the case of shares or certificates issued by a corporation to which subchapter M of chapter 1 applies for the taxable year during which such share or certificate is issued. The tax imposed by this section shall be computed on the basis of all certificates (or shares) so issued by the corporation on each day.

[Sec. 4301 as amended and in effect Jan. 1, 1959, and as further amended by Act of Apr. 8, 1960 (Pub. Law 86-416, 74 Stat. 36)]

§ 47.4301-1 Imposition of the tax on original issue of stock.

(a) *Scope of tax—(1) In general.* Section 4301 imposes a tax on each original issue of shares or certificates of stock issued by a domestic corporation. See section 4381(b) and paragraph (b) of § 47.4381-1 and section 4381(c) and paragraph (c) of § 47.4381-1, respectively, for definitions of the terms "corporation" and "shares or certificates of stock". In the case of subscriptions, stock is deemed to be issued when the subscription is accepted. The tax applies to each original issue of the shares or certificates, whether upon organization, reorganization, or otherwise, regardless of the purpose of the issue, the person to whom issued, or the time of delivery. Thus, the tax applies to shares or certificates issued in a recapitalization where the recapitalization results in the dedication of an amount as capital for the first time (see § 47.4302-1).

(2) *Original issue.* An original issue of stock means any issue of shares or certificates of stock which reflects in whole or in part the addition of an amount to the capital stock account.

(b) *Rate and computation of tax—(1) Rate of tax—(i) In general.* Except as otherwise provided in subdivision (ii) of this subparagraph, the rate of tax is 10 cents on each \$100 (or major fraction thereof) of the actual value of the cer-

tificates (or of the shares where no certificates are issued).

(ii) *Regulated investment companies.* In the case of shares or certificates issued on or after April 9, 1960, by a corporation to which subchapter M of chapter 1 of the Code applies for the taxable year during which such shares or certificates are issued, the rate of tax is 4 cents on each \$100 (or major fraction thereof) of the actual value of the certificates (or of the shares where no certificates are issued). The terms "taxable year" and "regulated investment company" as used in this subdivision, have the same meaning as when used in subchapter M of chapter 1 of the Code and the regulations thereunder. The tax is to be computed at the 4-cent rate in respect of shares or certificates issued by a company which qualified as a regulated investment company for the year immediately preceding the taxable year in which the shares or certificates are issued provided the company intends to elect to be taxed as a regulated investment company for Federal income tax purposes during the year that such shares or certificates are issued. In the case of a newly created company which has filed its notification of registration with the Securities and Exchange Commission pursuant to the provisions of the Investment Company Act of 1940, the 4-cent rate will apply if—

(a) The company intends to elect to be taxed as a regulated investment company for Federal income tax purposes, and

(b) The company qualifies to be taxed as a regulated investment company for the taxable year.

If tax is computed at the 4-cent rate in respect of shares or certificates issued by a company during a taxable year, such shares or certificates shall be subject to tax at the 10-cent rate if the company fails to qualify as a regulated investment company for such taxable year. If the tax is paid at the 10-cent rate, refund of the difference between the 10-cent and the 4-cent rate is allowable within the applicable period of limitation to the person who paid the tax with respect to shares or certificates issued by a company if it is shown that the company qualified as a regulated investment company for the taxable year during which such shares or certificates were issued.

For provisions with respect to period of limitation for filing claims for refund, see section 6511 and the regulations thereunder in Part 301 of this chapter (Regulations on Procedure and Administration).

(iii) *Major fraction.* A major fraction of \$100 is any amount in excess of \$50 and less than \$100.

(2) *Computation of tax—(i) In general.* A single computation of tax must be made with respect to the certificates (and shares which are not represented by certificates) issued by a corporation on each day. The amount of tax imposed under section 4301 in respect of shares or certificates issued by a corporation on a particular day is computed by ascertaining the actual value of all certificates (and shares which are not represented by certificates) issued on such day and applying to such actual value the applicable rate of tax.

(ii) *Actual value.* (a) In general, the actual value of stock is the fair market value of the stock. Fair market value of stock is considered to be the price agreed upon by the parties to the issuance to be paid for the stock unless the price includes property or services or the issuance transaction is not an arm's length transaction or is subject to special conditions which result in a price not reflecting the value of the stock as such value would be determined by reference to the mean selling price of the stock on the open market or to all the facts and circumstances of the case. In the absence of a price agreed upon by the parties or if the price agreed upon includes property or services, results from a transaction not at arm's length, or is affected by special conditions, the fair market value of each share of stock issued on a particular day shall be considered to be the mean between the high and low selling prices of the stock on the open market for such day. Thus, the price to be paid for stock to be issued by reason of the exercise of a stock option in a case where the option price is less than the mean selling price of the stock on the open market may not be used in ascertaining the value of the stock so issued for the reason that the transaction is subject to special conditions which result in the option price not reflecting the mean selling price of the stock. If the fair market value of the stock cannot be de-

terminated by reference to the price of the stock agreed upon by the parties or the mean between the high and low selling prices thereof on the open market, the fair market value shall be determined on the basis of all the facts and circumstances of the particular case.

(b) In the case of a unit offering by a corporation, as, for example, a share of stock and a certificate of indebtedness, the fair market value of the stock shall be considered to be the mean between the high and low selling prices of the stock on the open market for the day of issuance if such stock is being traded on the open market other than as a part of such a unit offering. Thus, the actual value and the face value of the certificate of indebtedness are to be disregarded for purposes of determining the value of the stock. If the fair market value of the stock cannot be determined by reference to the mean between the high and low selling prices thereof on the open market, the fair market value shall be determined on the basis of all the facts and circumstances of the particular case. The provisions of this subdivision (b) shall have application only to shares or certificates of stock, constituting a part of a unit offering, issued on or after the tenth day following the date of publication of the regulations in this part in the **FEDERAL REGISTER**.

§ 47.4301-2 Illustrations.

(a) *Issues subject to tax.* The following are examples of issues subject to the tax:

(1) Certificates or shares representing beneficial interests in any organization which is a corporation within the meaning of section 4381(b) or section 7701(a)(3).

(2) Stock issued for property, real or personal, or for the purpose of purchasing a business.

(3) Stock issued by joint-stock land banks.

(4) Stock issued as a dividend. (For limitation of tax, see § 47.4302-1.)

(5) Temporary or interim certificates.

(6) The issue of a fractional share, or a certificate for a fractional share, of stock (see, however, paragraph (b)(6) of this section).

(7) Stock issued upon exercise of a warrant or rights entitling the holder to subscribe for unissued stock (see paragraph (a) of § 47.4321-3)

(8) Stock issued in connection with a consolidation by a consolidated corporation in exchange for stock of the consolidating corporations whether issued directly to the consolidating corporations or to the stockholders of the consolidating corporations (see also paragraph (a)(9) of § 47.4321-2 relating to the imposition of the stock transfer tax where the stock is issued directly to the stockholders). For exemption from tax in respect of issuances of stock to make effective a plan of reorganization or adjustment whereby a mere change in identity, form, or place of organization is affected, see paragraph (d) of § 47.4382-1.

(9) Stock issued in connection with a merger by the continuing corporation whether issued directly to the merging corporation or to the stockholders of the merging corporation (see also paragraph (a)(9) of § 47.4321-2) and stock issued to the stockholders of the continuing corporation in a recapitalization under section 4302 which results in the dedication of an amount as capital which amount is so dedicated for the first time. For exemption from tax in respect of issuances of stock to make effective a plan of reorganization or adjustment whereby a mere change in identity, form, or place of organization is effected, see paragraph (d) of § 47.4382-1.

(10) Stock issued outside the United States by a domestic corporation.

(11) A business property investment certificate, wherein it is certified that the holder thereof is the owner of an interest in certain specified property, legal title to which has been previously conveyed to a trustee, and whereby the issuing corporation agrees to manage the property and distribute the proceeds.

(12) Stock issued where the capital stock account, although not increased at the time of such issuance, was previously increased by a dedication of an amount as capital for the first time which was not accompanied by an issuance of shares or certificates of stock and with respect to which there has been no other issuance of shares or certificates of stock. (For limitation of tax, see § 47.4302-1.)

(b) *Issues not subject to tax.* In addition to the various issues specifically exempt under sections 4303 and 4382,

the following are examples of issues not subject to the tax:

(1) The issue of warrants or rights to subscribe for unissued stock (see, however, § 47.4321-3).

(2) The issue of certificates of stock in exchange for outstanding certificates representing the same stock as, for instance, to reflect a change in the name of the issuing corporation or to secure several certificates for one certificate, or vice versa.

(3) The issue of voting-trust certificates.

(4) The issue of definitive certificates of stock in exchange for temporary or interim certificates upon the issuance of which the tax has been paid.

(5) The issue of stock in a recapitalization or reorganization where there is no dedication of additional capital, either by transfer of earned surplus or otherwise (see, however, paragraph (b) of § 47.4302-1).

(6) Stock issued on the surrender of fractional shares or certificates for fractional shares of stock (see, however, paragraph (a) (6) of this section).

(7) The issue in the United States of stock of a foreign corporation.

(8) The issue of stock to effect a mere split in outstanding shares without any increase in the issuing corporation's capital stock account. See, however, paragraph (a) (12) of this section.

(9) The issue of one type of stock for another type of stock and in which the new stock does not reflect the addition of an amount to the capital stock account.

§ 47.4302 Statutory provisions; stock issued in recapitalization.

Sec. 4302 Recapitalization. In the case of a recapitalization, the tax imposed by section 4301 shall be that proportion of the tax computed on the certificates (or on the shares where no certificates are issued) issued in the recapitalization that (1) the amount dedicated as capital for the first time by the recapitalization, whether by a transfer of earned surplus or otherwise, bears to (2) the total actual value of such certificates or shares issued in the recapitalization.

[Sec. 4302 as amended and in effect Jan. 1, 1959]

§ 47.4302-1 Limitation on tax in case of recapitalization.

(a) *In general.* Where stock is issued in a recapitalization, the tax payable is

that proportion of the total tax imposed by section 4301 computed with respect to all the shares or certificates issued in the recapitalization that the amount dedicated as capital for the first time by the recapitalization, whether by a transfer of earned surplus or otherwise, bears to the total actual value of the shares or certificates so issued.

(b) *Dedication of capital for first time.* A tax is not payable with respect to stock issued in a recapitalization unless the recapitalization results in the dedication of an amount as capital which amount is so dedicated for the first time. Thus, where a corporation transferred an amount from the capital stock account to capital surplus in a prior recapitalization, and such corporation in a subsequent or second recapitalization transfers such amount from capital surplus to the capital stock account under such circumstances that the amount so restored to the capital stock account is clearly identifiable, a tax is not payable with respect to the amount so rededicated as capital. If the amount transferred to the capital stock account from capital surplus cannot be clearly identified as having been previously dedicated to the capital stock account, the portion of the amount so transferred which is attributable to the amount in capital surplus not previously dedicated to capital is considered to be the amount dedicated to capital for the first time, and tax will be imposed with respect thereto. The amount so transferred which is attributable to the amount in capital surplus not previously dedicated to capital is that proportion of the total amount so transferred that the amount in the capital surplus account before such transfer not previously dedicated to capital bears to the total amount in the capital surplus account before such transfer. The tax is also payable with respect to a transfer of capital surplus to the capital stock account by way of a recapitalization where the amount so transferred can be clearly identified as not having been previously dedicated as capital. Any stock dividend constitutes a recapitalization regardless of the amount of such dividend.

(c) *Examples of computation of tax in a recapitalization.*—(1) *Statutory method of computing tax.* The computation of tax in a recapitalization in ac-

cordance with the formula specified in section 4302 may be illustrated by the following examples:

Example (1). Corporation A has outstanding 10,000 shares of common stock having a stated value of \$50 per share and has an earned surplus of \$1,500,000. Corporation A declares a stock dividend of one share for each share outstanding and issues shares pursuant thereto. As a part of the transaction, \$500,000 is transferred from earned surplus to the capital stock account. The actual value of the 10,000 shares issued in the recapitalization is \$2,400,000, and the tax computed on \$2,000,000 would be \$2,000.

$\frac{\$500,000}{\$2,000,000} \times \$2,000$ or \$500 is the portion of the tax computed on the shares issued in the recapitalization which is considered under section 4302 to be attributable to the amount dedicated to capital for the first time. The tax imposed on the shares issued in such recapitalization is, therefore, \$500.

Example (2). Corporation B has outstanding 1,000 shares of no par common stock with a stated value of \$20 per share which is shown in the capital stock account in the amount of \$20,000. Corporation B also maintains an account designated "capital surplus" which consists of \$100,000, of which \$75,000 is attributable to paid-in-surplus and \$25,000 is attributable to a reduction in the capital stock account. Corporation B issues to its shareholders for each share outstanding one additional share of no par common stock. As a part of such transaction, the capital stock account is increased to \$50,000 by the transfer of \$20,000 from capital surplus, and the transfer of \$10,000 from earned surplus. The stated value of the no par common stock is increased from \$20 per share to \$25 per share. Since \$75,000 of the amount in the capital surplus account has not been previously dedicated to the capital stock account, \$75,000 or

$\frac{3}{4}$ of \$20,000 (\$15,000) is the portion of the amount transferred to the capital stock account from capital surplus considered to be dedicated to capital for the first time. The \$10,000 transferred from earned surplus is clearly identified as having never been previously dedicated to capital. The total amount, therefore, considered to be dedicated to capital for the first time is \$25,000. The 1,000 shares of stock issued have an actual value of \$130,000, and the tax computed on such amount would be \$130. Applying the formula provided in section 4302, $\frac{\$25,000}{\$130,000} \times \$130$ or \$25 is the portion of the tax computed on all shares issued in the recapitalization which is attributable to the amount dedicated to capital for the first time. The tax imposed on the shares issued in such recapitalization is, therefore, \$25

(2) *Alternative method of computing tax.* The examples in subparagraph (1) of this paragraph illustrate the method of computing the tax in a recapitalization in accordance with the formula provided in section 4302. The taxpayer may, if he wishes, compute the tax by an alternative method under which actual value of the shares issued in a recapitalization need not be determined. The same tax result will be obtained under this alternative method except for a possible nominal variation due to the application of the major fraction rule of section 4301. Under this alternative method the tax in a recapitalization is computed by multiplying the amount dedicated as capital for the first time by the applicable tax rate. Thus, in example (1) of subparagraph (1) of this paragraph, \$500,000 multiplied by .001 (\$0.10 on each \$100 equals the factor of .001) results in a tax of \$500, and in example (2) of the same subparagraph \$25,000 multiplied by .001 results in a tax of \$25.

(d) *Recapitalization as part of other transaction.* Where a recapitalization is effected in connection with, or as part of, some other transaction, for example, an original or an additional issue of stock, a merger, etc., the limitation of the tax payable to the proportion specified in this section applies only to the stock issued in that part of the transaction which constitutes a recapitalization. Thus, where a corporation makes a change in its capital structure by transferring to the capital stock account a portion of its earned surplus and replacing an issue of stock with another issue of stock and at the same time disposes of part of the new stock by sale to underwriters, the tax limitation is applicable only to that portion of the new stock which is issued in exchange for the old stock retired thereby. In such case, the portion of the new stock sold to the underwriters is taxable in its entirety without any adjustment on account of the recapitalization. Similarly, where a corporation retires its preferred stock by transferring to the capital stock account a portion of its earned surplus and issuing common stock in exchange therefor, and such exchange is made in connection with a merger in which the corporation issues common stock also to the former stockholders of the merged company, the tax limitation is applicable only to the common stock

issued in exchange for the preferred stock, and the shares or certificates of common stock issued to the former stockholders of the merged company are subject to tax without any adjustment on account of the recapitalization.

§ 47.4303 Statutory provisions; exemptions.

SEC. 4303 *Exemptions*—(a) *Common trust funds*. The tax imposed by section 4301 shall not apply to the issue of shares or certificates of a common trust fund, as defined in section 584.

(b) *Pooled investment funds*. The tax imposed by section 4301 shall not apply to the issue of shares or certificates of a fund maintained by a bank exclusively for the collective investment and reinvestment of assets of qualified trusts (within the meaning of section 401, relating to qualified pension, profit-sharing, and stock bonus plans).

(c) *Installment purchases of certain shares or certificates*. The tax imposed by section 4301 shall not apply to shares or certificates issued by a corporation pursuant to an installment purchase agreement which provides that—

(1) The periodic payments by the purchaser will be applied (as received by the corporation) solely to the acquisition of shares or certificates in specified other corporations (and in specified percentages), and

(2) The corporation will transfer to the purchaser, on or before the termination of the agreement, all shares or certificates in other corporations acquired by it for the purchaser.

For the purposes of the preceding sentence, the term "purchaser" includes a successor in interest of the purchaser.

(d) *Other exemptions*. For other exemptions, see section 4382.

[Sec. 4303 as amended and in effect Jan. 1, 1959]

§ 47.4303-1 Exemptions.

(a) *Common trust funds*. For regulations under section 584, see Part 1 of this chapter (Income Tax Regulations).

(b) *Pooled investment funds*. Section 4303(b) exempts from the tax imposed by section 4301 the issue of shares or certificates of stock of a fund maintained by a bank exclusively for the collective investment and reinvestment of assets of trusts which are qualified trusts within the meaning of section 401, relating to qualified pension, profit-sharing, and stock bonus plans. The exemption applies to such issue of shares or certificates regardless of the capacity in which the bank holds those assets of the qualifying trusts which have been pooled

for the purpose of collective investment or reinvestment. For regulations under section 401, see Part 1 of this chapter (Income Tax Regulations).

(c) *Installment purchases of certain shares or certificates*. Section 4303(c) exempts from the tax imposed by section 4301, under certain circumstances, shares or certificates of stock issued by a corporation pursuant to an installment purchase agreement. The exemption has application only if the installment purchase agreement provides that:

(1) The periodic payments required to be made by the purchaser under the installment purchase agreement will be applied, as received by the corporation, solely to the acquisition of shares or certificates of stock in other corporations which are designated in the agreement and that the periodic payments will be so applied in accordance with the specified percentages set forth in the agreement, and

(2) The corporation, on or before the termination of the installment purchase agreement, will transfer to the purchaser all shares or certificates of stock in the designated corporations which were acquired by it for such purchaser pursuant to such agreement.

The exemption will have application only if all of the foregoing conditions are met. The exemption will not apply, for example, if the corporation has an option, under the installment purchase agreement or otherwise, to distribute cash in lieu of the stock purchased for the purchaser. However, the exemption will apply if the purchaser has the option to receive cash in lieu of the stock purchased for him. For purposes of subparagraph (1) of this paragraph, periodic payments will be considered as being applied "solely to the acquisition of shares or certificates of stock in other corporations" notwithstanding that the agreement authorizes the corporation to apply a portion of such payments to cover loading charges or to retain amounts insufficient to purchase a full share of stock. For purposes of section 4303(c) and this paragraph, the term "purchaser" includes a successor in interest of the purchaser.

§ 47.4304 Statutory provisions; affixing of stamps.

SEC. 4304 *Affixing of stamps*. The stamps representing the tax imposed by section 4301

shall be affixed to the stock books or corresponding records of the organization and not to the certificates issued.

[Sec. 4304 as originally enacted and in effect Jan. 1, 1959]

§ 47.4304-1 Affixing of stamps.

(a) *Documentary stamps.* Only documentary stamps shall be used in payment of the tax imposed by section 4301. The requisite stamps shall be affixed to the stock books or corresponding records of the corporation, and not to the certificates issued. See §§ 47.6804-1 and 47.6804-2 for appropriate use, denominations, and cancellation of such stamps.

(b) *Purchase of documentary stamps.* Documentary stamps may be purchased, and requisition forms for the purchase of such stamps may be obtained, from the sources and in the manner provided in § 47.6802-1. For provisions relating to distribution, supply, and redemption of stamps, see sections 6801 (§ 47.6801), 6802 (§ 47.6802), and 6805 (§ 47.6805), and the regulations thereunder contained in Part 301 of this chapter (Regulations on Procedure and Administration), and § 47.6801-1.

§ 47.4305 Statutory provisions; cross references.

SEC. 4305 *Cross references.* For definitions, penalties, and other general and administrative provisions applicable to this part, see sections 4381 and 4384 and subtitle F.

[Sec. 4305 as amended and in effect Jan. 1, 1959]

§ 47.4305-1 Cross references.

(a) For definitions, see section 4381, § 47.4381-1, and section 7701 (§ 47.7701).

(b) For penalties, see section 7271 and § 47.7271-1.

(c) For other general and administrative provisions, see section 4384, § 47.4384-1, Subpart J, and the applicable sections of subtitle F and the regulations in Part 301 of this chapter (Regulations on Procedure and Administration).

Subpart C—Tax on Issuance of Certificates of Indebtedness

§ 47.4311 Statutory provisions; imposition of tax.

SEC. 4311 *Imposition of tax.* There is hereby imposed, on all certificates of indebtedness issued by a corporation, a tax at the rate of 11 cents on each \$100 of face value or fraction thereof.

[Sec. 4311 as amended and in effect Jan. 1, 1959]

§ 47.4311-1 Imposition of tax on issuance of certificates of indebtedness.

(a) *Scope of tax.* Section 4311 imposes a tax on the issue within the territorial jurisdiction of the United States by any corporation of certificates of indebtedness as defined in section 4381(a) and paragraph (a) of § 47.4381-1. See section 4381(b) and paragraph (b) of § 47.4381-1 for definition of the term "corporation". Every renewal of a certificate of indebtedness is subject to tax as a new issue (see § 47.4312-1). A certificate of indebtedness is issued within the meaning of the law at the time it is delivered so as to constitute an obligation of the issuer.

(b) *Rate and computation of tax.* The rate of tax is 11 cents on each \$100 or fraction thereof of the face value of each certificate of indebtedness; except that, where a certificate conditioned for the repayment or payment of money is given in a penal sum, greater than the debt secured, the tax is based upon the amount secured (see section 4313). A separate computation of tax must be made with respect to each certificate of indebtedness regardless of the number of certificates which may be issued in a single transaction. For example, the tax on the issuance of a certificate having a face value of \$1,000 is \$1.10. The tax on the issuance of 2 certificates having a face value of \$50 each is 22 cents, that is, 11 cents on each certificate, whether the certificates are issued to the same person or to different persons.

(c) *Affixing of stamps.* (1) The requisite documentary stamps shall be affixed either to the certificates of indebtedness or to the indenture or agreement under which they are issued. If the stamps are affixed to the indenture or agreement, the certificate must bear a legend showing that the proper documentary stamps have been affixed to the indenture or agreement and duly cancelled. If the indenture provides for the issue of certificates over a period of years, the requisite stamps may be affixed at the time of each issue. Only documentary stamps shall be used in payment of the tax imposed by section 4311. See §§ 47.6804-1 and 47.6804-2 for the appropriate use, denominations, and cancellation of such stamps.

(2) Documentary stamps may be purchased, and requisitions for the purchase of such stamps may be obtained, from the sources and in the manner provided in § 47.6802-1. For provisions relating to distribution, supply, and redemption of stamps, see sections 6801 (§ 47.6801), 6802 (§ 47.6802), and 6805 (§ 47.6805), and the regulations thereunder contained in Part 301 of this chapter (Regulations on Procedure and Administration), and § 47.6801-1.

§ 47.4311-2 Illustrations.

(a) *Issues subject to tax.* The following are examples of corporate instruments taxable upon issue:

(1) A bond secured by a real estate mortgage.

(2) A bond delivered to a bank or trust company as security for the payment of an obligation.

(3) Bonds executed outside the United States by a foreign corporation and delivered in the United States.

(4) Interim certificates or temporary bonds issued in lieu of definitive bonds. However, no additional tax is due on the issuance of the corresponding permanent or definitive bonds, but each of such permanent or definitive bonds must bear notation of the fact that requisite stamps were duly affixed to the interim certificates or temporary bonds or to the indenture or agreement under which such interim certificates or temporary bonds were issued.

(5) Equipment trust certificates.

(6) Any certificate of indebtedness issued by any receiver, trustee in bankruptcy, assignee, or other person, having custody of property, or charge of the affairs, of any corporation (see section 4381(b)).

(b) *Issues not subject to tax.* In addition to the various issues specifically exempt under sections 4314(a) and 4382, the following are examples of instruments not taxable upon issue:

(1) An instrument issued by an individual or partnership.

(2) An instrument merely representing the assignment of an interest in a bond (see, however, § 47.4331-1 and paragraph (b) of § 47.4351-1).

(3) Bonds issued in exchange for outstanding bonds of different denominations but of the same kind, the same total face amount, and the same maturity date.

(4) Permanent or definitive bonds issued in exchange for interim certificates or temporary bonds representing the same obligation (see, however, paragraph (a)(4) of this section).

(5) A certificate of deposit issued by a bank, whether or not negotiable, and whether payable on demand or at some specified time; and a certificate of deposit issued by an organization operating under the Morris Plan.

(6) Indemnity, fidelity, and surety bonds.

(7) A business property investment certificate, wherein it is certified that the holder thereof is the owner of an interest in certain specified property, legal title to which has been previously conveyed to a trustee, and whereby the issuing corporation agrees to manage the property and distribute the proceeds. However, such instrument is subject to the tax imposed by section 4301 (see paragraph (a)(11) of § 47.4301-2).

(8) A bond issued by a trust company on behalf of the estate of a decedent for which it is acting as executor or administrator, provided the certificate is issued solely on the credit of the estate.

(9) A warrant granting the right to purchase unissued bonds (see § 47.4331-3).

(10) A promissory note of a corporation which does not have the characteristics of a certificate of indebtedness. (For an instrument designated a promissory note which may be subject to tax, see paragraph (a) of § 47.4381-1.)

§ 47.4312 Statutory provisions; renewal of certificates of indebtedness.

Sec. 4312 *Renewals.* Every renewal of any certificate of indebtedness shall be taxed as a new issue.

[Sec. 4312 as redesignated and in effect Jan. 1, 1959]

§ 47.4312-1 Tax on renewal of certificates of indebtedness.

Every renewal of a certificate of indebtedness is subject to the tax imposed by section 4311 as a new issue. Whenever there is such a material change in the obligation as to constitute a new obligation, as, for example, an extension of maturity date or a change in the interest rate of the outstanding certificate of indebtedness, such change constitutes a renewal subject to tax as a new issue. The time when the original certificate was issued is immaterial.

Likewise, the time when the certificate is renewed, whether before or after the original date of maturity, is immaterial. A tax liability is not dependent upon use of any particular form of instrument to effect the renewal. The renewal may, for example, be evidenced by a notation on the original certificate, by a collateral agreement, or by an extension agreement.

§ 47.4313 Statutory provisions; bond as security for debt.

SEC. 4313 Bond as security for debt. In the case where a bond conditioned for the repayment or payment of money is given in a penal sum greater than the debt secured, the tax imposed by section 4311 shall be based upon the amount secured.

[Sec. 4313 as redesignated and in effect Jan. 1, 1959]

§ 47.4313-1 Bond as security for debt.

For the effect of section 4313 on the computation of the tax, see paragraph (b) of § 47.4311-1.

§ 47.4314 Statutory provisions; exemption for certain installment obligations.

SEC. 4314 Exemptions—(a) Installment purchase of obligations. The tax imposed by section 4311 shall not apply to any instrument under the terms of which the obligee is required to make payment therefor in installments and is not permitted to make in any year a payment of more than 20 percent of the cash amount to which entitled upon maturity of the instrument.

(b) *Other exemptions.* For other exemptions, see section 4382.

[Sec. 4314 as redesignated and in effect Jan. 1, 1959]

§ 47.4315 Statutory provisions; cross references.

SEC. 4315 Cross references. For definitions, penalties, and other general and administrative provisions applicable to this part, see sections 4381 and 4384 and subtitle F.

[Sec. 4315 as redesignated and amended and in effect Jan. 1, 1959]

§ 47.4315-1 Cross references.

(a) For definitions, see section 4381. § 47.4381-1, and section 7701 (§ 47.7701)

(b) For penalties, see section 7271 and § 47.7271-1.

(c) For other general and administrative provisions, see section 4384, § 47.4384-1, Subpart J, and the applicable sections of subtitle F and the regulations in Part 301 of this

chapter (Regulations on Procedure and Administration).

Subpart D—Tax on Sales or Transfers of Capital Stock and Similar Interests

§ 47.4321 Statutory provisions; imposition of tax.

SEC. 4321 Imposition of tax. There is hereby imposed on each sale or transfer of shares or certificates of stock, or of rights to subscribe for or to receive such shares or certificates, issued by a corporation, a tax at the rate of 4 cents on each \$100 (or major fraction thereof) of the actual value of the certificates, of the shares where no certificates are sold or transferred, or of the rights, as the case may be. In no case shall the tax so imposed on any such sale or transfer be—

- (1) More than 8 cents on each share, or
- (2) Less than 4 cents on the sale or transfer.

[Sec. 4321 as amended and in effect Jan. 1, 1959, and as further amended by sec. 5(a), Act of Sept. 21, 1959 (Pub. Law 86-344, 73 Stat. 619)]

§ 47.4321-1 Imposition of tax.

(a) *Scope of tax.* Section 4321 imposes a tax on each sale or transfer (as defined in section 4351(b)), within the territorial jurisdiction of the United States of shares or certificates of stock, or of rights to subscribe for or to receive such shares or certificates, issued by a corporation. As to sales or transfers of warrants to subscribe for or to purchase stock, see § 47.4321-3. The tax applies to the specified dealings or transactions in stock, whether occurring before, after, or without the issuance of a certificate. The tax attaches at the time of making the sale or transfer, regardless of the time or manner of delivery of the certificate, agreement, or memorandum of sale. For requirements as to the making and keeping of records of such sales or transfers, see §§ 47.4352-1 and 47.6001-1. See section 4381 and § 47.4381-1 for definitions of the terms "corporation" and "shares or certificates of stock". For purposes of the tax imposed by section 4321, the term "stock", as used in the regulations in this part, includes shares or certificates of stock and rights to subscribe for or to receive such shares or certificates.

(b) *Rate and computation of tax—*
(1) *Computation.* Where, by sale or transfer, stock of the same class issued by one corporation is transferred from

a single transferor to a single transferee, the tax is computed on the basis of the aggregate actual value of all the shares transferred. Where there are two or more transferors or two or more transferees, or where in a single transaction transfer is made of the stock of two or more corporations or of two or more classes issued by a single corporation, a separate tax computation must be made with respect to each transferor and each transferee and with respect to the stock of each corporation and the stock of each class issued by a single corporation. The foregoing rule may be illustrated by the following examples:

Example (1). A, owning 25 shares of common stock and 25 shares of preferred stock of the X Corporation, and 50 shares of the common stock of the Y Corporation, transfers all the stock by delivering the certificates to B. In this situation, there are three distinct transactions, namely, a transfer of 25 shares of common stock of the X Corporation, a transfer of 25 shares of preferred stock of the X Corporation, and a transfer of 50 shares of common stock of the Y Corporation, and the tax is computed, in the case of each transfer, upon the actual value of the stock.

Example (2). A, owning 100 shares of stock in the X Corporation represented by one or more certificates, sells 50 shares each to B and C. To that end, A sends his certificate or certificates to the transfer agent with instructions to issue one or more certificates aggregating 50 shares to each purchaser. In this situation, there are two distinct transactions, namely, two sales of 50 shares of stock each, and the tax is computed upon the actual value of the stock transferred to each purchaser.

Example (3). A and B, each owning 50 shares of stock in the X Corporation represented in each case by one or more certificates, make a gift of their stock to C. To that end, they send their certificates to the transfer agent with instructions to issue to the donee one or more certificates for the entire 100 shares. In this situation, there are likewise two distinct transactions, namely, two gifts of 50 shares of stock each, and a separate computation must be made with respect to each gift.

(2) *Rate of tax—(i) In general.* The rate of tax applicable to each sale or transfer of shares or certificates of stock or of rights to subscribe for or to receive shares or certificates of stock is 4 cents on each \$100 (or major fraction thereof) of the actual value of the certificates, of the shares where no certificates are sold or transferred, or of the rights. In

no case, however, shall the tax imposed on any such sale or transfer be—

(a) More than 8 cents on each share sold or transferred or, in the case of the sale or transfer of rights to subscribe for or to receive shares or certificates of stock, more than 8 cents in respect of each share covered by such rights, or

(b) Less than 4 cents on any one sale or transfer.

(ii) *Exception in the case of rights sold or transferred prior to November 1, 1959.* The rate of tax applicable in respect of any sale or transfer, prior to November 1, 1959, of rights to subscribe for or to receive shares or certificates of stock is 4 cents on each \$100 (or major fraction thereof) of the actual value of the stock to which the rights relate. However, the provisions of subdivision

(i) (a) (insofar as they relate to rights) and (b) of this subparagraph are applicable in computing the maximum and minimum amount of tax imposed on any sale or transfer of rights to which this subdivision has application.

(iii) *Major fraction.* A major fraction of \$100 is any amount in excess of \$50 and less than \$100.

(3) *Actual value.* The principles set forth in paragraph (b) (2) (ii) of § 47.4301-1 for determining the actual value of shares or certificates of stock issued are equally applicable for purposes of determining the actual value of shares or certificates of stock, or rights thereto, sold or transferred.

(4) *Examples of computation.* The computation of the tax imposed by section 4321 may be illustrated by the following examples:

Example (1). A sells to B 100 shares of stock of the X Corporation having an actual value of \$10,000 and gives to B 10 shares of stock of the Y Corporation having an actual value of \$2,560. A separate computation must be made with respect to the stock of each corporation. Applying the rate of 4 cents for each \$100 of actual value (or major fraction thereof), the tax on the sale of the X Corporation stock is \$4 ($100 \times \0.04) and the tax on the gift of the Y Corporation stock is \$1.04 (26, applying the major fraction rule, $\times \$0.04$). Since the application of the 4-cent rate results in tax in excess of 8 cents per share in the case of the Y Corporation stock ($\$1.04 \div 10$), the tax in respect of such stock is computed at the rate of 8 cents per share resulting in tax of \$.80. Thus, the total tax in respect of the sale and gift of the stock of X Corporation and of Y Corporation is \$4.80.

Example (2). A sells to B 10 shares of stock having an actual value of \$50. Since \$50 does not constitute a major fraction of \$100 the provision of section 4321 imposing a minimum tax of not less than 4 cents on a sale or transfer applies. Accordingly, the tax on the sale of the 10 shares is 4 cents.

(5) *Cross reference.* For provisions relating to the application of the tax imposed by section 4321 in the case of certain changes in a partnership, see section 4383 and § 47.4383-1.

§ 47.4321-2 Illustrations.

(a) *Sales and transfers subject to tax.* The following transfers of stock are illustrations of transactions which are taxable, unless exempt from tax under a specific provision of the Internal Revenue Code (see sections 4322, 4341 to 4344, inclusive, 4382, and 4383(a) with respect to such exemptions):

(1) Transfer by gift.

(2) Transfer by an administrator or executor to a distributee or legatee (see, however, section 4344(b) and paragraph (b) of § 47.4344-1).

(3) Transfer to or by trustees (see, however, section 4343(a)(8)).

(4) Transfer of an interim certificate, a voting trust certificate, or a certificate of beneficial interest in an association.

(5) Transfer from persons holding legal title as tenants in common, as joint tenants, or as tenants by the entirety, to the same persons separately to effect a partition, or from one person to two or more persons, whether or not including the transferor, as tenants in common, as joint tenants, or as tenants by the entirety (see, however, section 4343(a)(9)).

(6) Transfer from a partnership on its termination under section 708; also from a partnership to an individual member thereof upon a dissolution of his interest in the partnership. See § 47.4383-1.

(7) Transfer to a corporation of its own stock (see, however, paragraph (b)(3) of this section).

(8) Transfer upon a merger from the name of a merging corporation of stock owned by it to the name of the continuing corporation. Similarly, upon a consolidation, a transfer from any of the consolidating corporations to the consolidated corporation (see, however, paragraphs (b)(6) and (7) of this section). For exemption from tax in re-

spect of transfers to make effective a plan of reorganization or adjustment whereby a mere change in identity, form, or place of organization is effected, see paragraph (d) of § 47.4382-1.

(9) In addition to the tax on the issuance of stock in connection with a merger or consolidation, where such stock is issued directly to the stockholders of the merging or consolidating corporations by the continuing or consolidated corporation (see paragraphs (a)(8) and (9) of § 47.4301-2), there is also a transfer tax imposed at the time of the issuance of such stock. The transfer tax is applicable to such a transaction inasmuch as there is involved the transfer to the stockholders of the merging or consolidating corporations of such corporations' right to receive the stock of the continuing or consolidated corporation. For exemption from tax in respect of transfers to make effective a plan of reorganization or adjustment whereby a mere change in identity, form, or place of organization is effected, see paragraph (d) of § 47.4382-1.

(10) Transfer of stock to another person upon order of the purchaser; transfer of the right to receive a stock dividend already declared; issuance of stock to a person other than the subscriber; all other transfers of rights to receive stock; and all transfers of rights to subscribe for stock.

(11) Transfer by a broker to a customer of stock issued as a dividend on stock purchased for the customer by the broker and held by the broker in his own name or in the name of his nominee.

(12) Transfer of stock on the books of a domestic corporation, regardless of where the sale is made or the stock certificate is delivered.

(13) Sale or transfer within the territorial jurisdiction of the United States of stock of a foreign corporation.

(14) Transfers by operation of law (see, however, § 47.4343-1).

(b) *Sales and transfers not subject to tax.* In addition to the exemptions prescribed in sections 4382 and 4383(a) which apply to documentary stamp taxes generally and to the specific exemptions provided in sections 4322 and 4341 to 4344, inclusive, and the regulations thereunder, the following are examples of transactions not subject to tax:

(1) Transfer of stock pursuant to a sale, where the requisite stamps have been affixed to the memorandum of sale.

(2) Surrender of certificates in exchange for other certificates representing the same stock issued to the same person (see also paragraph (b) (2) of § 47.4301-2).

(3) Surrender of stock to the issuing corporation for extinguishment (see also paragraph (a) (7) of this section).

(4) Change in the registration of stock for the sole purpose of recording a change in the name of a stockholder, such as from the maiden name to the married name of a stockholder, or a change in the name of a corporation which is a stockholder.

(5) Transfer of stock to or by an insolvent bank, where such transfer is within the provisions of section 7507.

(6) In a consolidation of corporations, the surrender of stock of any of the consolidating corporations in exchange for stock of the consolidated corporation (see, however, paragraph (a) (9) of this section and paragraph (a) (8) of § 47.4301-2).

(7) In a merger of corporations, the surrender of stock of both the merging and the continuing corporations in exchange for stock of the continuing corporation (see, however, paragraph (a) (9) of this section and paragraph (a) (9) of § 47.4301-2).

(8) Deliveries of stock to or by a clearinghouse for the sole purpose of clearing or adjusting accounts of its members.

(9) Transfer of stock pursuant to a call, since a "call" is an agreement to sell stock and taxable as such. However, a person making such nontaxable transfer shall furnish and attach to the certificate a statement in substantially the following form:

It is hereby certified that the transfer of _____ shares of the within stock to _____ has been made pursuant to a "call", and that the requisite Federal documentary stamps for the transaction are affixed to such "call", which is in the possession of the undersigned.

Signature

(10) The mere delivery of a certificate of stock by a customer to his broker solely for the purpose of enabling such broker to sell the stock for the customer,

where the broker has no legal title or other interest in the stock.

(11) The mere delivery of a certificate of stock by a purchasing broker to his customer, if the tax was paid upon the sale of the stock to such broker and such broker has no legal title or other interest in the stock.

§ 47.4321-3 Tax on warrants.

(a) *To subscribe for stock.* Transfers of warrants entitling the holder to subscribe for stock are taxable as transfers of rights to subscribe. For computation of the tax on transfers of rights to subscribe for stock, see paragraph (b) of § 47.4321-1. The issue of a warrant entitling the holder to subscribe for stock is not subject to tax, but the issue of stock upon exercise of the warrant is subject to the tax imposed by section 4301 (see paragraph (a) (7) of § 47.4301-2).

(b) *To purchase issued stock.* (1) Warrants entitling the holder to purchase issued stock are taxable upon issuance as agreements to sell stock (see definition of "sale or transfer" in section 4351(b) and paragraph (b) of § 47.4351-1). The tax imposed by section 4321 is computed on the basis of the actual value of the stock at the time the warrant is issued. The warrant price is not indicative of the actual value to be attributed to the stock for purposes of the tax.

(2) Transfers of warrants entitling the holder to purchase issued stock are not subject to the stamp tax since the statute does not impose a tax on sales or transfers of agreements to sell stock. If the transfer tax is paid upon the issuance of a warrant as an agreement to sell stock, no additional transfer tax is incurred upon the subsequent transfer of the stock pursuant to the exercise of the warrant. However, the person making such exempt transfer of stock shall furnish and attach to the certificate a statement in substantially the following form:

It is hereby certified that the transfer of the attached certificate for _____

(Number of shares and description of stock) _____

_____ is made

(Name of transferee)
pursuant to the exercise of a warrant which is in the possession of the undersigned, and that the requisite stamps due upon the issu-

ance of such warrant have been affixed thereto.

Signature

§ 47.4321-4 Cross references.

(a) *Records of sales and transfers of stock.* For recordkeeping requirements, see § 47.6001-1.

(b) *Registration of nominees.* For provisions with respect to registration of nominees, see paragraph (a) of § 47.4351-1.

(c) *Rules applicable to securities exchanges and clearinghouses.* For rules applicable to securities exchanges and clearinghouses, see § 47.4353-1.

§ 47.4322 Statutory provisions; exemptions.

Sec. 4322 Exemptions—(a) *Exemptions for certain transfers.* The tax imposed by section 4321 shall not apply to any delivery or transfer of shares, certificates, or rights—

(1) *Brokers.* To a broker or his registered nominee for sale of such shares, certificates, or rights; by a broker or his registered nominee to a customer for whom and upon whose order the broker has purchased same; or by a purchasing broker to his registered nominee to be held by such nominee for the same purpose as if held by the broker; or

(2) *Nominees of corporations.* From a corporation to a registered nominee of such corporation, or from one such nominee to another such nominee, provided that in each instance such shares, certificates, or rights are to be held by the nominee for the same purpose as if retained by the corporation; or from such nominee to such corporation.

(b) *Certain odd-lot transactions—*(1) *Exemption.* The tax imposed by section 4321 shall not apply to any odd-lot sale by an odd-lot dealer if the shares, certificates, or rights are delivered or transferred to a broker pursuant to an order of a customer of such broker for such shares, certificates, or rights.

(2) *Definitions.* For purposes of paragraph (1)—

(A) The term "odd-lot sale" means an odd-lot transaction under the rules of the securities exchange of which the odd-lot dealer is a member.

(B) The term "odd-lot dealer" means a person who is (i) a member of a securities exchange which is registered with the Securities and Exchange Commission as a national securities exchange, and (ii) registered under the rules of such exchange as an odd-lot dealer or as a specialist.

(c) *Other exemptions.* For other exemptions, see sections 4341, 4342, 4343, 4344, and 4382.

[Sec. 4322 as amended and in effect Jan. 1, 1959]

§ 47.4322-1 Exemptions.

(a) *Transfer from customer to broker.*

(1) If stock is transferred to the name of a broker, or to the name of a broker's registered nominee, solely for the purpose of enabling such broker to sell the stock for the customer, the transfer is exempt from tax provided the broker furnishes at the time of transfer or delivery an exemption certificate in substantially the form prescribed in § 47.4345-1. For provisions relating to the registration of nominees, see paragraph (a) of § 47.4351-1.

(2) A transfer to the name of a selling agent other than a broker, as, for example, a bank, whether the sale be made by the agent direct or through a broker for the agent's account, is subject to tax, since the exemption applies only to deliveries and transfers to brokers (but see paragraph (b) of § 47.4342-1). However, liability is not incurred by the mere delivery of a certificate of stock to an agent who obtains no legal title or other interest in the stock.

(b) *Transfer from broker to customer.* (1) If stock is transferred to the name of a purchasing broker or his registered nominee who holds the stock for the same purpose as if held by the broker and tax on such transfer is paid, transfer may thereafter be made to the name of the purchaser (for whom and upon whose order the broker has purchased such stock) without payment of tax. If the tax was paid upon the transfer to the name of the purchasing broker, transfer may be made to the name of his registered nominee and from such nominee to the name of the purchaser without payment of tax. However, no exemption will be allowed under this paragraph unless the broker furnishes at the time of transfer or delivery an exemption certificate in substantially the form prescribed in § 47.4345-1. For provisions relating to the registration of nominees, see paragraph (a) of § 47.4351-1.

(2) Delivery to, or transfer to the name of, the customer may not be made tax free in any case in which the stock was transferred from the seller to the broker or his registered nominee without payment of the tax, since the law requires that the tax shall be paid on the transfer or transfers between the actual seller and actual buyer. A transfer from

the name of a purchasing agent other than a broker, as, for example, a bank, whether the purchase be made directly or through a broker for the agent's account, is subject to tax, since the exemption applies only to deliveries and transfers from brokers (but see paragraph (b) of § 47.4342-1). However, liability is not incurred by the mere delivery to the principal of a certificate of stock by an agent having no legal title or other interest in the stock, or by a broker for the account of such agent.

(c) *Transfers between corporations and nominees.* The tax does not apply to the delivery or transfer of stock from a corporation to a registered nominee of such corporation, or from one such nominee to another such nominee, if in either case the shares or certificates continue to be held by such nominee for the same purpose for which they would be held if retained by such corporation; or from such nominee to such corporation. No exemption is granted unless the nominee is registered in the manner provided in paragraph (a) of § 47.4351-1. Nor shall the exemption be granted in any case unless the delivery or transfer is accompanied by an exemption certificate, executed by the person making the exempt transfer, in substantially the form prescribed in § 47.4345-1.

(d) *Certain odd-lot transactions.* The tax imposed by section 4321 shall not apply to any odd-lot sale by an odd-lot dealer if the shares, certificates, or rights are delivered or transferred to a broker pursuant to an order of a customer of such broker for such shares, certificates, or rights and the broker furnishes at the time of transfer or delivery an exemption certificate in substantially the form prescribed in § 47.4345-1. Actual physical delivery or transfer of the shares, certificates, or rights sold is not required if the effect of the transaction is a sale to a customer of the broker. Thus, if an odd-lot dealer executes odd-lot purchase and sale orders in a particular stock for a broker pursuant to orders of the broker's customers during a given day and only the net balance of such stock for that day is physically delivered or transferred to the broker, all of the odd-lot sales which contributed to such net balance are exempt. The term "odd-lot sale" means an odd-lot transaction under the rules of the securities exchange of which the odd-lot dealer

making the sale is a member. The term "odd-lot dealer" means a person who is (1) a member of a securities exchange which is registered with the Securities and Exchange Commission as a national securities exchange, and (2) registered under the rules of such exchange as an odd-lot dealer or as a specialist.

§ 47.4323 Statutory provisions; affixing of stamps.

Sec. 4323 *Affixing of stamps*—(a) *Books of the corporation.* The stamps representing the tax imposed by section 4321 shall be affixed to the books of the corporation in case of a sale where the evidence of transfer is shown only by the books of the corporation.

(b) *Certification as to value by transferor or transferee.* Where shares or certificates of stock, or of rights to subscribe for or to receive such shares or certificates, are presented for transfer and the tax thereon is paid by the use of adhesive stamps, such shares, certificates, or rights shall be accompanied by a certification signed by the transferor or his agent or the transferee or his agent as to the actual value of the shares, certificates, or rights so transferred, and any corporation or transfer agent to whom such shares, certificates, or rights are presented shall be entitled to rely on such certification without further inquiry.

(c) *Other evidences of sale or transfer.* For provisions applicable to the affixing of stamps in cases of sale or transfer shown otherwise than only by the books of the corporation, see section 4352.

[Sec. 4323 as amended and in effect Jan. 1, 1959 and as further amended by sec. 5(b), Act of Sept. 21, 1959 (Pub. Law 86-344, 73 Stat. 619)]

§ 47.4323-1 Affixing of stamps.

(a) *Books of the corporation.* (1) Except as provided in section 4353 and § 47.4353-1, only documentary stamps shall be used in payment of the tax imposed by section 4321. In the case of a sale or transfer evidenced only by the books of the corporation or other organization, the requisite stamps shall be affixed to such books. In the case of a sale or transfer evidenced otherwise than only by the books of the corporation or other organization, see section 4352 and § 47.4352-1 for provisions relating to the affixing of the requisite stamps. See also §§ 47.6804-1 and 47.6804-2 for the appropriate use, denominations, and cancellation of such stamps. For provisions relating to payment, through a national securities exchange or a clear-

inghouse for such exchange, of tax without use of stamps, see § 47.4353-1.

(2) Documentary stamps may be purchased, and requisitions for the purchase of such stamps may be obtained, from the sources and in the manner provided in § 47.6802-1. For provisions relating to distribution, supply, and redemption of stamps, see sections 6801 (§ 47.6801), 6802 (§ 47.6802), and 6805 (§ 47.6805), and the regulations thereunder contained in Part 301 of this chapter (Regulations on Procedure and Administration), and § 47.6801-1.

(b) *Certification as to value by transferor or transferee.* Where shares or certificates of stock, or of rights to subscribe for or to receive such shares or certificates, are presented for transfer and the tax thereon is paid by the use of documentary stamps, such shares, certificates, or rights shall be accompanied by a certification signed by the transferor or his agent or the transferee or his agent as to the actual value of the shares, certificates, or rights so transferred and any corporation or transfer agent to whom such shares, certificates, or rights are presented shall be entitled to rely on such certification without further inquiry. Where the documents are presented for transfer with a bill or memorandum of agreement to sell, sale, or transfer as required by paragraph (b) of § 47.4352-1, such bill or memorandum shall constitute the certification. Where the documents are presented for transfer without such bill or memorandum, the certification referred to in this paragraph shall be in substantially the following form:

It is hereby certified that the actual value on -----
 (Date of taxable transfer or sale)
 of the accompanying instrument(s) is \$-----,
 as determined by -----
 (Basis of valuation—sale
 price, mean selling price
 on market, etc.)

 Signature of transferor, transferee,
 or agent of either

§ 47.4324 Statutory provisions; cross references.

Sec. 4324 Cross references. For definitions, penalties, and other general and administrative provisions applicable to this part, see sections 4345, 4351, 4353, 4381, and 4384, and subtitle F.

[Sec. 4324 as amended and in effect Jan. 1, 1959]

§ 47.4324-1 Cross references.

(a) For definitions, see section 4351 and § 47.4351-1, section 4381 and § 47.4381-1, and section 7701 (§ 47.7701).

(b) For penalties, see section 7271 and § 47.7271-1.

(c) For other general and administrative provisions, see section 4345 and § 47.4345-1, section 4352 and § 47.4352-1, section 4353 and § 47.4353-1, section 4384 and § 47.4384-1, Subpart J, and the applicable sections of subtitle F and the regulations in Part 301 of this chapter (Regulations on Procedure and Administration).

Subpart E—Tax on Sales or Transfers of Certificates of Indebtedness

§ 47.4331 Statutory provisions; imposition of tax.

Sec. 4331 Imposition of tax. There is hereby imposed, on each sale or transfer of any certificates of indebtedness issued by a corporation, a tax at the rate of 5 cents on each \$100 or fraction thereof of the face value.

[Sec. 4331 as amended and in effect Jan. 1, 1959]

§ 47.4331-1 Imposition of tax.

(a) *Scope of tax.* Section 4331 imposes a tax on each sale or transfer (as defined in section 4351(b)) within the territorial jurisdiction of the United States of certificates of indebtedness issued by a corporation. See section 4381 and § 47.4381-1 for definitions of the terms "certificates of indebtedness" and "corporation". The tax attaches at the time of making the sale or transfer, regardless of the time or manner of delivery of the certificate or agreement or memorandum of sale. As to sales or transfers of warrants to subscribe for or purchase certificates of indebtedness, see § 47.4331-3. For requirements in respect of records and memoranda of such sales or transfers, see §§ 47.4331-4 and 47.4352-1. For provisions relating to the application of the tax imposed by section 4331 in the case of certain changes in a partnership, see section 4383 and § 47.4383-1.

(b) *Rate and computation of tax.* (1) Where by sale or otherwise certificates of indebtedness of the same issue of a single corporation are transferred by a single transferor to a single transferee, the tax is 5 cents on each \$100 of face

value, or fraction thereof, of the aggregate face value of all the certificates. Where there are two or more transferors or two or more transferees, or where in a single transaction transfer is made of certificates of two or more corporations or of two or more classes issued by a single corporation, a separate tax computation must be made with respect to each transferor and each transferee, and with respect to the certificates of each corporation and of the certificates of each class issued by a single corporation. The foregoing rule may be illustrated by the following examples:

Example (1). M, owning 25 class A bonds of the X Corporation and 25 class B bonds of the same corporation, and 50 class A bonds of the Y Corporation, transfers all the bonds to N. In this situation there are three taxable transfers, and a separate tax computation must be made with respect to the aggregate face value of the bonds involved in each.

Example (2). M, owning 100 class A bonds of the X Corporation, sells 50 bonds to N and 50 bonds to O. In this situation, there are two sales of 50 bonds each, and the tax is measured by the aggregate face value of the bonds sold to each purchaser.

Example (3). A husband and wife, each owning \$50,000 face amount of class A bonds of the X Corporation, simultaneously give their bonds to their son. In this situation, there are two gifts, and a separate computation must be made with respect to the aggregate face value of the bonds included in each gift.

(2) The separate tax computation required will result in a difference in the amount of tax only where the face value of the certificates transferred is not \$100 or multiples thereof.

(c) *Affixing of stamps.* (1) Except as provided in section 4353 and § 47.4353-1, only documentary stamps shall be used in payment of the tax imposed by section 4331. For provisions relating to the affixing of the requisite stamps in case of a sale or transfer of certificates of indebtedness, see section 4352 and § 47.4352-1. See also §§ 47.6804-1 and 47.6804-2 for the appropriate use, denominations, and cancellation of such stamps. For provisions relating to payment, through a national securities exchange or a clearinghouse for such exchange, of tax without use of stamps, see § 47.4353-1.

(2) Documentary stamps may be purchased, and requisition forms for the

purchase of such stamps may be obtained, from the sources and in the manner provided in § 47.6802-1. For provisions relating to distribution, supply, and redemption of stamps, see sections 6801 (§ 47.6801), 6802 (§ 47.6802), and 6805 (§ 47.6805), and the regulations thereunder contained in Part 301 of this chapter (Regulations on Procedure and Administration), and § 47.6801-1.

§ 47.4331-2 Illustrations.

(a) *Sales and transfers subject to tax.* The tax on sales or transfers of certificates of indebtedness imposed by section 4331 is similar in scope to the tax on stock transfers imposed by section 4321. Accordingly, the various examples set forth in paragraph (a) of § 47.4321-2 of sales and transfers of stocks subject to the stock transfer tax apply, with certain exceptions, to sales and transfers of certificates of indebtedness unless such sales and transfers of certificates of indebtedness are exempt from tax under a specific provision of the Internal Revenue Code (see sections 4332, 4341 to 4344, inclusive, 4382, and 4383(a) with respect to such exemptions). These exceptions are the examples stated in paragraphs (a) (9) and (10) of § 47.4321-2.

(b) *Sales and transfers not subject to tax.* In addition to the exemptions prescribed in sections 4382 and 4383(a) which apply to documentary stamp taxes generally and to the specific exemptions provided in sections 4332, and 4341 to 4344, inclusive, and the regulations thereunder, the examples set forth in paragraph (b) of § 47.4321-2 of sales and transfers of stocks not subject to the stock transfer tax illustrate sales and transfers of certificates of indebtedness which are not subject to the tax imposed by section 4331.

§ 47.4331-3 Tax on warrants.

(a) *To subscribe for certificates of indebtedness.* Warrants entitling the holder to subscribe for unissued certificates of indebtedness are not subject to tax under section 4331.

(b) *To purchase issued certificates of indebtedness.* Warrants entitling the holder to purchase issued certificates of indebtedness are, upon issuance, subject to tax under section 4331, as agreements to sell certificates (see definition of "sale

or transfer" in section 4351(b) and paragraph (b) of § 47.4351-1). Subsequent transfers of such warrants are not subject to the transfer tax since the statute does not impose a tax upon transfers of agreements to sell certificates of indebtedness. For rate and computation of tax, see paragraph (b) of § 47.4331-1. If the transfer tax is paid upon issuance of a warrant, the subsequent transfer of the certificate pursuant to the exercise of such warrant is not subject to the transfer tax. However, the person transferring the certificate shall furnish and attach thereto a statement substantially as follows:

It is hereby certified that the transfer of the attached certificates of indebtedness,

(description and face value of certificates) to -----,

(name of transferee)

is made pursuant to the exercise of a warrant which is in the possession of the undersigned, and that the requisite stamps due upon the issuance of such warrant have been affixed thereto.

(Signature)

§ 47.4331-4 Records of sales and transfers of certificates of indebtedness.

The provisions of § 47.6001-1 relating to records of sales and transfers of stock are also applicable to sales and transfers of certificates of indebtedness, except that the records of sales of certificates of indebtedness need not show the sales prices, since the selling price is immaterial for purposes of the tax imposed by section 4331.

§ 47.4331-5 Registration of nominees.

The provisions of paragraph (a) of § 47.4351-1 relating to registration requirements in connection with transactions involving stock are also applicable to transactions involving certificates of indebtedness.

§ 47.4331-6 Rules applicable to securities exchanges and clearinghouses.

For rules applicable to securities exchanges and clearinghouses, see § 47.4353-1.

§ 47.4332 Statutory provisions; exemptions.

SEC. 4332 *Exemptions*—(a) *Brokers*. The tax imposed by section 4331 shall not

apply to any delivery or transfer to a broker for sale, nor upon any delivery or transfer by a broker to a customer for whom and upon whose order he has purchased the certificate of indebtedness.

(b) *Installment purchase of obligations*. The tax imposed by section 4331 shall not apply to any instrument under the terms of which the obligee is required to make payment therefor in installments and is not permitted to make in any year a payment of more than 20 percent of the cash amount to which entitled upon maturity of the instrument.

(c) *Other exemptions*. For other exemptions, see sections 4341, 4342, 4343, 4344, and 4382.

[Sec. 4332 as amended and in effect Jan. 1, 1959]

§ 47.4332-1 Exemptions.

(a) *Transfer to or from brokers*. The rules stated in paragraphs (a) and (b) of § 47.4322-1 with respect to the exemption of transfers to or by brokers from the tax imposed by section 4321 also apply with respect to the tax imposed by section 4331.

(b) *Other exemptions*. For other exemptions with respect to the tax imposed on sales or transfers of certificates of indebtedness, see sections 4341, 4342, 4343, 4344, and 4382 and the regulations thereunder.

§ 47.4333 Statutory provisions; cross references.

SEC. 4333 *Cross references*. For definitions, penalties, and other general and administrative provisions applicable to this part, see sections 4345, 4381, and 4384; sections 4351 to 4353 inclusive; and subtitle F.

[Sec. 4333 as amended and in effect Jan. 1, 1959]

§ 47.4333-1 Cross references.

(a) For definitions, see section 4351 and § 47.4351-1, section 4381 and § 47.4381-1, and section 7701 (§ 47.7701).

(b) For penalties, see section 7271 and § 47.7271-1.

(c) For other general and administrative provisions, see section 4345 and § 47.4345-1, section 4352 and § 47.4352-1, section 4353 and § 47.4353-1, section 4384 and § 47.4384-1, Subpart J, and the applicable sections of subtitle F and the regulations in Part 301 of this chapter (Regulations on Procedure and Administration)

Subpart F—Provisions Common to Sales or Transfers of Capital Stock and Certificates of Indebtedness

EXEMPTIONS

§ 47.4341 Statutory provisions; transfers as security.

SEC. 4341 *Transfers as security.* The taxes imposed by sections 4321 and 4331 shall not apply to any delivery or transfer of any of the instruments referred to in such sections—

(1) *Collateral security.* To a lender as collateral security for money loaned thereon, if such collateral security is not actually sold, or by such lender as a return of such collateral security.

(2) *Security for performance.* To a trustee or public officer made pursuant to Federal or State law as security for the performance of an obligation, or by such trustee or public officer as a return of such security.

[Sec. 4341 as amended and in effect Jan. 1, 1959]

§ 47.4341-1 Transfers as security.

(a) *Stock or certificates of indebtedness deposited as collateral security.* The tax imposed by section 4321 or 4331 does not apply to an agreement evidencing a deposit of certificates of stock or certificates of indebtedness as collateral security for money loaned thereon, which certificates are not actually sold, nor upon the delivery or transfer for such purpose of the certificates so deposited. The exemption applies also to transfers of stock or certificates of indebtedness to a nominee of the lender and from such nominee back to the lender, if the stock or certificates of indebtedness are at all times held as collateral security for the loan; and to the return of the stock or certificates of indebtedness to the borrower by the lender or his nominee upon payment of the loan. The exemption does not apply, however, to deposits of stock or certificates of indebtedness as collateral security made otherwise than in connection with money loaned on such stock or certificates. The person making an exempt transfer under this paragraph shall, at the time of transfer or delivery, furnish an exemption certificate in substantially the form prescribed in § 47.4345-1. If the delivery or transfer is not accompanied by the required exemption certificate the person making

the delivery or transfer will be required to pay the tax imposed by section 4321 or 4331. However, if an exemption certificate is furnished after the transfer or delivery, such person will be entitled to a refund of the tax paid upon filing a timely claim for refund. For provisions with respect to timely filing of claims, see section 6511 and the regulations thereunder in Part 301 of this chapter (Regulations on Procedure and Administration).

(b) *Transfer of stock or certificates of indebtedness made pursuant to Federal or State law to secure the performance of obligations.* The tax imposed by section 4321 or section 4331 does not apply to any delivery or transfer of stock or certificates of indebtedness to a trustee or public officer, which is made pursuant to Federal or State law to secure the performance of an obligation, or to a redelivery or retransfer of such stock or certificates of indebtedness to the transferor. The exemption provided under this paragraph shall be granted only if the delivery or transfer is accompanied by an exemption certificate in substantially the form prescribed in § 47.4345-1.

§ 47.4342 Statutory provisions; fiduciaries and custodians.

SEC. 4342 *Fiduciaries and custodians.* The taxes imposed by section[s] 4321 and 4331 shall not apply to any delivery or transfer of any of the instruments referred to in such sections—

(1) *Fiduciaries.* From a fiduciary to his nominee, or from one nominee of the fiduciary to another nominee, provided that in each instance such instruments are to be held by the nominee for the same purpose as if retained by the fiduciary; or from the nominee to such fiduciary; or

(2) *Custodians.* (A) From the owner to a custodian if under a written agreement between the parties such instruments are to be held or disposed of by such custodian for, and subject at all times to the instructions of, the owner; or from such custodian to such owner; or

(B) From a custodian as specified in subparagraph (A) to a registered nominee of such custodian, or from one such nominee to another such nominee, provided that in each instance such instruments are to be held by the nominee for the same purpose as if retained by the custodian; or from such nominee to such custodian.

[Sec. 4342 as amended and in effect Jan. 1, 1959]

§ 47.4342-1 Transfers to or by fiduciaries or custodians.

(a) *Transfers between fiduciaries and their nominees.* The tax imposed by section 4321 or 4331 does not apply to deliveries or transfers of stock or certificates of indebtedness from a fiduciary to a nominee of such fiduciary, or from one nominee of such fiduciary to another, if the stock or certificates of indebtedness are to be held by such nominee for the same purpose as they would be held if retained by such fiduciary. Nor does the tax apply to deliveries or transfers from a nominee of a fiduciary to such fiduciary. The exemption provided under this paragraph shall be granted only if the delivery or transfer is accompanied by an exemption certificate in substantially the form prescribed in § 47.4345-1.

(b) *Transfers to or by a custodian.*

(1) The tax imposed by section 4321 or 4331 does not apply to the delivery or transfer of stock or certificates of indebtedness from the owner thereof to a custodian if, under a written agreement between the owner and the custodian, the instruments so delivered or transferred are to be held or disposed of by such custodian for, and subject at all times to the instructions of, the owner; or the delivery or transfer of stock or certificates of indebtedness from such custodian to such owner.

(2) The tax also does not apply to the delivery or transfer of stock or certificates of indebtedness from a custodian specified in subparagraph (1) of this paragraph to a registered nominee of such custodian, or from the owner direct to such registered nominee, or from one such nominee to another such nominee, if the stock or certificates of indebtedness are to be held by the nominee for the same purpose as they would be held if retained by such custodian. Nor does the tax apply to deliveries or transfers from a nominee of a custodian to such custodian or to the owner. No exemption is granted unless the nominee is registered in the manner provided in paragraph (a) of § 47.4351-1.

(3) Moreover, the tax does not apply to the delivery or transfer of stock or certificates of indebtedness from a custodian of the owner to another custodian of the owner or from a registered nominee of the first custodian to the second

custodian or to the registered nominee of the latter, if the transfer would have been exempt under subparagraph (1) or (2) of this paragraph if made by the owner direct to the second custodian or to the registered nominee of the latter.

(4) For purposes of this paragraph, a custodian is a person to whom stock or certificates of indebtedness are delivered or transferred to be held or disposed of by such person for, and subject at all times to the instructions of, the owner and not otherwise. The term "custodian", as used in this paragraph, does not include a trustee. A custodian is to be distinguished from a nominee who merely lends his name and usually does not retain possession of the securities registered in his name.

(5) The exemption provided under this paragraph shall be granted only if the delivery or transfer is accompanied by an exemption certificate in substantially the form prescribed in § 47.4345-1.

§ 47.4343 Statutory provisions; transfers by operation of law.

SEC. 4343 Transfers by operation of law—

(a) *Exempt transfers.* The taxes imposed by sections 4321 and 4331 shall not apply to any delivery or transfer of any of the instruments referred to in such sections—

(1) *Decedents.* From a decedent to his executor or administrator.

(2) *Minors.* From a minor to his guardian, or from a guardian to his ward upon attaining majority.

(3) *Incompetents.* From an incompetent to his committee or similar legal representative, or from a committee or similar legal representative to a former incompetent upon removal of disability.

(4) *Financial institutions.* From a bank, trust company, financial institution, insurance company, or other similar entity, or nominee, custodian, or trustee therefor, to a public officer or commission, or person designated by such officer or commission or by a court, in the taking over of its assets, in whole or part, under Federal or State law regulating or supervising such institutions, nor upon redelivery or retransfer by any such transferee or successor thereto.

(5) *Bankrupts.* From a bankrupt or person in receivership due to insolvency to the trustee in bankruptcy or receiver, from such receiver to such trustee, or from such trustee to such receiver, nor upon redelivery or retransfer by any such transferee or successor thereto.

(6) *Successors.* From a transferee under paragraphs (1) to (5), inclusive, to his successor acting in the same capacity, or from one such successor to another.

(7) *Foreign governments and aliens.* From a foreign country or national thereof to the United States or any agency thereof, or to the government of any foreign country, directed pursuant to the authority vested in the President by section 5(b) of the Trading With the Enemy Act, as amended by the First War Powers Act, 1941 (50 U.S.C. App. sec. 5).

(8) *Trustees.* From trustees to surviving, substituted, succeeding, or additional trustees of the same trust.

(9) *Survivors.* Upon the death of a joint tenant or tenant by the entirety, to the survivor or survivors.

(b) *Nonexempt transfers.* No delivery or transfer shall be exempt because effected by operation of law unless an exemption is otherwise specifically provided.

[Sec. 4343 as amended and in effect Jan. 1, 1959]

§ 47.4343-1 Transfers by operation of law.

No delivery or transfer shall be exempt from the tax imposed by section 4321 or 4331 because effected by operation of law unless an exemption is otherwise specifically provided. Each of the transfers specified in section 4343(a) is exempt from tax, but only if the delivery or transfer is accompanied by an exemption certificate as provided in § 47.4345-1.

§ 47.4344 Statutory provisions; certain other transfers.

Sec. 4344 *Certain other transfers—(a) Loans.* The taxes imposed by sections 4321 and 4331 shall not apply to any delivery or transfer of any of the instruments referred to in such sections to a borrower as a loan of such instruments, or to the lender as a return of such loan.

(b) *Worthless stock and obligations.* The taxes imposed by sections 4321 and 4331 shall not apply to any delivery or transfer of any of the instruments referred to in such sections by an executor or administrator to a legatee, heir, or distributee, if it is shown to the satisfaction of the Secretary or his delegate that the value of such instrument is not greater than the amount of the tax which would otherwise be imposed on such delivery or transfer.

(c) *Transfers between certain revocable trusts.* The taxes imposed by sections 4321 and 4331 shall not apply to any delivery or transfer of any of the instruments referred to in such sections by one revocable trust to another revocable trust if—

(1) The grantor of both trusts is the same person, and

(2) At the time of such delivery or transfer, such grantor is treated under section 676 as the owner of both trusts.

For purposes of the preceding sentence, if 2 or more grantors are treated under section 676 as owners in the same relative proportions of both trusts, such grantors shall be treated as the same person.

[Sec. 4344 as added and in effect Jan. 1, 1959]

§ 47.4344-1 Certain other transfers.

(a) *Loan of stock or certificate of indebtedness and the return thereof.* A mere loan of stock or certificates of indebtedness or the return of stock or certificates of indebtedness loaned is exempt from the taxes imposed by sections 4321 and 4331 if the loan or return is accompanied by an exemption certificate in substantially the form prescribed in § 47.4345-1.

(b) *Transfers of worthless stock or certificates of indebtedness by executors, etc.* The taxes imposed by sections 4321 and 4331 do not apply to deliveries or transfers of stock or certificates of indebtedness by an executor or administrator to a legatee, heir, or distributee, if it is shown to the satisfaction of the district director that the value of the stock or certificates of indebtedness so delivered or transferred is not greater than the amount of tax that would otherwise be imposed on such delivery or transfer.

(c) *Transfers between certain revocable trusts.* The taxes imposed by sections 4321 and 4331 do not apply to any delivery or transfer of stock or certificates of indebtedness by one revocable trust to another revocable trust if (1) the grantor of both trusts is the same person, (2) at the time of such delivery or transfer such grantor is treated under section 676 and the regulations thereunder as the owner of the entire interest in both trusts, and (3) the delivery or transfer is accompanied by an exemption certificate in substantially the form prescribed in § 47.4345-1. If two or more grantors are treated under section 676 as owners in the same relative proportions of the entire interest in both trusts, such grantors shall be treated as the same person. For regulations under section 676, see Part 1 of this chapter (Income Tax Regulations).

§ 47.4345 Statutory provisions; exemption certificates.

Sec. 4345 *Exemption certificates.* Except as provided in regulations prescribed by the Secretary or his delegate, no exemption shall

be granted under section 4322, 4332(a), 4341, 4342, 4343(a), or 4344 (a) or (c) unless the delivery or transfer is evidenced by a certificate setting forth such facts as the Secretary or his delegate may by regulations prescribe.

[Sec. 4345 as amended and redesignated and in effect Jan. 1, 1959]

§ 47.4345-1 Exemption certificates.

No exemption shall be granted under section 4322, 4332(a), 4341, 4342, 4343 (a), or 4344 (a) or (c) unless the delivery or transfer is accompanied by a certificate in substantially the following manner:

It is hereby certified that the transfer of the accompanying instrument(s) is made under such circumstances as to come within one of the exemptions specified in section 4322, 4332(a), 4341, 4342, 4343(a), or 4344 (a) or (c) of the Internal Revenue Code, and that the evidence in proof of the exemption is maintained by the undersigned and is available for inspection by internal revenue officers.

(Signature)

§ 47.4346 Statutory provisions; cross references.

SEC. 4346 *Cross references.* For other exemptions, see sections 4322, 4332, and 4382.

[Sec. 4346 as redesignated and in effect Jan. 1, 1959]

MISCELLANEOUS PROVISIONS

§ 47.4351 Statutory provisions; definitions.

SEC. 4351 *Definitions*—(a) *Registered nominee.* For purposes of this subchapter, the term "registered nominee" means any person registered in accordance with such regulations as the Secretary or his delegate shall prescribe.

(b) *Sale or transfer.* For purposes of this subchapter, the term "sale or transfer" means any sale, agreement to sell, memorandum of sale or delivery, or transfer of legal title, whether or not shown by the books of the corporation or other organization (or by any assignment in blank, or by any delivery, or by any paper or agreement or memorandum or other evidence of transfer or sale), and whether or not the holder acquires a beneficial interest in the instruments.

[Sec. 4351 as amended and in effect Jan. 1, 1959]

§ 47.4351-1 Definitions.

(a) *Registered nominee.* For purposes of the regulations in this part, the term "registered nominee" means

any person appointed as nominee of a broker, custodian, or corporation if the person so appointed is registered with the district director for the district in which the principal office of the broker, custodian, or corporation is located. No special form is prescribed for use in registering a nominee. Substitution of a nominee may be effected by the registration of the successor nominee. Upon registration of any person as a nominee of a broker, custodian, or corporation, the district director shall issue to the broker, custodian, or corporation a certificate of registration signed by him and setting forth the date of issue, the name of the person registered as nominee, and the name of the broker, custodian, or corporation on whose behalf the nominee is registered. Such certificate shall be kept at the principal place of business of the broker, custodian, or corporation to whom the certificate is issued. The certificate of registration issued as provided in this paragraph shall be held available for ready inspection by internal revenue officers.

(b) *Sale or transfer.* For purposes of the regulations in this part, the term "sale or transfer" includes sales of, agreements to sell, or memoranda of sales of, stock or certificates of indebtedness; deliveries of stock or certificates of indebtedness with intent to pass title; transfer of legal title to stock or certificates of indebtedness; transfers of rights to subscribe for stock; and transfers of rights to receive stock. The taxes imposed by sections 4321 and 4331 apply to the specified dealings or transactions in stock or certificates of indebtedness, whether effected by any assignment in blank, or by any delivery, or by any paper, agreement, memorandum or other evidence of transfer or sale (and in the case of stock, whether made before, after, or without the issuance of a certificate and whether made upon or shown by the books of the corporation or other organization), and without regard to whether the holder or transferee of the stock or certificate of indebtedness (or specified right in the case of stock) is entitled to any beneficial interest therein.

(c) *Agreement to sell.* As used in the regulations in this part, unless otherwise specified or indicated by the context, the term "agreement to sell" includes contracts to sell, either written or oral, and

whether on the deferred or partial payment plan or otherwise, options, calls, offers, indemnities, and privileges.

(d) *Clearinghouse*. For definition of the term "clearinghouse", see paragraph (d) of § 47.4353-1.

§ 47.4352 Statutory provisions; affixing of stamps.

Sec. 4352 Affixing of stamps. The stamps representing the taxes imposed by section 4321 and section 4331 shall be affixed to—

(1) *Instrument*. The instrument where the change of ownership is by transfer of the instrument.

(2) *Bill or memorandum of sale*. The bill or memorandum of sale in cases of an agreement to sell or where the transfer is by delivery of the instrument assigned in blank. Such bill or memorandum of sale shall be made and delivered by the seller to the buyer, and shall show the date thereof, the name of the seller, the amount of the sale, and the instrument to which it refers.

[Sec. 4352 as amended and redesignated and in effect Jan. 1, 1959]

§ 47.4352-1 Affixing of stamps.

(a) *Documents to which stamps to be affixed*. (1) In all cases where the change of ownership of stock or a certificate of indebtedness is by transfer or by delivery of the stock or certificate of indebtedness under special endorsement, i.e., by insertion of the name of the transferee in the endorsement on the back of the certificate, the stamps shall be affixed to the certificate, whether or not the change of ownership results from a sale.

(2) In cases of agreements to sell stock or certificates of indebtedness and in cases of transfers of title thereto by delivery of certificates assigned in blank, the stamps shall be affixed to the memoranda of such transactions. See paragraph (b) of this section. For cases where the evidence of sale or transfer of stock is shown only by the books of the corporation or other organization, see paragraph (a) (1) of § 47.4323-1.

(b) *Requirement of memoranda of agreements to sell, etc.* Every person who makes an agreement to sell stock or certificates of indebtedness, or who, by sale or otherwise, transfers title to stock or certificates of indebtedness by delivery of certificates assigned in blank, shall, as a part of the transaction, promptly make and deliver to the buyer or transferee, a bill or memorandum of such agreement to sell, sale, or transfer,

duly signed by the seller, or transferor, or his agent. Such bill or memorandum shall show the date of the transaction, the names of the parties thereto, the description and number of shares of stock or certificates of indebtedness, the tax paid on the transaction, and, where a sale of stock is involved, the sale price, or where a transfer is involved without a sale, the actual value of the stock and the basis used for determining such value. (For definition of "actual value" see paragraph (b) (2) (ii) of § 47.4301-1 and paragraph (b) (3) of § 47.4321-1.) No more than one stamped bill or memorandum shall be required in respect of a single transaction. (See § 47.4353-1 relative to rules applicable to securities exchanges and clearinghouses.)

(c) *In general*. In no event shall any corporation or transfer agent transfer any shares, certificates of stock, or certificates of indebtedness unless stamps for the transfer tax due have been properly affixed and cancelled as required by the regulations in this part or unless tax has been paid without the use of stamps as provided in § 47.4353-1.

§ 47.4353 Statutory provisions: payment of tax through national securities exchanges without use of stamps.

Sec. 4353 Payment of tax through national securities exchanges without use of stamps—(a) General rule. Under regulations prescribed by the Secretary or his delegate, if a member of a securities exchange which is registered with the Securities and Exchange Commission as a national securities exchange appoints such exchange, or the clearinghouse for such exchange, as his agent for purposes of paying the taxes imposed by sections 4321 and 4331 in respect of his transactions, the taxes imposed by such sections in respect of such transactions may be paid through such agent without the use of stamps.

(b) *Treatment as stamp tax*. For purposes of this title—

(1) Any tax which is payable as provided under subsection (a) shall be treated as tax payable by stamp, and

(2) Any amount of tax which is paid as provided under subsection (a) shall be treated as tax paid by stamp.

[Sec. 4353 as added and in effect Jan. 1, 1959]

§ 47.4353-1 Payment of tax through national securities exchanges or their clearinghouses.

(a) *Appointment of agent*. A member of a securities exchange which is regis-

tered with the Securities and Exchange Commission as a national securities exchange may appoint in writing such exchange or the clearinghouse for such exchange as his agent for the purpose of paying the tax required in respect of his transactions in stock or certificates of indebtedness.

(b) *Conditions for payment through agent.* The privilege granted by paragraph (a) of this section may be exercised only upon compliance with the following conditions:

(1) *Authorization.* The member shall authorize and require the exchange or the clearinghouse to pay the tax in respect of all transactions in stock or certificates of indebtedness, including rights to subscribe for or to receive stock, arising in the conduct of his business, irrespective of whether the stock or certificates of indebtedness are listed or unlisted, whether the transactions are clearable or not, and including transactions involving over-the-counter sales.

(2) *Daily report of member.* The member shall make a daily report to the exchange or clearinghouse for each business day showing the total amount of tax payable on all his business transactions as specified in subparagraph (1) of this paragraph. The report shall be filed with the exchange or clearinghouse on the day on which the transactions covered thereby are due for settlement (blotter date).

(3) *Daily records to be kept by member.* The member shall maintain complete and adequate daily records, such as a blotter or similar book of original entry, of all transactions in stock or certificates of indebtedness as specified in subparagraph (1) of this paragraph, whether the transaction is taxable or not. In the case of taxable transactions, the daily record shall show the amount of tax payable in respect of each transaction. In the case of nontaxable transactions, the daily record shall disclose the basis on which the exemption from the tax is claimed. Such daily records shall be kept in permanent form for a period of at least 3 years from the date any part of the tax is paid on the transaction and must be available for ready inspection by internal revenue officers.

(4) *Payment of tax.* The exchange or clearinghouse shall pay to the dis-

trict director for the district in which the exchange or clearinghouse is located the total tax shown on the daily reports specified in subparagraph (2) of this paragraph. Any such payment of tax shall be made on the day on which the report specified in subparagraph (2) of this paragraph is received by the exchange or clearinghouse. Each daily payment of tax to the district director shall be accompanied by a statement, in substantially the following form:

The accompanying check No. ----- in the amount of \$----- is in payment of the total documentary stamp transfer tax liability as shown to be due on the reports received by the exchange or clearinghouse for -----.

(Date)

(Name of stock exchange or clearinghouse)
by -----

(Name)

(Title)

(5) *Records to be kept by exchange or clearinghouse.* The daily reports received from its members shall be kept in permanent form by the exchange or clearinghouse for a period of at least 3 years from the date any part of the tax is paid with respect to any transaction reported therein, and must be available for ready inspection by internal revenue officers.

(6) *Endorsement showing payment of tax.* The member shall make and deliver to the buyer the bill or memorandum required by paragraph (b) of § 47.4352-1 and shall make an endorsement on the bill or memorandum substantially in the following form:

It is hereby certified that the Federal stamp tax applicable to this transaction has been paid through the -----

----- (Insert name of stock exchange or clearinghouse) on our behalf.

(Member ----- Stock Exchange)

If so desired, the member may also make a similar endorsement on the certificates of stock or certificates of indebtedness covered by the bill or memorandum. In that event, the endorsement shall be in substantially the following form:

It is hereby certified that the Federal stamp tax applicable to the transfer of ----- shares of this certificate (or applicable to

the transfer of this certificate of indebtedness) has been paid through -----

(Insert name of ----- on our stock exchange or clearinghouse) behalf.

(Date) (Member ----- Stock Exchange)

The endorsement (including a facsimile signature of the member) may be made on the bill or memorandum and on the accompanying certificate of stock or certificates of indebtedness by a hand-stamped impression, if (i) the hand-stamp is held at all times in the custody of the person authorized to make such impression, and (ii) the records of the member contain sufficient information to establish the identity of the person so authorized.

(c) *Treatment of payment of tax without use of stamps.* For purposes of the regulations in this chapter, any tax payable under section 4353 and the regulations in this section shall be treated as tax payable by stamp, and any amount of tax paid as provided thereunder shall be treated as tax paid by stamp.

(d) *Definition of clearinghouse.* The term "clearinghouse" includes every corporation, and every association of individuals, partnerships, or corporations, wholly or partly engaged in the business of clearing, settling or adjusting transactions in the purchase, sale, receipt, or delivery of stock, certificates of indebtedness, rights, or warrants, whether or not a part or department of a securities exchange or an independent body.

§ 47.4354 Statutory provisions; cross references.

SEC. 4354 *Cross references.* For penalties and other general and administrative provisions applicable to this subchapter, see section 4384 and subtitle F.

[Sec. 4354 as amended and in effect Jan. 1, 1959]

§ 47.4354-1 Cross references.

(a) For other definitions, see section 4381, § 47.4381-1, and section 7701 (§ 47.7701).

(b) For penalties, see section 7271 and § 47.7271-1.

(c) For other general and administrative provisions, see section 4384, § 47.4384-1, Subpart J, and the applicable sections of subtitle F and regulations in Part 301 of this chapter (Regulations on Procedure and Administration).

Subpart G—Tax on Conveyances

§ 47.4361 Statutory provisions; imposition of tax.

SEC. 4361 *Imposition of tax.* There is hereby imposed, on each deed, instrument, or writing by which any lands, tenements, or other realty sold shall be granted, assigned, transferred, or otherwise conveyed to, or vested in, the purchaser or purchasers, or any other person or persons, by his or their direction, 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, a tax at the rate of 55 cents for each \$500 or fractional part thereof.

[Sec. 4361 as amended and in effect Jan. 1, 1959]

§ 47.4361-1 Imposition of tax.

(a) *Scope of tax.* (1) Section 4361 imposes a tax upon deeds, instruments; or other writings, whereby realty sold is granted, assigned, transferred, or otherwise conveyed to, or vested in, the purchaser or, at his direction, any other person, when the consideration for, 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.

(2) The tax is limited to conveyances of realty sold and does not apply to other conveyances (see paragraph (b) of § 47.4361-2). The tax attaches at the time the deed or other instrument of conveyance is delivered, irrespective of the time when the sale is made. Deeds deposited in escrow become subject to the tax upon delivery to the grantee. A conveyance of realty subject to an equity of redemption is taxable when made, not when the time for redemption expires.

(3) For purposes of the tax imposed by section 4361, the determination of what constitutes "realty" is not controlled by the definition or scope of that term under State law. State law determines the character of the rights conveyed by an instrument, but whether such conveyance constitutes a conveyance of "realty" is to be determined under Federal law.

(4) For purposes of the regulations in this part—

(i) The term "realty" includes—

(a) Those interests in real property which endure for a period of time, the termination of which is not fixed or ascertained by a specific number of years, such as an estate in fee simple, life estate, perpetual easement, etc., and

(b) Those interests enduring for a fixed period of years but which, either by reason of the length of the term or the grant of a right to extend the term by renewal or otherwise, consist of a bundle of rights approximating those of the class of interests mentioned in (a) of this subdivision.

(ii) The term "sold" imports a transfer of an interest for a valuable consideration, which may involve money or anything of value.

(iii) The term "deed" includes any instrument or writing whereby realty is assigned, transferred, or otherwise conveyed to, or vested in, the purchaser, or at his direction, any other person.

(b) *Rate and computation of tax.* The rate of tax is 55 cents on each \$500 or fractional part thereof of the net consideration paid for, or the net value of, the realty conveyed, that is, the gross consideration or gross value less, in either case, the amount of all liens or encumbrances on the realty existing before the sale and not removed thereby. The tax is based upon the net consideration where it is definite in amount, or may be definitely determined. The tax is based upon net value where the amount of the consideration is indefinite, or is left open to be fixed by future contingencies. In determining the amount of the net consideration for, or net value of, the realty conveyed, only the amount of the liens and encumbrances on the property existing before the sale and not removed thereby may be deducted. Thus, for example, taxes or assessments which are liens on the property before the sale and are not paid at the time of sale are deductible. No deduction shall be made on account of any lien or encumbrance placed upon the property in connection with the sale, or by reason of deferred payments of the purchase price whether represented by notes or otherwise.

§ 47.4361-2 Illustrations.

(a) *Conveyances subject to tax.* The following are examples of conveyances subject to the tax:

(1) A conveyance of realty in exchange for other property; also the conveyance of the other property, if it is realty.

(2) A conveyance of realty in consideration of life maintenance. The tax is computed on the net value of the realty conveyed.

(3) A conveyance by a defaulting mortgagor to the mortgagee in consideration of the cancellation of the mortgage debt. The tax is computed on the amount of the unpaid mortgage debt plus unpaid accrued interest.

(4) Deeds given by masters in chancery, sheriffs, clerks of court, etc., for realty sold under foreclosure or execution. The tax is computed on the amount bid for the property plus the costs if paid by the purchaser, whether the purchaser is the mortgagee, judgment creditor, or any other person.

(5) A conveyance of realty by a judgment or decree in a condemnation proceeding under the power of eminent domain, or a conveyance of such property under threat or imminence of such proceeding.

(6) Conveyances to or by building and loan associations. However, the tax does not apply to a conveyance of realty to a building and loan association for the purpose of securing a loan thereon, nor to the reconveyance of the realty to its owner as part of the loan transaction.

(7) A conveyance of realty to a corporation in exchange for shares of its capital stock.

(8) A conveyance of realty by a corporation in liquidation or in dissolution to its shareholders subject to the debts of the corporation; however, if there are no corporate debts and the conveyance is made solely for the cancellation and retirement of the capital stock, the tax does not apply.

(9) Deeds to standing timber and to mines. (For definition of the term "deed", see paragraph (a)(4)(iii) of § 47.4361-1.)

(10) In jurisdictions where common-law dower still exists, an instrument conveying the estate acquired by a widow upon assignment of dower. However, an instrument purporting to convey the inchoate right of dower of a wife, or the consummate right of dower of a widow prior to assignment of dower, is not subject to the tax. Where by statute dower has been abolished and in lieu thereof a different interest in the husband's real property conferred upon the wife, the taxability of an instrument purporting to convey such interest prior to its assignment must be determined by the nature of the wife's interest as fixed by the statutes and decisions of the jurisdiction in which the real estate is located.

(11) A conveyance of real estate sold to or by the United States (see, however, paragraph (a) of § 47.4384-1).

(12) A conveyance of realty by a partner to the partnership as a contribution of partnership assets. See section 4383 and § 47.4383-1 for application of tax in case of a termination of a partnership owning realty.

(b) *Conveyances not subject to tax.* In addition to the various exemptions prescribed in sections 4362 and 4382 and in the Bankruptcy Act as amended, the following are examples of conveyances not subject to tax:

(1) The reconveyance of realty, conveyed to secure a debt, upon payment of such debt.

(2) Conveyances of realty without consideration and otherwise than in connection with a sale, including a deed conveying realty as a bona fide gift, although the deed may recite a consideration for the transfer, such as "natural love and affection and \$1", "desire to promote public welfare and \$1", or "\$1 and other valuable consideration"; a gift of realty by a husband to his wife accomplished through the conveyance of the property for an ostensible consideration to a "straw man" who immediately reconveys the property to the wife; and a deed to or by a trustee not pursuant to a sale.

(3) A deed to confirm title already vested in the grantee, such as a quit claim deed to correct a flaw in title.

(4) A deed given by an executor in accordance with the terms of the will; however, if, by reason of a consideration passing between devisees, one of them takes a greater share in the realty than that to which he is entitled under the will, the deed given by the executor to convey such greater share is subject to a tax computed upon the amount of such consideration.

(5) A deed from an agent to his principal conveying real estate purchased for and with funds of the principal.

(6) An option for the purchase of real property or a contract for the sale of real property, if the contract does not vest legal title.

(7) Partition deeds, unless, for consideration, some of the parties take shares greater in value than their undivided interests, in which event a tax attaches to each deed conveying such

greater share computed upon the consideration for the excess.

(8) Ordinary leases of real property for a definite term of years (see, however, paragraph (a)(4)(i) of § 47.4361-1).

(9) A deed executed by a debtor conveying property to a trustee for the benefit of his creditors; however, when the trustee conveys such property to a creditor or sells it to any other person, the deed executed by him is taxable.

(10) Conveyance to a receiver of realty included in the receivership assets, and reconveyance of such realty upon termination of the receivership.

(11) A deed conveying real estate situated in a foreign country.

(12) Transfer of real estate in a statutory merger or consolidation from a constituent corporation to the continuing or new corporation.

§ 47.4361-3 Affixing of stamps.

(a) Only documentary stamps shall be used in payment of the tax imposed by section 4361. The requisite stamps shall be affixed to the deed, instrument, or other writing by which the realty is conveyed. See §§ 47.6804-1 and 47.6804-2 for the appropriate use, denominations, and cancellation of such stamps.

(b) Documentary stamps may be purchased, and requisition forms for the purchase of such stamps may be obtained, from the sources and in the manner provided in § 47.6802-1. For provisions relating to distribution, supply, and redemption of stamps, see sections 6801 (§ 47.6801), 6802 (§ 47.6802), and 6805 (§ 47.6805), and the regulations thereunder contained in Part 301 of this chapter (Regulations on Procedure and Administration) and § 47.6801-1.

§ 47.4362 Statutory provisions; exemptions.

SEC. 4362 *Exemptions*—(a) *Security for debt.* The tax imposed by section 4361 shall not apply to any instrument or writing given to secure a debt.

(b) *State and local government conveyances.* No State or Territory, or political subdivision thereof, or the District of Columbia, shall be liable for the tax imposed by section 4361 with respect to any deed, instrument, or writing to which it is a party, and affixing of stamps thereby shall not be deemed payment for the tax, which may be collected by assessment from any other party liable therefor.

(c) *Other exemptions.* For other exemptions, see section 4382.

[Sec. 4362 as amended and in effect Jan. 1, 1959]

§ 47.4362-1 Exemptions.

(a) *Security for debt.* Section 4362 expressly exempts from the tax imposed by section 4361 any instrument or writing, such as a mortgage or a deed of trust, given to secure a debt.

(b) *Conveyance to which State is party.* No State or Territory, or political subdivision thereof, or the District of Columbia shall be liable for the tax imposed by section 4361 in respect of a conveyance to which it is a party regardless of the capacity in which it acts. However, the conveyance is not exempt from tax, and the nonexempt party to the conveyance shall be liable for the tax. The affixing of stamps to the deed or other instrument of conveyance by the exempt governmental body does not constitute payment of the tax, and the non-exempt party remains liable for the tax in such case. Where all parties to a taxable conveyance are governmental bodies exempt under section 4362, no tax shall be imposed.

(c) *Other exemptions.* For other exemptions, see section 4382 and § 47.4382-1.

§ 47.4363 Statutory provisions; cross references.

SEC. 4363 *Cross references.* For penalties and other general and administrative provisions applicable to this subchapter, see section 4384 and subtitle F.

[Sec. 4363 as amended and in effect Jan. 1, 1959]

§ 47.4363-1 Cross references.

(a) For definitions, see section 4381, § 47.4381-1, and section 7701 (§ 47.7701).

(b) For penalties, see section 7271 and § 47.7271-1.

(c) For other general and administrative provisions, see section 4384, § 47.4384-1, Subpart J, and the applicable sections of subtitle F and the regulations in Part 301 of this chapter (Regulations on Procedure and Administration).

Subpart H—Tax on Policies Issued by Foreign Insurers

§ 47.4371 Statutory provisions; imposition of tax.

SEC. 4371 *Imposition of tax.* There is hereby imposed, on each policy of insurance, indemnity bond, annuity contract, or policy

of reinsurance issued by any foreign insurer or reinsurer, a tax at the following rates:

(1) *Casualty insurance and indemnity bonds.* Four cents on each dollar, or fractional part thereof, of the premium charged on the policy of casualty insurance or the indemnity bond, if issued to or for, or in the name of, an insured as defined in section 4372(d).

(2) *Life insurance, sickness, and accident policies, and annuity contracts.* One cent on each dollar, or fractional part thereof, of the premium charged on the policy of life, sickness, or accident insurance, or annuity contract, unless the insurer is subject to tax under section 819.

(3) *Reinsurance.* One cent on each dollar, or fractional part thereof, of the premium charged on the policy of reinsurance covering any of the contracts taxable under paragraph (1) or (2).

[Sec. 4371 as amended and in effect Jan. 1, 1959, and as further amended by sec. 3(f) (3) Life Insurance Income Tax Act 1959 (73 Stat. 140)]

§ 47.4371-1 Imposition of tax on policies issued by foreign insurers; scope of tax.

(a) *Certain insurance policies, and indemnity, fidelity, or surety bonds.* Section 4371(1) imposes a tax upon each policy of insurance (other than those referred to in paragraph (b) of this section), upon each indemnity, fidelity, or surety bond, or upon each certificate, binder, covering note, receipt, memorandum, cablegram, letter, or other instrument by whatever name called, whereby a contract of insurance of the character involved or an obligation of the nature of an indemnity, fidelity, or surety bond is made, continued, or renewed, if issued—

(1) By a nonresident alien individual, a foreign partnership, or a foreign corporation, as insurer, and the policy or other instrument is not signed or countersigned by an officer or agent of the insurer in a State, Territory, or the District of Columbia in which the insurer is authorized to do business; and

(2) To or for, or in the name of, a domestic corporation, domestic partnership, or an individual resident of the United States, against or with respect to hazards, risks, losses, or liabilities wholly or partly within the United States; or

(3) To or for, or in the name of, a foreign corporation, foreign partnership, or nonresident individual, engaged in a trade or business within the United States with respect to hazards, risks, or

liabilities wholly within the United States.

For definition of the term "indemnity bond", see section 4372(c).

(b) *Life insurance, sickness, and accident policies and annuity contracts.* Section 4371(2) imposes a tax upon each policy of insurance or annuity contract, or certificate, binder, covering note, receipt, memorandum, cablegram, letter, or other instrument by whatever name called, whereby a contract of insurance or an annuity contract is made, continued, or renewed, if issued—

(1) By a nonresident alien individual, a foreign partnership, or a foreign corporation, as insurer, and the policy or other instrument is not signed or countersigned by an officer or agent of the insurer in a State, Territory, or the District of Columbia in which such insurer is authorized to do business, or if not so signed or countersigned, the insurer is not subject to tax under section 819; and

(2) To any person with respect to the life or hazards to the person of a citizen or resident of the United States.

(c) *Reinsurance.* Section 4371(3) imposes a tax upon each policy of reinsurance, certificate, binder, covering note, receipt, memorandum, cablegram, letter, or other instrument by whatever name called, whereby a contract of reinsurance is made, continued, or renewed, if issued—

(1) By a nonresident alien individual, a foreign partnership, or a foreign corporation, as reinsurer, and the policy or other instrument is not signed or countersigned by an officer or agent of the reinsurer in a State, Territory, or the District of Columbia in which such reinsurer is authorized to do business; and

(2) To any person against, or with respect to, any of the hazards, risks, losses, or liabilities covered by contracts described in section 4371 (1) or (2).

(d) *Exempt indemnity bonds.* The tax imposed by section 4371 does not apply to any indemnity bond described in section 4373(2).

§ 47.4371-2 Rate and computation of tax.

(a) *Rate of tax.* (1) The tax under section 4371(1) is imposed at the rate of 4 cents on each dollar, or fractional part thereof, of the premium charged.

(2) The tax under section 4371 (2) and (3) is imposed at the rate of 1 cent on each dollar, or fractional part thereof, of the premium charged.

(b) *Computation of tax.* The tax is measured strictly by the amount of the premium charged. The time and method of payment of the premium are immaterial; the tax liability attaches if the insurance becomes effective, even though the premium is never paid. The full rate of tax applies to each fractional part of a dollar of the premium charged. For example, upon a premium charge of \$10.10, the tax at the rate of 4 cents amounts to 44 cents, and at the rate of 1 cent amounts to 11 cents.

(c) *Meaning of premium.* For purposes of the regulations in this part, the term "premium" means the agreed price or consideration for assuming and carrying the risk or obligation, and includes any additional assessment or charge which may be assessed or charged under the contract, whether payable in one sum or installments.

§ 47.4372 Statutory provisions; definitions.

SEC. 4372 *Definitions*—(a) *Foreign insurer or reinsurer.* For purposes of this subchapter, the term "foreign insurer or reinsurer" means an insurer or reinsurer who is a nonresident alien individual, foreign partnership, or a foreign corporation. The term includes a nonresident alien individual, foreign partnership, or foreign corporation which shall become bound by an obligation of the nature of an indemnity bond.

(b) *Policy of casualty insurance.* For purposes of section 4371(1), the term "policy of casualty insurance" means any policy (other than life) or other instrument by whatever name called whereby a contract of insurance is made, continued, or renewed.

(c) *Indemnity bond.* For purposes of this subchapter, the term "indemnity bond" means any instrument by whatever name called whereby an obligation of the nature of an indemnity, fidelity, or surety bond is made, continued, or renewed. The term includes any bond for indemnifying any person who shall have become bound or engaged as surety, and any bond for the due execution or performance of any contract, obligation, or requirement, or the duties of any office or position, and to account for money received by virtue thereof, where a premium is charged for the execution of such bond.

(d) *Insured.* For purposes of section 4371(1), the term "insured" means—

(1) A domestic corporation or partnership, or an individual resident of the United

States, against, or with respect to, hazards, risks, losses, or liabilities wholly or partly within the United States, or

(2) A foreign corporation, foreign partnership, or nonresident individual, engaged in a trade or business within the United States, against, or with respect to, hazards, risks, losses, or liabilities within the United States.

(e) *Policy of life, sickness, or accident insurance, or annuity contract.* For purposes of section 4371(2), the term "policy of life, sickness, or accident insurance, or annuity contract" means any policy or other instrument by whatever name called whereby a contract of insurance or an annuity contract is made, continued, or renewed with respect to the life or hazards to the person of a citizen or resident of the United States.

(f) *Policy of reinsurance.* For purposes of section 4371(3), the term "policy of reinsurance" means any policy or other instrument by whatever name called whereby a contract of reinsurance is made, continued, or renewed against, or with respect to, any of the hazards, risks, losses, or liabilities covered by contracts taxable under paragraph (1) or (2) of section 4371.

[Sec. 4372 as amended and in effect Jan. 1, 1959]

§ 47.4373 Statutory provisions; exemptions.

Sec. 4373 *Exemptions.* The tax imposed by section 4371 shall not apply to—

(1) *Domestic agent.* Any policy, indemnity bond, or annuity contract signed or countersigned by an officer or agent of the insurer in a State, Territory, or District of the United States within which such insurer is authorized to do business.

(2) *Indemnity bond.* Any indemnity bond required to be filed by any person to secure payment of any pension, allowance, allotment, relief, or insurance by the United States, or to secure a duplicate for, or the payment of, any bond, note, certificate of indebtedness, war-saving certificate, warrant, or check, issued by the United States.

[Sec. 4373 as amended and in effect Jan. 1, 1959]

§ 47.4374 Statutory provisions; affixing of stamps.

Sec. 4374 *Affixing of stamps.* Any person to or for whom or in whose name any policy, indemnity bond, or annuity contract referred to in section 4371 is issued, or any solicitor or broker acting for or on behalf of such person in the procurement of any such instrument shall affix the proper stamps to such instrument.

[Sec. 4374 as originally enacted and in effect Jan. 1, 1959]

§ 47.4374-1 Affixing of stamps.

(a) *General.* (1) *Documentary stamps* shall be used in payment of the tax. Requisite stamps must be affixed to the first instrument whereby the taxable contractual relationship is created, continued, or renewed, whether it be a letter of acceptance, a cablegram, or other instrument by whatever name called. Where the instrument which creates or evidences the contractual relationship is confirmed by a subsequent instrument, the latter shall bear a notation designating such prior instrument (referred to in this section as the original instrument) and showing that the requisite stamps have been affixed thereto and canceled.

(2) In any case where the amount of the premium is not definitely determined at the time of entering into the taxable contractual relationship, the stamps may be affixed to the receipts for monthly or other payments if proper notation be made upon such receipts identifying the original instruments to which they apply.

(3) The stamps shall be affixed by any person who is a party to the taxable contractual relationship, including any solicitor or broker acting for or on behalf of such person.

(b) *Subsequent instruments.* In case a subsequent instrument provides for the payment of a premium greater than that provided for in the original instrument, the subsequent instrument must have affixed thereto stamps equal to the tax imposed upon the additional premium charged and must bear a notation of the stamps affixed to the original instrument.

(c) *Affixing of stamps.* (1) Only documentary stamps shall be used in payment of the tax imposed by section 4371. See also §§ 47.6804-1 and 47.6804-2 for the appropriate use, denominations, and cancellation of such stamps.

(2) Documentary stamps may be purchased, and requisition forms for the purchase of such stamps may be obtained, from the sources and in the manner provided in § 47.6802-1. For provisions relating to distribution, supply, and redemption of stamps, see sections 6801 (§ 47.6801), 6802 (§ 47.6802), 6805 (§ 47.6805), and the regulations thereunder contained in Part 301 of this chapter (Regulations on Procedure and Administration), and § 47.6801-1.

(d) *Instruments without stamps or notation of stamping.* For provisions

relating to the penalty for failure to comply with the requirements of section 4374, see § 47.7270.

(e) *Record requirements.* For provisions relating to the requirements concerning records and the retention of policies for a period of 3 years, see § 47.6001-2.

§ 47.4375 Statutory provisions; cross references.

Sec. 4375. Cross references. For penalties and other general and administrative provisions, see section 4384 and subtitle F.

[Sec. 4375 as amended and in effect Jan. 1, 1959]

§ 47.4375-1 Cross references.

(a) For definitions, see section 4381, § 47.4381-1, and section 7701 (§ 47.7701).

(b) For penalties, see section 7271 and § 47.7271-1.

(c) For other general and administrative provisions, see section 4384, § 47.4384-1, Subpart J, and the applicable sections of subtitle F and the regulations in Part 301 of this chapter (Regulations on Procedure and Administration).

Subpart I—Miscellaneous Provisions Applicable to Documentary Stamp Taxes

§ 47.4381 Statutory provisions; definitions.

SEC. 4381 Definitions.—(a) *Certificates of indebtedness.* For purposes of the taxes imposed by sections 4311 and 4331, the term "certificates of indebtedness" means bonds, debentures, or certificates of indebtedness; and includes all instruments, however termed, issued by a corporation with interest coupons or in registered form, known generally as corporate securities.

(b) *Corporation.* For purposes of the taxes imposed by this chapter, the term "corporation" includes any investment trust or similar organization (or any person acting in behalf of such investment trust or similar organization) issuing, holding or dealing in shares or certificates of stock, or in certificates of indebtedness. For purposes of the tax imposed by section 4311, the term "corporation" also includes any receiver, trustee in bankruptcy, assignee, or other person having custody of property of, or charge of the affairs of, the corporation. Nothing contained in this subsection shall be construed to limit the effect of the definition of the term "corporation" provided in section 7701(a)(3).

(c) *Shares or certificates of stock.* For purposes of the taxes imposed by sections

4301 and 4321, the term "shares or certificates of stock" includes shares or certificates of profits or of interest in property or accumulations.

[Sec. 4381 as amended and in effect Jan. 1, 1959]

§ 47.4381-1 Definitions.

(a) *Certificates of indebtedness.* The term "certificates of indebtedness" includes bonds, debentures, and certificates of indebtedness. Such term also includes all instruments, however termed, issued by a corporation with interest coupons or in registered form and known generally as corporate securities. The essence of a corporate security is marketability. An instrument is ordinarily considered to be marketable if it is issued in series, under a trust indenture, and in registered form or with interest coupons attached. For example, an instrument containing the essential features of a promissory note is included within the meaning of the term "certificates of indebtedness" if it has, in addition, the general characteristics of a corporate security. Whether or not an instrument is a certificate of indebtedness within the meaning of section 4381(a) is not determined by its name alone, but depends upon all the facts which can be derived from the face of the instrument, such as the form and terms of the instrument. The nature of the transaction or any act appearing outside of the instrument itself is immaterial for purposes of making such determination.

(b) *Corporation.* For purposes of the taxes imposed by sections 4301, 4311, 4321, 4331, 4361, and 4371, the term "corporation" includes associations, joint-stock companies, and insurance companies (see § 47.7701), as well as any investment trust or similar organization (or any person acting in behalf of such investment trust or similar organization) issuing, holding or dealing in shares or certificates of stock, or in certificates of indebtedness. In addition, for purposes of the tax imposed by section 4311, the term "corporation" also includes any receiver, trustee in bankruptcy, assignee, or other person having custody of property, or charge of the affairs, of the corporation.

(c) *Shares or certificates of stock.* For purposes of the regulations in this part, the term "stock" includes shares or certificates of stock. The term "stock" also includes shares in an association.

joint-stock company, or insurance company (see § 47.7701). For purposes of the tax imposed by section 4321, the term "stock" also includes rights to subscribe for or to receive shares or certificates of stock (see paragraph (a) of § 47.4321-1). For purposes of the taxes imposed by sections 4301 and 4321, the term "shares or certificates of stock" includes shares or certificates of profits or of interest in property or accumulations.

(d) *Cross references.* For other definitions of general application, see §§ 47.0-2 and 47.7701.

§ 47.4382 Statutory provisions; exemptions.

SEC. 4382 *Exemptions*—(a) *Governments; certain associations.* The taxes imposed by this chapter shall not apply to—

(1) *Government and State obligations.* Any certificate of indebtedness, note, or other instrument, issued by the United States, or by any foreign government, or by any State, Territory, or the District of Columbia, or local subdivision thereof, or municipal or other corporation exercising the taxing power.

(2) *Domestic building and loan associations and mutual ditch or irrigation companies.* Shares or certificates of stock and certificates of indebtedness issued by domestic building and loan associations, savings and loan associations, cooperative banks, and homestead associations substantially all the business of which is confined to making loans to members, or by mutual ditch or irrigation companies.

(3) *Farmers', fruit growers', or cooperative associations.* Shares or certificates of stock and certificates of indebtedness issued by any farmers' or fruit growers' or like associations organized and operated on a cooperative basis for the purposes, and subject to the conditions, prescribed in section 521.

(b) *Certain reorganizations, etc.* The taxes imposed by sections 4301, 4311, 4321, 4331, and 4361 shall not apply to—

(1) *Corporate and railroad reorganization.* The issuance, transfer, or exchange of securities, or the making, delivery, or filing of conveyances, to make effective any plan of reorganization or adjustment—

(A) Confirmed under the Bankruptcy Act, as amended (11 U.S.C.),

(B) Approved in an equity receivership proceeding in a court involving a railroad corporation, as defined in section 77(m) of the Bankruptcy Act, as amended (11 U.S.C. 205(m)),

(C) Approved in an equity receivership proceeding in a court involving a corporation, as defined in section 106(3) of the Bankruptcy Act, as amended (11 U.S.C. 506), or

(D) Whereby a mere change in identity, form, or place of organization is effected, but only if the issuance, transfer, or exchange of securities, or the making, delivery, or filing of instruments of transfer or conveyances, occurs within 5 years from the date of such confirmation, approval, or change.

(2) *Orders of the Securities and Exchange Commission.* The issuance, transfer, or exchange of securities, or making or delivery of conveyances, to make effective any order of the Securities and Exchange Commission as defined in section 1083(a); but only if—

(A) The order of the Securities and Exchange Commission in obedience to which such issuance, transfer, exchange, or conveyance is made recites that such issuance, transfer, exchange, or conveyance is necessary or appropriate to effectuate the provisions of section 11(b) of the Public Utility Holding Company Act of 1935 (15 U.S.C. 79k(b)),

(B) Such order specifies and itemizes the securities and other property which are ordered to be issued, transferred, exchanged, or conveyed, and

(C) Such issuance, transfer, exchange, or conveyance is made in obedience to such order.

[Sec. 4382 as amended and in effect Jan. 1, 1959]

§ 47.4382-1 Exemptions.

(a) *Government and State obligations.* Section 4382(a) (1) exempts from the tax imposed by section 4311 or 4331 any certificate of indebtedness issued by the United States, or by any foreign government, or by any State, Territory, or the District of Columbia, or local subdivision thereof, or municipal or other corporation exercising the taxing power.

(b) *Stocks and certificates of indebtedness of domestic building and loan associations, etc.* Section 4382(a) (2) exempts from the tax imposed by section 4301, 4311, 4321, or 4331 any stock or certificate of indebtedness issued by a (1) domestic building and loan association, savings and loan association, cooperative bank, or homestead association, substantially all the business of which is confined to making loans to members, or (2) mutual ditch or irrigation company. For definition of the term "domestic building and loan association", see § 47.7701.

(c) *Stocks and certificates of indebtedness of farmers', fruit growers', or cooperative associations.* Section 4382(a) (3), exempts from the tax imposed by section 4301, 4311, 4321, or 4331 any

stock or certificate of indebtedness issued by any farmers' or fruit growers' or like associations organized and operated on a cooperative basis for the purposes, and subject to the conditions, prescribed in section 521. For regulations under section 521, see Part 1 of this chapter (Income Tax Regulations).

(d) *Corporate and railroad reorganizations.* (1) Section 4382(b) (1) exempts from the taxes imposed by sections 4301, 4311, 4321, 4331, and 4361 the issuance, transfer, or exchange of securities, or the making, delivery, or filing of conveyances, to make effective any plan of reorganization or adjustment—

(i) Confirmed under the Bankruptcy Act, as amended (11 U.S.C.) ;

(ii) Approved in an equity receivership proceeding in a court involving a railroad corporation, as defined in section 77(m) of the Bankruptcy Act, as amended (11 U.S.C. 205(m)) ;

(iii) Approved in an equity receivership proceeding in a court involving a corporation, as defined in section 106(3) of the Bankruptcy Act, as amended (11 U.S.C. 506) ; or

(iv) Whereby a mere change in identity, form, or place of organization is effected,

if the issuance, transfer, or exchange of securities, or the making, delivery, or filing of instruments of transfer or conveyance, occurs within 5 years from the date of such confirmation, approval, or change.

(2) Section 267 of the Bankruptcy Act (11 U.S.C. 667) also exempts from stamp tax the issuance, transfer, or exchange of securities, or the making or delivery of instruments of transfer under any plan of reorganization confirmed under chapter X of the Bankruptcy Act, as amended. However, by reason of the provisions of section 4382(b) (1) the exemption conferred by section 267 has no application to the issuance, transfer, or exchange of securities, or the making, delivery, or filing of conveyances, which occurs after 5 years from the date of confirmation or approval of the plan of reorganization.

(e) *Orders of the Securities and Exchange Commission.* Section 4382(b) (2) exempts from the taxes imposed by sections 4301, 4311, 4321, 4331, and 4361 the issuance, transfer, or exchange of securities, or the making or delivery of conveyances, to make effective

any order of the Securities and Exchange Commission as defined in section 1083(a), if (1) the order of the Securities and Exchange Commission in obedience to which such issuance, transfer, or exchange of securities or conveyance is made recites that such issuance, transfer, or exchange of securities or conveyance is necessary or appropriate to effectuate the provisions of section 11(b) of the Public Utility Holding Company Act of 1935 (15 U.S.C. 79k(b)) ; (2) such order specifies and itemizes the securities and other property which are ordered to be issued, transferred, exchanged, or conveyed; and (3) such issuance, transfer, exchange, or conveyance is made in obedience to such order.

(f) *Alteration and modification of securities under the Interstate Commerce Act.* Section 20b of the Interstate Commerce Act (49 U.S.C. 20b) provides for alteration or modification of securities of a carrier as defined in section 20a(1). Paragraph (12) of such section 20b (by application of section 7852) makes sections 4301, 4311, 4321, 4331, and 4361, and any amendments thereto, unless specifically provided to the contrary, inapplicable to the issuance, transfer, or exchange of securities or the making or delivery of conveyances to make effective any alteration or modification effected pursuant to section 20b.

§ 47.4383 Statutory provisions; certain changes in partnerships.

SEC. 4383 *Certain changes in partnerships.*—(a) *Continuing partnerships.* In the case of any share, certificate, right, or realty held by a partnership, no tax shall be imposed under section 4321, 4331, or 4361 by reason of any transfer of an interest in a partnership or otherwise, if—

(1) Such partnership (or another partnership) is considered as a continuing partnership (within the meaning of section 708), and

(2) Such continuing partnership continues to hold the share, certificate, right, or realty concerned.

(b) *Terminated partnerships.* If there is a termination of any partnership (within the meaning of section 708)—

(1) For purposes of this chapter, such partnership shall be treated—

(A) As having transferred all shares, certificates, and rights held by such partnership at the time of such termination; and

(B) As having executed an instrument whereby there was conveyed, for fair market value (exclusive of the value of any lien or

encumbrance remaining thereon), all realty held by such partnership at the time of such termination; but

(2) Not more than one tax shall be imposed under section 4321, 4331, or 4361, as the case may be, by reason of such termination (and any transfer pursuant thereto) with respect to the shares, certificates, rights, or realty held by such partnership at the time of such termination.

[Sec. 4383 as added and in effect Jan. 1, 1959]

§ 47.4383-1 Certain changes in partnerships.

(a) *Continuing partnerships.* No tax shall be imposed under section 4321, 4331, or 4361 by reason of any transfer of an interest in a partnership holding shares, certificates, rights, or realty if such partnership (or another partnership) is considered to be a continuing partnership within the meaning of section 708 and if such shares, certificates, rights, or realty continue to be held, regardless of the name in which held, by the continuing partnership (or the continuing partnerships if more than one). For rules relating to continuations of partnerships, see section 708 and the regulations thereunder in Part 1 of this chapter (Income Tax Regulations). To the extent that the shares, certificates, rights, or realty do not continue to be so held, the taxes imposed by sections 4321, 4331, and 4361 will apply. For example, if a partner withdraws from a partnership under such circumstances that the withdrawal does not constitute a termination of the partnership under the provisions of section 708 and the regulations thereunder, and if the partnership transfers to him, in consideration for his withdrawal, stock owned by the partnership, the stock so transferred will be subject to tax. However, if the partner receives cash in consideration for his withdrawal, and the partnership retains the stock, no tax is imposed since the stock is held by a continuing partnership.

(b) *Termination of partnerships.* If there is a termination, within the meaning of section 708, of a partnership holding shares, certificates, rights, or realty, the partnership is considered, for purposes of the taxes imposed by sections 4321, 4331, and 4361, as having transferred at the time of such termination all of such shares, certificates, and rights, and as having executed at the time of such termination an instrument

conveying, for fair market value (exclusive of the value of any lien or encumbrance remaining thereon), all of such realty. However, not more than one tax shall be imposed under each section with respect to such shares, certificates, rights, or realty by reason of a termination and any transfer pursuant thereto. Tax should be computed with respect to the transfer or conveyance deemed to occur under this paragraph. Any other deemed or actual transfer or conveyance which occurs by reason of the transaction resulting in the termination is not subject to tax. The operation of this paragraph may be illustrated by the following examples:

Example (1). Partnership AB owns 150 shares of X Corporation stock having a total actual value of \$13,000 and real estate having a fair market value (exclusive of the value of any lien or encumbrance thereon) of \$10,000. Partner B retires and receives 100 shares of X Corporation stock in liquidation of his entire partnership interest. Partner A receives the remainder of the partnership properties in liquidation of his entire partnership interest, and he continues to run the business as a sole proprietor. Partnership AB is terminated within the meaning of section 708 since the partnership business is no longer carried on by a partnership. Partnership AB is, therefore, considered to have executed an instrument conveying the real estate for \$10,000 and to have transferred the X Corporation stock having a total actual value of \$13,000. The transaction is subject to the taxes imposed by sections 4321 and 4361. No tax is imposed on the actual transfer of 100 shares of X Corporation stock to partner B or on the actual transfer and conveyance of the remaining stock and realty to partner A since such conveyance and transfers are made by reason of the transaction resulting in the termination.

Example (2). Partnership ABCD owns 1,000 shares of Y Corporation stock having a total actual value of \$60,000. Partner A owns a 40 percent interest in the capital and profits of the partnership and partners B, C, and D each have a 20 percent interest. In January, 1960, partner A sells his partnership interest to E, and in September, 1960, partner B sells his partnership interest to F thereby causing a termination of the partnership within the meaning of section 708. The partnership is, therefore, considered to have transferred in September, 1960, the 1,000 shares of Y Corporation stock, and there is a tax under section 4321 with respect to such shares. No further tax is imposed with respect to the transaction. Inasmuch as A is not a partner in the partnership at the time of its termination, he incurs no liability for the tax imposed with respect to the 1,000 shares of stock.

Example (3). Partnership ABCDE terminates within the meaning of section 708 by reason of the sale by E of his partnership interest to F. Pursuant to the termination transaction, partners A and B withdraw from the partnership, receiving stock owned by the partnership in consideration for their withdrawal, under such circumstances that the withdrawal constitutes a liquidation under section 708 and the regulations thereunder. All of the stock owned by the partnership is considered to be transferred on termination and tax is imposed with respect to such stock, but no additional tax is imposed with respect to the stock actually distributed to partners A and B in liquidation of their partnership interest. Furthermore, no tax will be imposed on the transfer by partners A and B of the stock distributed to them to a new partnership AB if such transfer is made pursuant to an agreement entered into concurrently with and as a result of the transaction in which partnership ABCDE is terminated.

(c) *Application of section.* Only those partnership changes occurring on or after January 1, 1959, shall be considered in determining whether a partnership is a continuing or terminated partnership under section 708.

§ 47.4384 Statutory provisions; liability for tax.

Sec. 4384 *Liability for tax.* The taxes imposed by this chapter shall be paid by any person who makes, signs, issues, or sells any of the documents and instruments subject to the taxes imposed by this chapter, or for whose use or benefit the same are made, signed, issued, or sold. The United States or any agency or instrumentality thereof shall not be liable for the tax with respect to an instrument to which it is a party, and affixing of stamps thereby shall not be deemed payment for the tax, which may be collected by assessment from any other party liable therefor.

[Sec. 4384 as amended and redesignated and in effect Jan. 1, 1959]

§ 47.4384-1 Liability for tax.

(a) *In general.* Except as otherwise provided in paragraphs (c) and (d) of this section, the tax is payable by any of the parties to a taxable transaction. For example, in the case of the transfer of stock, the liability therefor is imposed upon the transferor, the transferee, and the corporation whose stock is transferred (if there is a transfer of record). The parties to the transaction may agree among themselves as to which shall pay the tax, but such agreement does not relieve the others from their liability in

the event it is not carried out. No provisions, by-laws, or rules, of any exchange, and no custom, shall exempt any person from payment of the tax imposed.

(b) *Liability of subscriber for tax on issuance of stock.* The liability of a subscriber for the tax imposed by section 4301 on an issuance of stock to him by a corporation extends only to that portion of the total tax on all issuances of stock by such corporation for the day that the total actual value of the shares or certificates of stock issued to him in that day bears to the total actual value of all shares or certificates issued by the corporation in such day. For example, if a total of 100 shares of stock having a total actual value of \$1,800 are issued in one day by a corporation, the tax would be \$1.80. If A were issued in that day 10 shares of such stock having a total value of \$180, his liability for tax would be 18 cents.

(c) *United States as party to transaction.* The United States or any agency or instrumentality thereof shall not be liable for tax in respect of an instrument to which it is a party regardless of the capacity in which it acts. However, the transaction is not exempt from tax, and the nonexempt party to the transaction shall be liable for the tax. The affixing of stamps to the instrument by the United States or any agency or instrumentality thereof does not constitute payment of the tax, and the nonexempt party remains liable for the tax in such case.

(d) *State as party to transaction.* Except with respect to the tax imposed by section 4361, where a State or a political subdivision thereof, acting in its governmental capacity, is a party to a taxable transaction, under chapter 34 of the Code, the transaction will not be exempt from the documentary stamp tax merely by reason of the governmental character of one of the parties. The legal incidence of the tax in such a case rests upon the other party to the transaction. However, if in a taxable transaction with a private party, a State or political subdivision thereof is acting in its proprietary function, both parties will be liable for the tax. Where all parties to a transaction are States or political subdivisions thereof, acting in their governmental capacity, no tax shall be imposed. See section 4362(b)

and paragraph (b) of § 47.4362-1 for the exemption of any State, Territory, political subdivision thereof, or the District of Columbia from the tax imposed by section 4361 on conveyances of realty to which it is a party, regardless of the capacity in which it acts.

Subpart J—Administrative Provisions Applicable to Documentary Stamp Taxes

§ 47.6001 Statutory provisions; notice or regulations requiring records, statements, and special returns.

Sec. 6001 *Notice or regulations requiring records, statements, and special returns.* Every person liable for any tax imposed by this title, or for the collection thereof, shall keep such records, render such statements, make such returns, and comply with such rules and regulations as the Secretary or his delegate may from time to time prescribe. Whenever in the judgment of the Secretary or his delegate it is necessary, he may require any person, by notice served upon such person or by regulations, to make such returns, render such statements, or keep such records, as the Secretary or his delegate deems sufficient to show whether or not such person is liable for tax under this title.

[Sec. 6001 as originally enacted and in effect Jan. 1, 1959]

§ 47.6001-1 Records of sales and transfers of stock.

(a) *Brokers, dealers, etc.* All persons who are wholly or partly engaged in the business of buying, selling, or transferring stock, either at public or private sale, whether or not they are members of an exchange, including persons engaged in transactions known as "matched", "on-order", "pass-outs", or "give-ups", or transactions which are settled directly between the seller and buyer or which are cleared or adjusted through a clearinghouse or otherwise, or persons (other than those described in paragraph (b) of this section) engaged in accepting and procuring the transmission of orders for purchase or sale of shares of stock shall keep a record as to each transaction showing:

- (1) Date of transaction.
- (2) Name of customer for whom sold or loaned, or for whom bought or borrowed.
- (3) Name of party to whom sold or loaned, or from whom bought or borrowed.

(4) Name of correspondent broker, if any.

(5) Number of shares involved.

(6) Name and description of stock.

(7) Selling price of stock, per share.

(8) Amount of tax paid.

(b) *Correspondent brokers.* Persons engaged in accepting and procuring the transmission of orders for the purchase or sale of stock, to be executed at a brokerage office or at an exchange, board of trade, or similar place, shall keep a record as to each transaction showing:

(1) Date of acceptance and transmission of order.

(2) Name of person from whom accepted.

(3) Name and address of person to whom transmitted.

(4) Name and description of stock.

(5) Number of shares involved.

(6) Whether purchase or sale.

(7) Selling price of stock, per share.

(8) Date of execution of order.

(c) *Floor brokers, etc.* Brokers known as strictly "floor brokers", "two-dollar men", or "room traders", whether their transactions are settled directly between seller and buyer, by "matched", "on-order", "pass-out", "scratch sale", or "give-up", or by any other kind of sale or purchase, or whether their transactions are cleared through a clearinghouse or otherwise, shall, in lieu of the record prescribed in paragraph (a) of this section, keep a record as to each transaction showing:

(1) Date of transaction.

(2) Name of seller.

(3) Name of purchaser.

(4) Name and description of stock.

(5) Number of shares involved.

(6) Selling price of stock, per share.

(7) Whether the transaction is "matched", "on-order", "pass-out", "scratch sale", or "give-up".

(8) Name of person to whom "given-up".

(d) *General.* Persons keeping records as prescribed in this section may incorporate therein additional information for their own use, which should be entered, however, so as not to interfere with the recording of the information required by this section. These records must be kept in permanent form for a period of at least three years from the date any part of the tax is paid on the transaction and must be available for ready inspection by internal revenue officers.

§ 47.6001-2 Records with respect to foreign insurance policies.

(a) *Records to be kept by solicitors, brokers, etc.* No return or statement showing a list of policies or other instruments subject to the tax imposed by section 4371 is required from any person to or for whom, or in whose name, such policy or other instrument is issued, or from the solicitor or broker acting directly or indirectly for or on behalf of such person. However, each person, solicitor, or broker, accepting, placing, soliciting, or making, directly or indirectly, or paying or receiving compensation with respect to, a policy or other instrument subject to the tax imposed by section 4371 shall keep a record of such policy or other instrument for a period of at least three years from the date any part of the tax was paid with respect to the issuance thereof and shall be prepared to furnish full information to the district director at any time upon demand.

(b) *Records to be kept by policy holder.* The person having control or possession of a policy of insurance, or reinsurance, or other instrument to which documentary stamps must be affixed shall retain such instrument for at least 3 years from the date any part of the tax was paid with respect to the issuance thereof to enable internal revenue officers to ascertain whether the requisite stamps have been affixed and cancelled.

§ 47.6801 Statutory provisions; authority for establishment, alteration, and distribution.

Sec. 6801 *Authority for establishment, alteration, and distribution.*—(a) *Establishment and alteration.* The Secretary or his delegate may establish, and from time to time alter, renew, replace, or change the form, style, character, material, and device of any stamp, mark, or label under any provision of the laws relating to internal revenue.

(b) *Preparation and distribution of regulations, forms, stamps and dies.* The Secretary or his delegate shall prepare and distribute all the instructions, regulations, directions, forms, blanks, and stamps; and shall provide proper and sufficient adhesive stamps and other stamps or dies for expressing and denoting the several stamp taxes.

[Sec. 6801 as originally enacted and in effect Jan. 1, 1959]

§ 47.6801-1 Establishment of meter machines and stamps.

The Commissioner of Internal Revenue or his delegate shall have the authority to set the standards for and to approve meter machines for use in the sale of documentary stamps and to prescribe instructions and requirements governing the circumstances and conditions under which such machines may be used. In addition to the documentary stamps customarily sold and used for the payment of taxes imposed under chapter 34 of the Code, stamps produced by authorized documentary stamp meter machines shall be proper for such use. See paragraph (a) (5) of § 47.0-2 for the definition of the term "documentary stamps".

§ 47.6802 Statutory provisions; supply and distribution.

Sec. 6802 *Supply and distribution.* The Secretary or his delegate shall furnish, without prepayment, to—

(1) *Postmaster General.* The Postmaster General a suitable quantity of adhesive stamps (other than the stamps on playing cards), coupons, tickets, or such other devices as may be prescribed by the Secretary or his delegate pursuant to section 6302(b) or this chapter, to be distributed to, and kept on sale by, the various postmasters in the United States in all post offices of the first and second classes, and such post offices of the third and fourth classes as—

(A) Are located in county seats, or

(B) Are certified by the Secretary to the Postmaster General as necessary;

(2) *Designated depository of the United States.* Any designated depository of the United States a suitable quantity of adhesive stamps to be kept on sale by such designated depository;

(3) *State agents.* Any person who is—

(A) Duly appointed and acting as agent of any State for the sale of stock transfer stamps of such State, and

(B) Designated by the Secretary or his delegate for the purpose,

a suitable quantity of such adhesive stamps as are required by section 4301, to be kept on sale by such person.

[Sec. 6802 as originally enacted and in effect Jan. 1, 1959]

§ 47.6802-1 Where stamps may be purchased and when unused documentary stamps may be used or resold.

(a) *Where stamps may be purchased.* Documentary stamps may be purchased from (1) district directors and other duly

authorized officials; (2) postmasters in all post offices of the first and second classes and such post offices of the third and fourth class as are located in county seats; (3) designated depositaries of the United States (see section 6802(2) (§ 47.6802)); and (4) State agents designated under paragraph (3) of section 6802 (§ 47.6802).

(b) *Use or resale of unused documentary stamps.* Unused documentary stamps may be used at any time in payment of any tax imposed by section 4301, 4311, 4321, 4331, 4361, or 4371, or may be resold by the owner at any time. For redemption of stamps see section 6805 (§ 47.6805).

§ 47.6804 Statutory provisions; attachment and cancellation.

SEC. 6804 *Attachment and cancellation.* Except as otherwise expressly provided in this title, the stamps referred to in section 6801 shall be attached, protected, removed, canceled, obliterated, and destroyed, in such manner and by such instruments or other means as the Secretary or his delegate may prescribe by rules or regulations.

[Sec. 6804 as originally enacted and in effect Jan. 1, 1959]

§ 47.6804-1 Stamps to be used and denominations thereof.

(a) *Documentary stamps only to be used.* Except as provided in section 4353 and § 47.4353-1, documentary stamps only shall be used in payment of the stamp taxes imposed by sections 4301, 4311, 4321, 4331, 4361, and 4371. Ordinary postage stamps shall not be used in payment of documentary stamp taxes.

(b) *Use of stamps.* Wherever feasible, a stamp tax shall be paid by the use of a single stamp. If a stamp of a denomination equal to the tax is not readily available, the smallest practical number of stamps shall be used. A stamp affixed to an instrument and canceled cannot lawfully be removed therefrom and affixed to another instrument requiring a stamp (see section 7208 (§ 47.7208)) relating to penalties).

(c) *Denominations of documentary stamps.* Documentary stamps (other than stamps issued by authorized meter machines) are issued in the following denominations: 1 cent, 2 cents, 3 cents, 4 cents, 5 cents, 8 cents, 10 cents, 20 cents, 25 cents, 40 cents, 50 cents, 55 cents, 80 cents, \$1, \$1.10, \$1.65, \$2, \$2.20, \$2.75, \$3, \$3.30, \$4, \$5, \$10, \$20, \$30, \$50,

\$60, \$100, \$500, \$1,000, \$2,500, \$5,000, and \$10,000.

§ 47.6804-2 Cancellation of stamps.

(a) *Stamps affixed by adhesion.* Except as provided by paragraph (b) of this section, a person using or affixing a stamp shall cancel it and so deface it as to render it unfit for reuse by marking it with his initials and the day, month, and year when the affixing occurs. (See section 7271(1) (§ 47.7271), relating to penalties.) Such marking shall be made by writing or stamping in indelible ink or by perforating with a machine or punch. However, the stamp shall not be so defaced as to prevent ready determination of its denomination and genuineness. (See paragraph (b) of § 47.6804-1 relating to the prohibition against reuse of used stamps.)

(b) *Stamps printed directly on documents.* A stamp printed directly on a document by an authorized meter machine is considered cancelled provided the printing on such stamp contains the date of such printing and a number which identifies the machine which printed the stamp.

§ 47.6805 Statutory provisions; redemption of stamps.

SEC. 6805 *Redemption of stamps*—(a) *Authorization.* The Secretary or his delegate, subject to regulations prescribed by him, may, upon receipt of satisfactory evidence of the facts, make allowance for or redeem such of the stamps, issued under authority of any internal revenue law, as may have been spoiled, destroyed, or rendered useless or unfit for the purpose intended, or for which the owner may have no use.

(b) *Method and conditions of allowance.* Such allowance or redemption may be made, either by giving other stamps in lieu of the stamps so allowed for or redeemed, or by refunding the amount or value to the owner thereof, deducting therefrom, in case of repayment, the percentage, if any, allowed to the purchaser thereof; but no allowance or redemption shall be made in any case until the stamps so spoiled or rendered useless shall have been returned to the Secretary or his delegate, or until satisfactory proof has been made showing the reason why the same cannot be returned; or, if so required by the Secretary or his delegate, when the person presenting the same cannot satisfactorily trace the history of said stamps from their issuance to the presentation of his claim as aforesaid.

(c) *Time for filing claims.* No claim for the redemption of, or allowance for, stamps shall be allowed under this section unless

presented within 3 years after the purchase of such stamps from the Government.

(d) *Finality of decisions.* The findings of fact in and the decision of the Secretary or his delegate upon the merits of any claim presented under or authorized by this section shall, in the absence of fraud or mistake in mathematical calculation, be final and not subject to revision by any accounting officer.

[Sec. 6805 as amended and in effect Jan. 1, 1959]

§ 47.6805-1 Redemption of stamps.

For provisions with respect to redemption of stamps, see the regulations under section 6805 in Part 301 of this chapter (Regulations on Procedure and Administration).

§ 47.7208 Statutory provisions; offenses relating to stamps.

Sec. 7208 *Offenses relating to stamps.* Any person who—

(1) *Counterfeiting.* With intent to defraud, alters, forges, makes, or counterfeits any stamp, coupon, ticket, book, or other device prescribed under authority of this title for the collection or payment of any tax imposed by this title, or sells, lends, or has in his possession any such altered, forged, or counterfeited stamp, coupon, ticket, book, or other device, or makes, uses, sells, or has in his possession any material in imitation of the material used in the manufacture of such stamp, coupon, ticket, book, or other device; or

(2) *Mutilation or removal.* Fraudulently cuts, tears, or removes from any vellum, parchment, paper, instrument, writing, package, or article, upon which any tax is imposed by this title, any adhesive stamp or the impression of any stamp, die, plate, or other article provided, made, or used in pursuance of this title; or

(3) *Use of mutilated, insufficient, or counterfeited stamps.* Fraudulently uses, joins, fixes, or places to, with, or upon any vellum, parchment, paper, instrument, writing, package, or article, upon which any tax is imposed by this title,

(A) Any adhesive stamp, or the impression of any stamp, die, plate, or other article, which has been cut, torn, or removed from any other vellum, parchment, paper, instrument, writing, package, or article, upon which any tax is imposed by this title; or

(B) Any adhesive stamp or the impression of any stamp, die, plate, or other article of insufficient value; or

(C) Any forged or counterfeited stamp, or the impression of any forged or counterfeited stamp, die, plate, or other article; or

(4) *Reuse of stamps.*—(A) *Preparation for reuse.* Willfully removes, or alters the cancellation or defacing marks of, or otherwise prepares, any adhesive stamp, with intent to

use, or cause the same to be used, after it has already been used; or

(B) *Trafficking.* Knowingly or willfully buys, sells, offers for sale, or gives away, any such washed or restored stamp to any person for use, or knowingly uses the same; or

(C) *Possession.* Knowingly and without lawful excuse (the burden of proof of such excuse being on the accused) has in possession any washed, restored, or altered stamp, which has been removed from any vellum, parchment, paper, instrument, writing, package, or article; or

(5) *Emptied stamped packages.* Commits the offense described in section 7271 (relating to disposal and receipt of stamped packages) with intent to defraud the revenue, or to defraud any person;

shall be guilty of a felony and, upon conviction thereof, shall be fined not more than \$10,000, or imprisoned not more than 5 years, or both.

[Sec. 7208 as originally enacted and in effect Jan. 1, 1959]

§ 47.7209 Statutory provisions; unauthorized use or sale of stamps.

Sec. 7209 *Unauthorized use or sale of stamps.* Any person who buys, sells, offers for sale, uses, transfers, takes or gives in exchange, or pledges or gives in pledge, except as authorized in this title or in regulations made pursuant thereto, any stamp, coupon, ticket, book, or other device prescribed by the Secretary or his delegate under this title for the collection or payment of any tax imposed by this title, shall, upon conviction thereof, be fined not more than \$1,000, or imprisoned not more than 6 months, or both.

[Sec. 7209 as originally enacted and in effect Jan. 1, 1959]

§ 47.7209-1 Use or resale of unused stamps.

For provisions with respect to the use or resale of unused stamps, see paragraph (c) of § 47.6802-1. For provisions with respect to the unauthorized use or sale of stamps, see the regulations under section 7209 in Part 301 of this chapter (Regulations on Procedure and Administration).

§ 47.7270 Statutory provisions; insurance policies.

Sec. 7270 *Insurance policies.* Any person who fails to comply with the requirements of section 4374 (relating to the affixing of stamps on insurance policies, etc.), with intent to evade the tax shall, in addition to other penalties provided therefor, pay a fine of double the amount of the tax.

[Sec. 7270 as originally enacted and in effect Jan. 1, 1959]

§ 47.7271 Statutory provisions; penalties for offenses relating to stamps.

Sec. 7271 *Penalties for offenses relating to stamps.* Any person who with respect to any tax payable by stamps—

(1) *Failure to attach or cancel stamps, etc.* Fails to comply with rules or regulations prescribed pursuant to section 6804 (relating to attachment, cancellation, etc., of stamps), unless such failure is shown to be due to reasonable cause and not willful neglect; or

(3) *Instruments.* Makes, signs, issues, or accepts, or causes to be made, signed, issued, or accepted, any instrument, document, or paper of any kind or description whatsoever without the full amount of tax thereon being duly paid; or

shall be liable for each such offense to a penalty of \$50.

[Sec. 7271 as originally enacted and in effect Jan. 1, 1959]

§ 47.7271-1 Cross references.

For other provisions relating to penalties, see the applicable sections of the regulations in Part 301 of this chapter (Regulations on Procedure and Administration).

§ 47.7701 Statutory provisions; definitions.

Sec. 7701 *Definitions.* (a) When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof—

(1) *Person.* The term "person" shall be construed to mean and include an individual, a trust, estate, partnership, association, company or corporation.

(2) *Partnership and partner.* The term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a trust or estate or a corporation; and the term "partner" includes a member in such a syndicate, group, pool, joint venture, or organization.

(3) *Corporation.* The term "corporation" includes associations, joint-stock companies, and insurance companies.

(4) *Domestic.* The term "domestic" when applied to a corporation or partnership means created or organized in the United States or under the law of the United States or of any State or Territory.

(5) *Foreign.* The term "foreign" when applied to a corporation or partnership means a corporation or partnership which is not domestic.

(6) *Fiduciary.* The term "fiduciary" means a guardian, trustee, executor, administrator, receiver, conservator, or any person acting in any fiduciary capacity for any person.

(7) *Stock.* The term "stock" includes shares in an association, joint-stock company, or insurance company.

(9) *United States.* The term "United States" when used in a geographical sense includes only the States and the District of Columbia.

(10) *State.* The term "State" shall be construed to include the District of Columbia, where such construction is necessary to carry out provisions of this title.

(11) *Secretary.* The term "Secretary" means the Secretary of the Treasury.

(12) *Delegate.*—(A) *In general.* The term "Secretary or his delegate" means the Secretary of the Treasury, or any officer, employee, or agency of the Treasury Department duly authorized by the Secretary (directly, or indirectly by one or more re-delegations of authority) to perform the function mentioned or described in the context, and the term "or his delegate" when used in connection with any other official of the United States shall be similarly construed.

(13) *Commissioner.* The term "Commissioner" means the Commissioner of Internal Revenue.

(19) *Domestic building and loan association.* The term "domestic building and loan association" means a domestic building and loan association; a domestic savings and loan association, and a Federal savings and loan association, substantially all the business of which is confined to making loans to members.

(b) *Includes and including.* The terms "includes" and "including" when used in a definition contained in this title shall not be deemed to exclude other things otherwise within the meaning of the term defined.

(d) *Cross references.*—(1) *Other definitions.* For other definitions, see the following sections of Title 1 of the United States Code:

(1) Singular as including plural, section 1.

(2) Plural as including singular, section 1.

(3) Masculine as including feminine, section 1.

[Sec. 7701 as originally enacted and in effect Jan. 1, 1959, and as amended by sec. 22 (g) and (h) of the Alaska Omnibus Act (73 Stat. 146, 147); sec. 18 (i) and (j) of the Hawaii Omnibus Act (74 Stat. 416); sec.

103(t) of the Social Security Amendments 1960 (74 Stat. 941)]

§ 47.7805 Statutory provisions; rules and regulations.

SEC. 7805 Rules and regulations—(a) Authorization. Except where such authority is expressly given by this title to any person other than an officer or employee of the Treasury Department, the Secretary or his delegate shall prescribe all needful rules and regulations for the enforcement of this title, including all rules and regulations as may be necessary by reason of any alteration of law in relation to internal revenue.

(b) Retroactivity of regulations or rulings. The Secretary or his delegate may prescribe the extent, if any, to which any ruling or regulation, relating to the internal revenue

laws, shall be applied without retroactive effect.

(c) Preparation and distribution of regulations, forms, stamps, and other matters. The Secretary or his delegate shall prepare and distribute all the instructions, regulations, directions, forms, blanks, stamps, and other matters pertaining to the assessment and collection of internal revenue.

[Sec. 7805 as originally enacted and in effect Jan. 1, 1959]

§ 47.7805-1 Promulgation of regulations.

In pursuance of section 7805 of the Internal Revenue Code of 1954, the foregoing regulations are hereby prescribed. (See § 47.0-3 relating to the scope of the regulations.)

Mortimer M. Caplin,
Commissioner of Internal Revenue.

Approved January 31, 1962.

Stanley S. Surrey,
Assistant Secretary of the Treasury.

(Filed by the Division of the Federal Register on February 6, 1962, 8:46 a.m., and published in the issue of the Federal Register for February 7, 1962, 27 F.R. 1038)

PART II.—ISSUANCE OF CERTIFICATES OF INDEBTEDNESS

SECTION 4311.—IMPOSITION OF TAX

26 CFR 47.4311: Statutory provisions;
imposition of tax.

Regulations under the Internal Revenue Code of 1954 relating to the documentary stamp tax on the issuance of certificates of indebtedness. See T.D. 6589, page 228.

26 CFR 47.4311-1: Imposition of tax on
issuance of certificates of indebtedness.
(Also Section 4331, 4361, 4371; 47.4331-1,
47.4361-1, 47.4371-1.)

Rev. Rul. 62-56

The "Articles of Agreement of the International Bank for Reconstruction and Development" provide that the "transactions" of the Bank shall be immune from all taxation. The Articles of Agreement became part of the statutory law of the United States upon the adoption of the Bretton Woods Agreements Act. Accordingly, certain described transactions of the Bank are exempt from the documentary stamp taxes imposed under Chapter 34 of the Internal Revenue Code of 1954.

Advice has been requested whether certain transactions involving the International Bank for Reconstruction and Development (hereinafter referred to as the Bank) are exempt from the documentary stamp taxes imposed under Chapter 34 of the Internal Revenue Code of 1954.

The Bank is an international organization established for the general purpose of facilitating the financing of the reconstruction and development of productive facilities in the territories of the member nations. The Bank was created pursuant to an agreement signed by the member nations in 1944, which is known as the "Articles of Agreement of the International Bank for Reconstruction and Development" (hereinafter referred to as the Agreement).

Section 9(a) of Article VII of the Agreement reads as follows:

The Bank, its assets, property, income and its operations and transactions authorized by this Agreement, shall be immune from all taxation, and from all customs duties. The Bank shall also be immune from liability for the collection or payment of any tax or duty.

The United States accepted membership in the Bank under the authority of the "Bretton Woods Agreements Act," 22 U.S.C. 286.

Section 11 of the Bretton Woods Agreements Act reads, in part, as follows:

The provisions of * * * Article VII, sections 2-9, both inclusive, of the Articles of Agreement of the Bank shall have full force and effect in the United States * * * upon the acceptance of membership by the United States in, and the establishment of, the * * * Bank.

The following questions, relative to the effect of section 9(a) of Article VII of the Agreement on documentary stamp taxes imposed under Chapter 34 of the Code, have been submitted to the Internal Revenue Service:

(1) Is the stamp tax on issuance of certificates of indebtedness, imposed by section 4311 of the Code, applicable to the issuance to the Bank, or upon its order, of the bonds of nongovernmental corporate borrowers, where delivery is made to the Bank within the United States?

(2) Is the stamp tax on the sale or transfer of certificates of indebtedness, imposed by section 4331 of the Code, applicable to the subsequent sale or transfer by the Bank of bonds described in (1) above?

(3) Is the stamp tax on conveyances, imposed by section 4361 of the Code, applicable to purchases or sales of realty in the United States by the Bank?

(4) Is the stamp tax on policies issued by foreign insurers, imposed by section 4371 of the Code, applicable with respect to policies of insurance, indemnity bonds or annuity contracts, issued (in a transaction to which the Bank is a party) to or for, or in the name of, any person who deals with the Bank as a participant in the transaction?

Section 4311 of the Code imposes a documentary stamp tax on all certificates of indebtedness issued by a corporation.

Section 4331 of the Code imposes a documentary stamp tax on each sale or transfer of any certificate of indebtedness issued by a corporation.

Section 4361 of the Code imposes a documentary stamp tax on each deed, instrument, or writing by which any lands, tenements, or other realty sold shall be granted, assigned, transferred, or otherwise conveyed to, or vested in, the purchaser or purchasers, or any other person or persons, by his or their direction, 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.

Section 4371 of the Code imposes a documentary stamp tax on each policy of insurance, indemnity bond, annuity contract, or policy of reinsurance issued by any foreign insurer or reinsurer.

The activities described in the four inquiries detailed above are considered to be "transactions" of the Bank, within the meaning of section 9(a) of Article VII of the Agreement. Through the adoption of the Bretton Woods Agreements Act, the Agreement became part of the statutory law of the United States. Accordingly, the transactions described in (1) through (4) above, where otherwise authorized by the Agreement, are exempt from all stamp taxes imposed under Chapter 34 of the Code, and no party to such transactions is liable for any of the stamp taxes imposed by Chapter 34. See Revenue Ruling 62-55, page 188, this Bulletin, for a related conclusion with respect to the retailers and the manufacturers excise taxes.

This ruling applies with equal effect to the transactions of certain other international organizations, as follows:

Inter-American Development Bank
International Development Association
International Finance Corporation
International Monetary Fund

The agreements establishing these organizations contain provisions substantially similar to section 9(a) of Article VII of the Agreement in the instant case, and the agreements have been made part of the statutory law of the United States.

**SUBCHAPTER B.—SALES OR TRANSFERS OF CAPITAL STOCK AND
CERTIFICATES OF INDEBTEDNESS OF A CORPORATION**

PART I.—SALES OR TRANSFERS OF CAPITAL STOCK AND SIMILAR INTERESTS

SECTION 4321.—IMPOSITION OF TAX

26 CFR 47.4321: Statutory provisions;
imposition of tax.

Regulations under the Internal Revenue Code of 1954 relating to the documentary stamp tax on the sale or transfer of capital stock and similar interests. See T.D. 6589, page 228.

PART II.—SALES OR TRANSFERS OF CERTIFICATES OF INDEBTEDNESS

SECTION 4331.—IMPOSITION OF TAX

26 CFR 47.4331: Statutory provisions;
imposition of tax.

Regulations under the Internal Revenue Code of 1954 relating to the documentary stamp tax on the sale or transfer of certificates of indebtedness. See T.D. 6589, page 228.

26 CFR 47.4331-1: Imposition of tax.

Whether transactions involving the sale or transfer of certain bonds by the International Bank for Reconstruction and Development are exempt from the documentary stamp tax on the sale or transfer of certificates of indebtedness. See Rev. Rul. 62-56, page 272.

**PART III.—PROVISIONS COMMON TO SALES OR TRANSFERS OF CAPITAL STOCK
AND CERTIFICATES OF INDEBTEDNESS**

Subpart A.—Exemptions

SECTION 4341.—TRANSFERS AS SECURITY

26 CFR 47.4341: Statutory provisions;
transfers as security.

Regulations under the Internal Revenue Code of 1954 relating to the exemption from the documentary stamp tax of transfers of capital stock and certificates of indebtedness as security. See T.D. 6589, page 228.

SUBCHAPTER C.—CONVEYANCES

SECTION 4361.—IMPOSITION OF TAX

26 CFR 47.4361: Statutory provisions;
imposition of tax.

Regulations under the Internal Revenue Code of 1954 relating to the documentary stamp tax on deeds of conveyance. See T.D. 6589, page 228.

26 CFR 47.4361-1: Imposition of tax.

Whether transactions involving the purchase or sale of realty in the United States by the International Bank for Reconstruction and Development are exempt from the documentary stamp tax on conveyances. See Rev. Rul. 62-56, page 272.

SUBCHAPTER D.—POLICIES ISSUED BY FOREIGN INSURERS

SECTION 4371.—IMPOSITION OF TAX

26 CFR 47.4371: Statutory provisions;
imposition of tax.

Regulations under the Internal Revenue Code of 1954 relating to the documentary stamp tax on policies issued by foreign insurers. See T.D. 6589, page 228.

26 CFR 47.4371-1: Imposition of tax on policies
issued by foreign insurers; scope of tax.

Whether transactions involving the issuance of policies of insurance, indemnity bonds, or annuity contracts by foreign insurers to or for the International Bank for Reconstruction and Development are exempt from the documentary stamp tax on policies issued by foreign insurers. See Rev. Rul. 62-56, page 272.

**SUBCHAPTER E.—MISCELLANEOUS PROVISIONS APPLICABLE
TO DOCUMENTARY STAMP TAXES**

SECTION 4381.—DEFINITIONS

26 CFR 47.4381: Statutory provisions;
definitions.

Regulations under the Internal Revenue Code of 1954 relating to definitions of terms for purposes of the documentary stamp taxes. See T.D. 6589, page 228.

CHAPTER 36.—CERTAIN OTHER EXCISE TAXES**SUBCHAPTER A.—PLAYING CARDS**

SECTION 4451.—IMPOSITION OF TAX

26 CFR 45.4451-1: Imposition, rate and application of tax. Rev. Rul. 62-18
(Also Section 7510; 45.7510-1.)

Under the provisions of section 7510 of the Internal Revenue Code of 1954 and section 45.7510-1 of the Miscellaneous Stamp Tax Regulations, playing cards may be shipped by manufacturers thereof, free of the excise tax imposed by section 4451 of the Code, for the use of the United States. Under those provisions, playing cards may be shipped tax-free to representatives of the United States Veterans Administration in hospitals and institutions operated by the governments of the several States and the District of Columbia solely for gratuitous distribution to present and former members of the Armed Forces of the United States who are patients in such hospitals or institutions. The procurement, storage, and distribution of the tax-free playing cards must be accomplished under the supervision of the Veterans Administration. See Revenue Ruling 54-348, C.B. 1954-2, 404, in which a similar conclusion was reached with respect to the withdrawal of tobacco products tax-free for shipment to United States Veterans Administration representatives for gratuitous distribution in the manner described above.

SUBCHAPTER B.—OCCUPATIONAL TAX ON COIN-OPERATED DEVICES

SECTION 4462.—DEFINITION OF COIN-OPERATED AMUSEMENT OR GAMING DEVICE

26 CFR 45.4462-1: Definition of coin operated amusement or gaming devices. Rev. Rul. 62-52

“Skee ball alleys” and “pokerino tables” which depend on the skill of the player for their successful operation, rather than upon the element of chance, are coin-operated amusement devices within the meaning of section 4462(a) (1) of the Internal Revenue Code of 1954, notwithstanding the fact that prizes are awarded for certain designated scores attained on the devices. Accordingly, every person who maintains for use or permits the use of such amusement devices on any place or premises occupied by him is required by section 4461(a) of the Code to pay the special tax of ten dollars a year with respect to each device.

Advice has been requested whether the coin-operated devices described below are considered to be coin-operated amusement devices or coin-operated gaming devices for purposes of the occupational tax.

A person maintains certain coin-operated devices called “skee ball alleys” and “pokerino tables” at his place of business for use by his customers. Both the “skee ball alleys” and the “pokerino tables” are

long, rectangular-shaped machines. When coins are inserted into the machines, the machines are activated and balls are released for play.

In the "skee ball alley" game, a player manually rolls the balls down the alley in an attempt to place them in numbered bucket-type holes. The object of the game is to obtain a high numerical score by propelling the balls across the playing surface in such a way that they will roll into the highest evaluated holes, scorewise. If a player makes a certain high score, which is indicated on a lighted scoreboard at the end of the machine, he is given a prize by the person who maintains the "skee ball alleys."

In the "pokerino table" game, a player manually rolls the balls down the playing surface into bucket-type holes bearing various markings that correspond to those found on ordinary playing cards. When a ball rolls into one of the holes, a figure, which corresponds to the one marked beside the hole, appears on a lighted scoreboard at the end of the "pokerino table." The object of the game is to roll the balls into certain marked holes so that playing card combinations, such as "three of a kind," "full house," or "royal flush," appear on the scoreboard. If a player makes a certain combination, he is given a prize by the person who maintains the "pokerino tables."

Under the provisions of section 4461(a) of the Internal Revenue Code of 1954, every person who maintains for use or permits the use of, on any place or premises occupied by him, a coin-operated amusement or gaming device shall pay a special tax of ten dollars a year with respect to each amusement device, as defined in paragraph (1) of section 4462(a) of the Code, and \$250 a year with respect to each gaming device as defined in paragraph (2) of section 4462(a) of the Code.

As defined in paragraph (1) of section 4462(a) of the Code, the term "coin-operated amusement device" includes any machine which is an amusement machine operated by means of the insertion of a coin, token, or similar object (but not including any device defined in paragraph (2) of section 4462(a) of the Code). That term also includes a similar machine which is operated without the insertion of a coin, token, or similar object.

As defined in paragraph (2) of section 4462(a) of the Code, the term "coin-operated gaming device" includes any machine which is a so-called "slot" machine which operates by means of insertion of a coin, token, or similar object and which, by application of the element of chance, may deliver, or entitle the person playing or operating the machine to receive, cash, premiums, merchandise, or tokens. That term also includes a similar machine which is operated without the insertion of a coin, token, or similar object.

Revenue Ruling 57-395, C.B. 1957-2, 781, states that the determination of whether a coin-operated device is an amusement or gaming device cannot be made solely on the fact that prizes are awarded in connection with its operation. If the successful operation of a coin-operated device, with respect to which prizes are awarded, depends on the application of the element of chance, the machine is considered a gaming device. Generally, with respect to this type of device, the player after inserting the coin in the machine has no further control over the final result, which is attained by the element of chance, such

as pulling a lever, setting reels into action, activity of dice, or in the case of "pin-ball" machines, propelling a ball over the playing surface by means of a plunger.

Revenue Ruling 57-395 further states that, on the other hand, where the insertion of a coin merely releases the machine for manual play and the successful operation thereof depends entirely on the skill of the player in operating the device, such as the propelling of pucks, the machine is considered an amusement device even though prizes may be awarded to some or all of the players. However, where a device of this type includes a feature whereby its successful operation, for which prizes are awarded, depends on the element of chance, it is considered a coin-operated gaming device.

The successful operation of the devices called "skee ball alleys" and "pokerino tables" in the manner described above depends upon the element of skill with which a player propels the balls across the playing surface and into the desired holes, rather than upon the element of chance. Accordingly, it is held that such "skee ball alleys" and "pokerino tables" are coin-operated amusement devices within the meaning of paragraph (1) of section 4462(a) of the Code, notwithstanding the fact that prizes are awarded for certain designated scores attained on the devices. Therefore, every person who maintains for use or permits the use of such amusement devices on any place or premises occupied by him is required by section 4461(a) of the Code to pay the special tax of ten dollars a year with respect to each amusement device.

The same conclusion would apply, of course, to such "skee ball alleys" and "pokerino tables" which are operated without the insertion of a coin, token, or similar object.

CHAPTER 39.—REGULATORY TAXES

SUBCHAPTER A.—NARCOTIC DRUGS AND MARIHUANA

PART I.—NARCOTIC DRUGS

Subpart D.—General Provisions Relating to Narcotic Drugs

SECTION 4731.—DEFINITIONS

21 CFR 307.73: List of basic classes of T.D. 66 (Narcotics)¹
narcotics drugs.

TITLE 21—FOOD AND DRUGS.—CHAPTER II, BUREAU OF NARCOTICS, DEPARTMENT OF THE TREASURY, PART 307.—MANUFACTURING OF NARCOTIC DRUGS

Addition of Norpethidine and its salts to the basic classes of narcotic drugs.

¹ 27 F.R. 1215.

On December 21, 1961, a notice was published in the Federal Register (26 F.R. 12222), which stated that the Commissioner of Narcotics, pursuant to the provisions of section 6 of the Narcotics Manufacturing Act of 1960 (74 Stat. 61, 21 U.S.C. 504) and 21 CFR 307.71-307.72, proposed to add Norpethidine (ethyl 4-phenyl-4-piperidinecarboxylate) and its salts, which have heretofore been determined to be narcotic drugs as defined in 26 U.S.C. 4731, as amended, to the existing classification of "basic classes of narcotic drugs" enumerated in section 3(g) of the Narcotics Manufacturing Act of 1960 (74 Stat. 56, 21 U.S.C. 502).

After due notice and opportunity for public hearing, and after consideration of all relevant matters, the addition to the list of "basic classes of narcotic drugs" has been determined, under paragraphs (c) and (e) of 21 CFR 307.72, to be consistent with the law and the public health and safety and Norpethidine (ethyl 4-phenyl-4-piperidinecarboxylate) and its salts are hereby established as a new basic class of narcotic drugs to be added to the existing classification set forth in section 3(g) of the Narcotics Manufacturing Act of 1960.

Accordingly § 307.73 is amended by adding a new basic class of narcotic drugs to the list of basic classes of narcotic drugs, as follows:

§ 307.73 LIST OF BASIC CLASSES OF NARCOTIC DRUGS.

The following substances and their salts constitute the list of basic classes of narcotic drugs:

* * * * *

34. Norpethidine (ethyl 4-phenyl-4-piperidinecarboxylate).

Because the amendment of § 307.73 is merely for the purpose of listing a new basic class of narcotic drugs, it is hereby found unnecessary to issue this Treasury Decision with notice and public procedure thereon under section 4(a) of the Administrative Procedure Act, approved June 11, 1946, or subject to the effective date limitation of section 4(c) of that Act.

Effective date.—This Treasury Decision shall become effective upon its filing for publication in the Federal Register.

(21 U.S.C. 504 (74 Stat. 61); 21 U.S.C. 514 (74 Stat. 67))

[SEAL]

HENRY L. GIORDANO,
Acting Commissioner of Narcotics.

Approved February 2, 1962.

JAMES A. REED,
Assistant Secretary of the Treasury.

(Filed by the Division of the Federal Register on February 8, 1962, 8:49 a.m., and published in the issue of the Federal Register for February 9, 1962, 27 F.R. 1215)

**SUBTITLE E.—ALCOHOL, TOBACCO, AND CERTAIN
OTHER EXCISE TAXES****CHAPTER 52.—TOBACCO, CIGARS, CIGARETTES, AND
CIGARETTE PAPERS AND TUBES**

SUBCHAPTER B.—QUALIFICATION REQUIREMENTS FOR MANUFACTURERS OF TOBACCO PRODUCTS AND CIGARETTE PAPERS AND TUBES, EXPORT WAREHOUSE PROPRIETORS, AND DEALERS IN TOBACCO MATERIALS

SECTION 5712.—APPLICATION FOR PERMIT

26 CFR 270.92: Change in trade name.
(Also 270.212.)

Rev. Rul. 62-64

Section 270.92 of the Manufacture of Tobacco Products Regulations provides that where there is a change in the trade name of a manufacturer of tobacco products, the manufacturer shall, within 30 days of the adoption of the new trade name, make application on Form 2098, Application for Amended Permit Under Chapter 52, Internal Revenue Code, for an amended permit. *Held*, where the manufacturer of tobacco products desires to use more than one trade name, the addition of a trade name is a "change in trade name" within the meaning of section 270.92 of the regulations. Therefore, if such trade name is in fact used in connection with his manufacturing operations, the manufacturer is required to make application, on Form 2098, for an amended permit in accordance with that section of the regulations. A trade name approved by the Assistant Regional Commissioner, Alcohol and Tobacco Tax, may be used on packages of tobacco products as the name of the manufacturer removing such products subject to tax as provided in section 270.212 of the regulations.

26 CFR 270.212: Mark.

The use of multiple trade names by a manufacturer of tobacco products. See Rev. Rul. 62-64, above.

**SUBCHAPTER C.—OPERATIONS BY MANUFACTURERS AND IMPORTERS
OF TOBACCO PRODUCTS AND CIGARETTE PAPERS AND TUBES AND
EXPORT WAREHOUSE PROPRIETORS**

**SECTION 5723.—PACKAGES, MARKS, LABELS, NOTICES,
AND STAMPS**

26 CFR 270.212: Mark.

Identification of the factory of production of tobacco products by imprinting symbols or identifying statements on the package. See Rev. Proc. 62-6, page 427.

26 CFR 270.214: Notice for cigars.

Appearance of the word "cigars" on packages of large cigars. See Rev. Proc. 62-5, page 426.

26 CFR 275.73: Notice for cigars.

Appearance of the word "cigars" on packages of large cigars. See Rev. Proc. 62-5, page 426.

SUBTITLE F.—PROCEDURE AND ADMINISTRATION

CHAPTER 61.—INFORMATION AND RETURNS

SUBCHAPTER A.—RETURNS AND RECORDS

PART I.—RECORDS, STATEMENTS, AND SPECIAL RETURNS

SECTION 6001.—NOTICE OR REGULATIONS REQUIRING RECORDS, STATEMENTS, AND SPECIAL RETURNS

26 CFR 47.6001: Statutory provisions; notice or regulations requiring records, statements, and special returns.

Regulations under the Internal Revenue Code of 1954 relating to the keeping of records required with respect to documentary stamp taxes. See T.D. 6589, page 228.

PART II.—TAX RETURNS OR STATEMENTS

Subpart B.—Income Tax Returns

SECTION 6012.—PERSONS REQUIRED TO MAKE RETURNS OF INCOME

26 CFR 1.6012-1: Individuals required to make returns of income. T.D. 6581 ¹
 (Also Sections 4, 142, 144, 6081; 1.4-2, 1.142-1, 1.144-1, 1.6081-1.)

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

Income Tax Regulations amended to eliminate the use of Form 1040W.

¹ 26 F.R. 11677.

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

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

In order to eliminate the use of Form 1040W for taxable years ending on and after December 31, 1961, the Income Tax Regulations (26 CFR Part 1) are amended as follows:

PARAGRAPH 1.—Paragraph (a) of § 1.4–2 is amended to read as follows:

§ 1.4–2 ELECTIONS.—(a) *Making of election.*—The election to pay the optional tax imposed under section 3 shall be made by (1) filing a return (whether a separate return or a joint return) on Form 1040A, or (2) filing a return (whether a separate return or a joint return) on Form 1040 and electing in such return, in accordance with the provisions of section 144 and the regulations thereunder, to take the standard deduction provided by section 141.

PAR. 2. Paragraph (b) of § 1.142–1 is amended to read as follows:

§ 1.142–1 HUSBAND AND WIFE.

* * * * *

(b) If each spouse files a separate individual income tax return (Form 1040 or 1040A), both spouses must elect to take the standard deduction or both spouses are denied the standard deduction. Thus, if one spouse files a return on Form 1040 and does not elect to take the standard deduction, the other spouse may not elect to take the standard deduction and, hence, may not file a return on Form 1040A. For example, if A and his wife B have adjusted gross incomes of \$6,000 and \$3,500, respectively, from wages subject to withholding and A files a return on Form 1040 and does not elect thereon to take the standard deduction, B may not file her return on Form 1040A, but must file on Form 1040 and compute her tax without regard to the standard deduction. In such case, however, if both elect to take the standard deduction, either taxpayer may file on Form 1040 or 1040A, but B's tax must be computed on the basis of the tax table in section 3.

PAR. 3. Paragraphs (a) and (b) of § 1.144–1 are amended to read as follows:

§ 1.144–1 MANNER AND EFFECT OF ELECTION TO TAKE THE STANDARD DEDUCTION.—The following rules are prescribed with respect to the manner of signifying an election by a taxpayer to take the standard deduction:

(a) In the case of a taxpayer whose adjusted gross income for the taxable year for which a return is required or permitted to be filed on Form 1040 is \$5,000 or more, the standard deduction shall be allowed to him if he elects on such return to take such deduction. Such taxpayer shall signify on his return his election to take the standard deduction by claiming thereon the deduction in the amount provided for in section 141 instead of itemizing the deductions (other than those specified in sections 62 and 151) allowable in computing taxable income. A taxpayer shall have signified his election to take the standard deduction if his return is filed on Form 1040A. If in any case the adjusted gross income shown on the return of the taxpayer is \$5,000 or more, but the correct adjusted gross income is less than \$5,000, then:

(1) If the taxpayer has elected on his return to take the standard deduction, he shall be deemed to have elected to pay the tax imposed by section 3; and
(2) If the taxpayer has not elected to take the standard deduction, he shall be deemed not to have elected to pay the tax imposed by section 3.

(b) In the case of a taxpayer whose adjusted gross income for the taxable year for which a return is required or permitted to be filed on Form 1040 is less than \$5,000, the standard deduction shall be allowed to him only if he elects, in accordance with the regulations under section 4, to pay the optional tax imposed by section 3. The filing of such return on Form 1040A constitutes an election by the taxpayer to pay the tax imposed by section 3. In any case, however, in which adjusted gross income shown on the return is less than \$5,000, but the correct adjusted gross income is in fact \$5,000 or more, then:

(1) If the taxpayer has elected to pay the tax imposed by section 3, he shall be deemed to have elected to take the standard deduction; and

(2) If the taxpayer has not elected to pay the tax imposed by section 3, he shall be deemed not to have elected to take the standard deduction.

PAR. 4. Paragraph (a) of § 1.6012-1 is amended by—revising subparagraph (6), revising subdivision (ii) (b) of subparagraph (7) and adding subdivisions (vii) and (viii) to subparagraph (7), revising subparagraph (8), and deleting subparagraphs (9) and (10). These amended provisions read as follows:

§ 1.6012-1 INDIVIDUALS REQUIRED TO MAKE RETURNS OF INCOME.—(a) *Individual citizen or resident.*— * * *

(6) *Form of return.*—Form 1040 is prescribed for general use in making the return required under this paragraph. Form 1040A is an optional short form which, in accordance with subparagraph (7) of this paragraph, may be used by certain taxpayers. A taxpayer otherwise entitled to use Form 1040A as his return for any taxable year may not make his return on such form if he elects not to take the standard deduction provided in section 141, and in such case he must make his return on Form 1040. However, a taxpayer entitled under section 6014 and § 1.6014-1 to elect not to show his tax on his return must, if he desires to exercise such election, make his return on Form 1040A. Form 1040W is an optional short form which, in accordance with subparagraph (8) of this paragraph, may be used only with respect to taxable years beginning after December 31, 1958 and ending before December 31, 1961.

(7) *Use of Forms 1040A by certain taxpayers with gross income less than \$10,000.*— * * *

(ii) *Restrictions on use of Form 1040A.* * * *

(b) Whose spouse makes a separate return on Form 1040 and elects to itemize deductions;

* * * * *

(vii) *Change of election to use Form 1040A.*—A taxpayer who has elected to make his return on Form 1040A may change such election. Such change of election shall be within the time and subject to the conditions prescribed in section 144(b) and § 1.144-2, relating to change of election to take, or not to take, the standard deduction.

(viii) *Joint return of husband and wife on Form 1040A.*—A husband and wife, eligible under section 6013 and the regulations thereunder to file a joint return for the taxable year, may, subject to the provisions of this subparagraph, make a joint return on Form 1040A for any such year in which the aggregate gross income of the spouses is less than \$10,000, consists entirely of remuneration for services performed as an employee, dividends, or interest, and does not include more than \$200 from dividends, interest, and remuneration other than wages as defined in section 3401(a). For purposes of determining whether gross income from sources to which the \$200 limitation applies exceeds such amount in cases where both spouses receive dividends from domestic corporations, the amount of such dividends received by each spouse is taken into account to the extent that such dividends are includible in gross income. See section 116 and §§ 1.116-1 and 1.116-2. If a joint return is made by husband and wife on Form 1040A, the liability for the tax shall be joint and several.

(8) *Use of Form 1040W for certain taxable years.*—(i) *In general.*—An individual may use Form 1040W as his return for any taxable year beginning after December 31, 1958, and ending before December 31, 1961, in which the gross income of the individual, regardless of the amount thereof—

(a) Consists entirely of remuneration for personal services performed as an employee (whether or not such remuneration constitutes wages as defined in section 3401(a)), dividends, or interest, and

(b) Does not include more than \$200 from dividends and interest.

For purposes of determining whether gross income from dividends and interest exceeds \$200, dividends from domestic corporations are taken into account to the extent that they are includible in gross income. For purposes of this subparagraph, any reference to Form 1040 in §§ 1.4-2, 1.142-1, and 1.144-1 and this section shall also be deemed a reference to Form 1040W.

(ii) *Change of election to use Form 1040W.*—A taxpayer who has elected to make his return on Form 1040W may change such election. Such change of elec-

tion shall be within the time and subject to the conditions prescribed in section 144(b) and § 1.144-2, relating to change of election to take, or not to take, the standard deduction.

(iii) *Joint return of husband and wife on Form 1040W.*—A husband and wife, eligible under section 6013 and the regulations thereunder to file a joint return for the taxable year, may, subject to the provisions of this subparagraph, make a joint return on Form 1040W for any taxable year beginning after December 31, 1958, and ending before December 31, 1961, in which the aggregate gross income of the spouses (regardless of amount) consists entirely of remuneration for personal services performed as an employee (whether or not such remuneration constitutes wages as defined in section 3401(a)), dividends, or interest, and does not include more than \$200 from dividends and interest. For purposes of determining whether gross income from sources to which the \$200 limitation applies exceeds such amount in cases where both spouses receive dividends from domestic corporations, the amount of such dividends received by each spouse is taken into account to the extent that such dividends are includible in gross income. See section 116 and §§ 1.116-1 and 1.116-2. If a joint return is made by husband and wife on Form 1040W, the liability for the tax shall be joint and several.

(9) [deleted]

(10) [deleted]

PAR. 5. Paragraph (c)(1) of § 1.6014-1 is amended to read as follows:

§ 1.6014-1 TAX NOT COMPUTED BY TAXPAYER WITH GROSS INCOME LESS THAN \$5,000.

* * * * *

(c) *Joint return.*—(1) A husband and wife who, pursuant to paragraph (a)(7) of § 1.6012-1, file a joint return on Form 1040A may elect not to show the tax on such return if their aggregate gross income for the taxable year is less than \$5,000.

PAR. 6. Paragraph (b) of § 1.6081-1 is amended by revising subparagraphs (2) and (5) to read as follows:

§ 1.6081-1 EXTENSION OF TIME FOR FILING RETURNS.

* * * * *

(b) *Application for extension of time.*— * * *

(2) *Additional information in the case of Form 1040.*—In addition to the information required under subparagraph (1) of this paragraph, the application of a taxpayer desiring an extension of the time for filing an individual income tax return on Form 1040 for any taxable year beginning after December 31, 1958, shall also set forth (i) whether an income tax return has been filed on or before its due date for each of the three taxable years immediately preceding the taxable year of such return, and if not, the reason for each failure, and (ii) whether the taxpayer was required to file a declaration of estimated tax for the taxable year of such return, and if so, whether each required estimated tax payment was made on or before its due date. For purposes of this subparagraph a return is considered as filed on or before its due date if it is filed on or before the applicable date provided in section 6072 or on or before the last day of the period covered by an extension of time granted pursuant to the provisions of section 6081, and each required payment of estimated tax is considered as paid on or before its due date if it is paid on or before the applicable date provided in section 6153 or on or before the last day of the period covered by an extension of time granted pursuant to the provisions of section 6161.

* * * * *

(5) *Form of application.*—The application for an extension of the time for filing a return, statement, or other document may be made in the form of a letter. However, in the case of an individual income tax return on Form 1040, the application for an extension of the time for filing may be made either on Form 2688 or in the form of a letter.

Because this Treasury Decision makes only procedural changes, it is hereby found that it is unnecessary to issue this Treasury Decision with notice and public procedure thereon under section 4(a) of the

Administrative Procedure Act, approved June 11, 1946, or subject to the effective date limitation of section 4(c) of that Act.

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

MORTIMER M. CAPLIN,
Commissioner of Internal Revenue.

Approved November 30, 1961.

STANLEY S. SURREY,
Assistant Secretary of the Treasury.

(Filed by the Division of the Federal Register on December 5, 1961, 8:51 a.m., and published in the issue of the Federal Register for December 6, 1961, 26 F.R. 11677)

PART III.—INFORMATION RETURNS

Subpart B.—Information Concerning Transactions With Other Persons

SECTION 6041.—INFORMATION AT SOURCE

26 CFR 1.6041-1: Return of information
as to payments of \$600 or more.

Rev. Rul. 62-54

Where, for the purpose of providing supplemental unemployment benefits for members of a labor union, a trust is formed pursuant to a collective bargaining agreement between the union and an employer whereby the employer contributes the necessary funds to the trust, the trustee of the trust and not the employer should file information returns for each individual receiving a payment of \$600 or more or payments aggregating \$600 or more from the trust fund in a calendar year.

Advice has been requested whether the trustee of a supplemental unemployment benefit trust or the employer who contributes the funds to the trust should file information returns where a payment of \$600 or more or payments aggregating \$600 or more are made in one year from the trust to any one individual.

Pursuant to a collective bargaining agreement between a labor union and an employer, a supplemental unemployment benefit plan was created requiring the establishment of a trust fund to provide payments to union members who, during temporary lay-off periods, become eligible to receive benefits from the fund.

The union and the employing company entered into a formal trust agreement providing for the creation of a trust fund to be administered by an independent trustee. The fund is established and maintained by contributions from the company based upon the number of man-hours of work performed over specified periods by union employees covered under the plan. In the event an employee becomes eligible for benefits, usually because of temporary lay-off, he receives stipulated payments from the fund in accordance with a schedule incorporated in the trust agreement. The trust fund must be held in cash or invested only in obligations of the United States

Government. The plan provides that under no circumstances shall any of the trust fund revert to, or be used for, the benefit of the company.

The plan is similar to the one described in detail in Revenue Ruling 56-249, C.B. 1956-1, 488, in that no employee has any right, title, or interest in or to any of the assets of the fund or in or to any company contributions thereto until such time as he is qualified and eligible to receive a benefit therefrom. In Revenue Ruling 56-249, it was held that benefits paid to individuals by trustees of a trust fund created pursuant to the plan discussed therein do not constitute "wages" for purposes of the taxes imposed by the Federal Unemployment Tax Act and the Federal Insurance Contributions Act, or for purposes of the Collection of Income Tax at Source on Wages (chapters 23, 21, and 24, respectively, subtitle C, Internal Revenue Code of 1954). However, it was also held that such payments are nevertheless includible in the gross incomes of such individuals for the year in which received.

Section 6041 of the Code provides that all persons engaged in a trade or business and making payment, in the course of such trade or business to another person, of rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable gains, profits, and income of \$600 or more in any taxable year shall render a true and accurate return to the Secretary of the Treasury or his delegate, under such regulations and in such form and manner and to such extent as may be prescribed by the Secretary of his delegate.

Section 1.6041-1 of the Income Tax Regulations provides, in part, that every person engaged in a trade or business shall make an information return for the calendar year with respect to payments made during such year in the course of trade or business to another person of fixed or determinable income of \$600 or more. The return required shall be made on Form 1099, U.S. Information Return For Calendar Year ———, and Form 1096, U.S. Annual Information Return, except that the return with respect to distributions to beneficiaries of a trust or of an estate shall be made on Form 1041, U.S. Fiduciary Income Tax Return.

The payments here in question are not made by the employer. He makes his required contributions to the trust fund and the trustee thereof makes the necessary payments to eligible persons covered under the plan. Therefore, the employer is not required to file an information return with respect to payments made by the trust.

The payments are not being made by a trust, as contemplated by section 641 of the Code, to a beneficiary who includes those payments in his gross income under section 662, nor are the payments considered "wages" for purposes of the collection of income tax at source on wages. However, as specified in Revenue Ruling 56-249, the payments are includible in the gross income of the individual in the year in which received.

Accordingly, it is held that if a payment of \$600 or more or payments aggregating \$600 or more are made in one year to an individual pursuant to the above plan or a plan substantially similar to the one considered in Revenue Ruling 56-249, then the trustee of the trust under such plan should file an annual information return on Form 1096, accompanied by a statement on Form 1099 for each such in-

dividual. Payments made by an employer or a person other than the trustee of the fund should not be considered in determining whether the \$600 minimum has been paid by the trustee.

A similar holding is contained in Revenue Ruling 57-383, C.B. 1957-2, 44, with respect to a fund established by a labor union through employee contributions. Revenue Ruling 57-383 is modified to the extent it infers that payments made by an employer, or a person other than the trustee of the fund, should be considered in determining whether the \$600 minimum has been paid.

PART IV.—SIGNING AND VERIFYING OF RETURNS AND OTHER DOCUMENTS

SECTION 6061.—SIGNING OF RETURNS AND OTHER DOCUMENTS

26 CFR 20.6061: Statutory provisions: signing of returns and other documents.

Signing of any return, statement, or other document required to be made under the Estate Tax Regulations. See T.D. 6600, page 164.

26 CFR 25.6061: Statutory provisions; signing of returns and other documents.

Signing of any return, statement, or other document required to be made under the Gift Tax Regulations. See T.D. 6600, page 164.

PART VI.—EXTENSION OF TIME FOR FILING RETURNS

SECTION 6081.—EXTENSION OF TIME FOR FILING RETURNS

26 CFR 1.6081-1: Extension of time for filing returns.

Regulations relating to the extension of time for filing an individual income tax return amended to eliminate authority for the use of Form 1040W, for taxable years ending on or after December 31, 1961. See T.D. 6581, page 281.

PART VII.—PLACE FOR FILING RETURNS OR OTHER DOCUMENTS

SECTION 6091.—PLACE FOR FILING RETURNS OR OTHER DOCUMENTS

26 CFR: Statutory provisions; place for filing returns or other documents.

Place for filing estate tax returns in exceptional cases. See T.D. 6600, page 164.

26 CFR 25.6091: Statutory provisions; place for filing returns or other documents.

Place for filing gift tax returns in exceptional cases. See T.D. 6600, page 161.

SUBCHAPTER B.—MISCELLANEOUS PROVISIONS

SECTION 6103.—PUBLICITY OF RETURNS AND LISTS OF TAXPAYERS

26 CFR 301.6103(a)-1: Inspection of returns by certain classes of persons and state and Federal government establishments pursuant to Executive order.

Inspection of Federal tax returns filed under the Internal Revenue Code of 1954, and the furnishing of copies of such returns. See Rev. Proc. 62-9, page 432.

26 CFR 301.6103(a)-2: Copies of returns.

Inspection of Federal tax returns filed under the Internal Revenue Code of 1954, and the furnishing of copies of such returns. See Rev. Proc. 62-9, page 432.

26 CFR 301.6103(a)-101: Inspection of returns by committees of Congress other than those enumerated in Section 6103(d) of the Internal Revenue Code of 1954. E. O. 10981
(Also Part II, Section 55; 458.324)

Inspection of income, excess-profits, estate, and gift tax returns by the Senate Committee on the Judiciary.

By virtue of the authority vested in me by section 55(a) of the Internal Revenue Code of 1939, as amended (53 Stat. 29, 54 Stat. 1008; 26 U.S.C. (1952 Ed.) 55(a)) and by section 6103(a) of the Internal Revenue Code of 1954 (68A Stat. 753; 26 U.S.C. 6103(a)), it is hereby ordered that any income, excess-profits, estate, or gift tax return for the years 1950 to 1961, inclusive, shall, during the Eighty-seventh Congress, be open to inspection by the Senate Committee on the Judiciary, or any duly authorized subcommittee thereof, in connection with its investigation of the administration, operation, and enforcement of the Internal Security Act of 1950 and other internal security laws pursuant to Senate Resolution 49, Eighty-seventh Congress, agreed to January 31, 1961, such inspection to be in accordance and upon compliance with the rules and regulations prescribed by the

Secretary of the Treasury in Treasury Decisions 6132 [C.B. 1955-1, 142] and 6133 [C.B. 1955-1, 335], relating to the inspection of returns by committees of the Congress, approved by the President on May 3, 1955.

This order shall be effective upon its filing for publication in the Federal Register.

JOHN F. KENNEDY.

THE WHITE HOUSE,
December 28, 1961.

(Filed by the Division of the Federal Register on December 29, 1961, 11:46 a.m., and published in the issue of the Federal Register for December 30, 1961, 26 F.R. 12749)

(Also Part II, Section 55; 458.324)

E. O. 11020

Inspection of income, excess-profits, estate, and gift tax returns
by the Senate Committee on Armed Services.

By virtue of the authority vested in me by section 55(a) of the Internal Revenue Code of 1939, as amended (53 Stat. 29, 54 Stat. 1008; 26 U.S.C. (1952 Ed.) 55(a)), and by section 6103(a) of the Internal Revenue Code of 1954 (68A Stat. 753; 26 U.S.C. 6103(a)), it is hereby ordered that any income, excess-profits, estate, or gift tax return for the years 1946 to 1962, inclusive, shall, during the Eighty-seventh Congress, be open to inspection by the Senate Committee on Armed Services or any duly authorized subcommittee thereof, in connection with its investigation of the acquisition, storage, and disposal of strategic and critical materials, pursuant to Senate Resolution 295, 87th Congress, agreed to February 22, 1962, such inspection to be in accordance and upon compliance with the rules and regulations prescribed by the Secretary of the Treasury in Treasury Decisions 6132 [C.B. 1955-1, 142] and 6133 [C.B. 1955-1, 335], relating to the inspection of returns by committees of the Congress, approved by the President on May 3, 1955.

This order shall be effective upon its filing for publication in the Federal Register.

JOHN F. KENNEDY.

THE WHITE HOUSE,
May 7, 1962.

(Filed by the Division of the Federal Register on May 8, 1962, 9:39 a.m., and published in the issue of the Federal Register for May 9, 1962, 27 F.R. 4407)

CHAPTER 62.—TIME AND PLACE FOR PAYING TAX

SUBCHAPTER A.—PLACE AND DUE DATE FOR PAYMENT OF TAX

SECTION 6155.—PAYMENT ON NOTICE AND DEMAND

26 CFR 301.6155-1: Payment on notice and demand. T. D. 6585¹

(Also Sections 6201, 6303, 6402, 6511, 6601, 6651, 6861, 7514, 7622, 7701; 301.6201-1, 301.6303-1, 301.6402-2, 301.6511(b)-1, 301.6601-1, 301.6651-1, 301.6861-1, 301.-7514-1, 301.7622-1, 301.7701-9.)

TITLE 26—INTERNAL REVENUE.—CHAPTER 1, SUBCHAPTER F, PART 301.—PROCEDURE AND ADMINISTRATION

Regulations on Procedure and Administration amended to provide directors or regional service centers with authority to make assessments, abatements, credits, and refunds, and for other purposes.

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

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

In order to provide directors of regional service centers with authority to make assessments of all taxes imposed by the Internal Revenue Code of 1954 or any prior internal revenue law, to certify the allowance of abatements, credits, and refunds of such taxes, and to perform necessary functions relating thereto; and in order to provide a seal of office for the Director of the Atlanta Regional Service Center, Atlanta, Georgia, the Regulations on Procedure and Administration (26 CFR Part 301) are amended as follows:

PARAGRAPH 1. Section 301.6155-1 is amended to read as follows:

§ 301.6155-1 PAYMENT ON NOTICE AND DEMAND.—Upon receipt of notice and demand from the district director (including the Director of International Operations) or the director of the regional service center, there shall be paid at the place and time stated in such notice the amount of any tax (including any interest, additional amounts, additions to the tax, and assessable penalties) stated in such notice and demand.

PAR. 2. Paragraphs (a) and (b) of § 301.6201-1 are amended to read as follows:

§ 301.6201-1 ASSESSMENT AUTHORITY.—(a) *In general.*—The district director is authorized and required to make all inquiries necessary to the determination and assessment of all taxes imposed by the Internal Revenue Code of 1954 or any prior internal revenue law. The district director is further authorized and required, and the director of the regional service center is authorized, to make the determinations and the assessments of such taxes. However, certain inquiries and determinations are, by direction of the Commissioner, made by other officials, such as assistant regional commissioners. The term "taxes" includes interest, additional amounts, additions to the taxes, and as-

¹ 26 F.R. 12553.

sessable penalties. The authority of the district director and the director of the regional service center to make assessments includes the following:

(1) *Taxes shown on return.*—The district director or the director of the regional service center shall assess all taxes determined by the taxpayer or by the district director or the director of the regional service center and disclosed on a return or list.

(2) *Unpaid taxes payable by stamp.*—(i) If without the use of the proper stamp:

(a) Any article upon which a tax is required to be paid by means of a stamp is sold or removed for sale or use by the manufacturer thereof, or

(b) Any transaction or act upon which a tax is required to be paid by means of a stamp occurs;

the district director, upon such information as he can obtain, must estimate the amount of the tax which has not been paid and the district director or the director of the regional service center must make assessment therefor upon the person the district director determines to be liable for the tax. However, the district director or the director of the regional service center may not assess any tax which is payable by stamp unless the taxpayer fails to pay such tax at the time and in the manner provided by law or regulations.

(ii) If a taxpayer gives a check or money order as a payment for stamps but the check or money order is not paid upon presentment, then the district director or the director of the regional service center shall assess the amount of the check or money order against the taxpayer as if it were a tax due at the time the check or money order was received by the district director.

(3) *Erroneous income tax prepayment credits.*—If the amount of income tax withheld or the amount of estimated income tax paid is overstated by a taxpayer on a return or on a claim for refund, the amount so overstated which is allowed against the tax shown on the return or which is allowed as a credit or refund shall be assessed by the district director or the director of the regional service center in the same manner as in the case of a mathematical error on the return. See section 6213(b)(1), relating to exceptions to restrictions on assessment.

(b) *Estimated income tax.*—Neither the district director nor the director of the regional service center shall assess any amount of estimated income tax required to be paid under section 6153 or 6154 which is unpaid.

PAR. 3. Section 301.6203-1 is amended to read as follows:

§ 301.6203-1 *METHOD OF ASSESSMENT.*—The district director and the director of the regional service center shall appoint one or more assessment officers. The district director shall also appoint assessment officers in a Service Center servicing his district. The assessment shall be made by an assessment officer signing the summary record of assessment. The summary record, through supporting records, shall provide identification of the taxpayer, the character of the liability assessed, the taxable period, if applicable, and the amount of the assessment. The amount of the assessment shall, in the case of tax shown on a return by the taxpayer, be the amount so shown, and in all other cases the amount of the assessment shall be the amount shown on the supporting list or record. The date of the assessment is the date the summary record is signed by an assessment officer. If the taxpayer requests a copy of the record of assessment, he shall be furnished a copy of the pertinent parts of the assessment which set forth the name of the taxpayer, the date of assessment, the character of the liability assessed, the taxable period, if applicable, and the amounts assessed.

PAR. 4. Section 301.6204-1 is amended to read as follows:

§ 301.6204-1 *SUPPLEMENTAL ASSESSMENTS.*—If any assessment is incomplete or incorrect in any material respect, the district director or the director of the regional service center, subject to the restrictions with respect to the assessment of deficiencies in income, estate, and gift taxes, and subject to the applicable period of limitation, may make a supplemental assessment for the purpose of correcting or completing the original assessment.

PAR. 5. Section 301.6213-1 is amended by revising subparagraphs (2) and (3) of paragraph (b), and revising paragraph (c), to read as follows:

§ 301.6213-1 RESTRICTIONS APPLICABLE TO DEFICIENCIES; PETITION TO TAX COURT.

* * * * *

(b) *Exceptions to restrictions on assessment of deficiencies.*—* * *

(2) *Tentative carryback adjustments.*—(i) If the district director or the director of the regional service center determines that any amount applied, credited, or refunded under section 6411(b) with respect to an application for a tentative carryback adjustment is in excess of the overassessment properly attributable to the carryback upon which such application was based, the district director or the director of the regional service center may assess the amount of the excess as a deficiency as if such deficiency were due to a mathematical error appearing on the return. That is, the district director or the director of the regional service center may assess an amount equal to the excess, and such amount may be collected, without regard to the restrictions on assessment and collection imposed by section 6213(a). Thus, the district director or the director of the regional service center may assess such amount without regard to whether the taxpayer has been mailed a prior notice of deficiency. Either before or after assessing such an amount, the district director or the director of the regional service center will notify the taxpayer that such assessment has been or will be made. Such notice will not constitute a notice of deficiency, and the taxpayer may not file a petition with the Tax Court of the United States based on such notice. However, the taxpayer, within the applicable period of limitation, may file a regular claim for credit or refund based on the carryback, if he has not already filed such a claim, and may maintain a suit based on such claim if it is disallowed or if it is not acted upon by the Internal Revenue Service within 6 months from the date the claim was filed.

(ii) The method provided in subdivision (i) of this subparagraph to recover any amount applied, credited, or refunded in respect of an application for a tentative carryback adjustment which should not have been so applied, credited, or refunded is not an exclusive method. Two other methods are available to recover such amount: (a) By way of a deficiency notice under section 6212; or (b) by a suit to recover an erroneous refund under section 7405. Any one or more of the three available methods may be used to recover any amount which was improperly applied, credited, or refunded in respect of an application for a tentative carryback adjustment.

(3) *Assessment of amount paid.*—Any payment made after the mailing of a notice of deficiency which is made by the taxpayer as a payment with respect to the proposed deficiency may be assessed without regard to the restrictions on assessment and collection imposed by section 6213(a) even though the taxpayer not filed a waiver of restrictions on assessment as provided in section 6213(d). A payment of all or part of the deficiency asserted in the notice together with the assessment of the amount so paid will not affect the jurisdiction of the Tax Court. If any payment is made before the mailing of a notice of deficiency, the district director or the director of the regional service center is not prohibited by section 6213(a) from assessing such amount, and such amount may be assessed if such action is deemed to be proper. If such amount is assessed, the assessment is taken into account in determining whether or not there is a deficiency for which a notice of deficiency must be issued. Thus, if such a payment satisfies the taxpayer's tax liability, no notice of deficiency will be mailed and the Tax Court will have no jurisdiction over the matter. In any case in which there is a controversy as to the correct amount of the tax liability, the assessment of any amount pursuant to the provisions of section 6213(b) (3) shall in no way be considered to be the acceptance of an offer by the taxpayer to settle such controversy.

* * * * *

(c) *Failure to file petition.*—If no petition is filed with the Tax Court within the period prescribed in section 6213(a), the district director or the director of the regional service center shall assess the amount determined as the deficiency and of which the taxpayer was notified by registered or certified mail and the taxpayer shall pay the same upon notice and demand therefor. In such case the district director will not be precluded from determining a further deficiency and notifying the taxpayer thereof by registered or certified mail. If a petition is filed with the Tax Court the taxpayer should notify the district director who issued the notice of deficiency that the petition has been filed in order to prevent an assessment of the amount determined to be the deficiency.

PAR. 6. Section 301.6215-1 is amended to read as follows:

§ 301.6215-1 ASSESSMENT OF DEFICIENCY FOUND BY TAX COURT.—Where a petition has been filed with the Tax Court, the entire amount redetermined as the deficiency by the decision of the Tax Court which has become final shall be assessed by the district director or the director of the regional service center and the unpaid portion of the amount so assessed shall be paid by the taxpayer upon notice and demand therefor.

PAR. 7. Section 301.6303-1 is amended to read as follows:

§ 301.6303-1 NOTICE AND DEMAND FOR TAX.—(a) *General rule.*—Where it is not otherwise provided by the Code, the district director or the director of the regional service center shall, after the making of an assessment of a tax pursuant to section 6203, give notice to each person liable for the unpaid tax, stating the amount and demanding payment thereof. Such notice shall be given as soon as possible and within 60 days. However, the failure to give notice within 60 days does not invalidate the notice. Such notice shall be left at the dwelling or usual place of business of such person, or shall be sent by mail to such person's last known address.

* * * * *

(b) *Assessment prior to last date for payment.*—If any tax is assessed prior to the last date prescribed for payment of such tax, demand that such tax be paid will not be made before such last date, except where it is believed collection would be jeopardized by delay.

PAR. 8. Paragraphs (b) (2) and (f) (1) of § 301.6402-2 are amended to read as follows:

§ 301.6402-2 CLAIMS FOR CREDIT OR REFUND.

* * * * *

(b) *Grounds set forth in claim.* * * *

(2) Neither the district director nor the director of the regional service center has authority to refund on equitable grounds penalties or other amounts legally collected.

* * * * *

(f) *Mailing of refund check.*—(1) Checks in payment of claims allowed will be drawn in the names of the persons entitled to the money and, except as provided in subparagraph (2) of this paragraph, the checks may be sent direct to the claimant or to such person in care of an attorney or agent who has filed a power of attorney specifically authorizing him to receive such checks.

PAR. 9. Paragraph (c) of § 301.6402-3 is amended to read as follows:

§ 301.6402-3 SPECIAL RULES APPLICABLE TO INCOME TAX.

* * * * *

(c) The filing of a properly executed income tax return on Form 1040A shall, in any case in which the taxpayer is not required to show his tax on such form, constitute an election by the taxpayer to have the return treated as a claim for refund, and such return shall constitute a claim for refund within the meaning of section 6402 and section 6511 for the amount of the overpayment shown by the computation of the tax made by the district director or the director of the regional service center on the basis of the return. For purposes of section 6511, such claim shall be considered as filed on the date on which such return is considered as filed, except that if the requirements of § 301.7502-1, relating to timely mailing treated as timely filing, are met the claim shall be considered to be filed on the date of the postmark stamped on the cover in which the return was mailed.

PAR. 10. Section 301.6402-4 is amended to read as follows:

§ 301.6402-4 PAYMENTS IN EXCESS OF AMOUNTS SHOWN ON RETURN.—In certain cases, the taxpayer's payments in respect of his tax liability, made before the filing of his return, may exceed the amount of tax shown on the return. For example, such payments may arise in the case of the income tax when the estimated tax or the credit for income tax withheld at the source on wages

exceed the amount of tax shown on the return, or where a corporation obtains an extension of time for filing its return and makes installment payments based on its estimate of its tax liability which exceed the tax liability shown on the return subsequently filed. In any case in which the district director or the director of the regional service center determines that the payments by the taxpayer (made within the period prescribed for payment and before the filing of the return) are in excess of the amount of tax shown on the return, he may make credit or refund of such overpayment without awaiting examination of the completed return and without awaiting filing of a claim for refund. However, the provisions of §§ 301.6402-2 and 301.6402-3 are applicable to such overpayment, and taxpayers should submit claims for refund (if the income tax return is not itself a claim for refund, as provided in § 301.6402-3) to protect themselves in the event the district director or the director of the regional service center fails to make such determination and credit or refund. The provisions of section 6405 (relating to reports of refunds of more than \$100,000 to the Joint Committee on Internal Revenue Taxation) are not applicable to the overpayments described in this section caused by timely payments of tax which exceed the amount of tax shown on a timely return.

PAR. 11. Paragraphs (a) and (c) of § 301.6404-1 are amended to read as follows:

§ 301.6404-1 ABATEMENTS.—(a) The district director or the director of the regional service center may abate any assessment, or unpaid portion thereof, if the assessment is in excess of the correct tax liability, if the assessment is made subsequent to the expiration of the period of limitations applicable thereto, or if the assessment has been erroneously or illegally made.

* * * * *

(c) Except in case of income, estate, or gift tax, if more than the correct amount of tax, interest, additional amount, addition to the tax, or assessable penalty is assessed but not paid to the district director, the person against whom the assessment is made may file a claim for abatement of such overassessment. Each claim for abatement under this section shall be made on Form 843 in accordance with the instructions relating to such form and shall be filed with the district director for the internal revenue district in which the tax would otherwise have been paid.

PAR. 12. Section 301.6407-1 is amended to read as follows:

§ 301.6407-1 DATE OF ALLOWANCE OF REFUND OR CREDIT.—The date on which the district director or the director of the regional service center, or an authorized certifying officer designated by either of them, first certifies the allowance of an over-assessment in respect of any internal revenue tax shall be considered as the date of allowance of refund or credit in respect of such tax.

PAR. 13. Paragraph (b) of § 301.6511(b)-1 is amended by revising subdivision (iv) of subparagraph (1) and subdivision (ii) of subparagraph (2) to read as follows:

§ 301.6511(b)-1 LIMITATIONS ON ALLOWANCE OF CREDITS AND REFUNDS.

* * * * *

(b) *Limit on amount to be credited or refunded.*—

(1) In the case of any tax (other than a tax payable by stamp):

* * * * *

(iv) If no claim is filed, the amount of the credit or refund allowed or made by the district director or the director of the regional service center shall not exceed the amount that would have been allowable under the preceding subdivisions of this subparagraph if a claim had been filed on the date the credit or refund is allowed.

(2) In the case of a tax payable by stamp:

* * * * *

(ii) If no claim is filed, the amount of the credit or refund allowed or made by the district director or the director of the regional service center shall not exceed the portion of the tax paid within the 3 years immediately preceding the allowance of the credit or refund.

PAR. 14. Section 301.6601-1 is amended by revising subdivision (i) of paragraph (c)(2), paragraph (c)(4), paragraph (d), and paragraph (f)(1). These amended provisions read as follows:

§ 301.6601-1 INTEREST ON UNDERPAYMENTS.

(c) *Last date prescribed for payment.*—The term “last date prescribed for payment”, as used in section 6601 and this section, means the last date prescribed for payment as determined under the provisions of chapter 62 of the Code and the following rules:

(2) (i) If a tax or portion thereof is payable in installments in accordance with an election made under section 6152(a), the last date prescribed for payment of any installment of such tax or portion thereof shall be determined under the provisions of section 6152(b), and interest shall run on any unpaid installment from such last date to the date on which payment is received. However, in the event installment privileges are terminated for failure to pay an installment when due as provided by section 6152(d) and the time for the payment of any remaining installment is accelerated by the issuance of a notice and demand therefor, interest shall run on such unpaid installment from the date of the notice and demand to the date on which payment is received. But see section 6601 (f)(4).

(4) In the case of taxes payable by stamp and in all other cases where the last date for payment of the tax is not otherwise prescribed, such last date for the purpose of the interest computation shall be deemed to be the date on which the liability for the tax arose. However, such last date shall in no event be later than the date of issuance of a notice and demand for the tax.

(d) *Suspension of interest; waiver of restrictions on assessment.*—In the case of a deficiency determined by a district director (or an assistant regional commissioner, appellate) with respect to any income, estate, or gift tax, if the taxpayer files with such internal revenue officer an agreement waiving the restrictions on assessment of such deficiency, and if notice and demand for payment of such deficiency is not made within 30 days after the filing of such waiver, no interest shall be imposed on the deficiency for the period beginning immediately after such 30th day and ending on the date notice and demand is made. In the case of an agreement with respect to a portion of the deficiency, the rules as set forth in this paragraph are applicable only to that portion of the deficiency to which the agreement relates.

(f) *Applicable rules.*—(1) Any interest prescribed by section 6601 shall be assessed and collected in the same manner as tax and shall be paid upon notice and demand by the district director or the director of the regional service center. Any reference in the Code (except in subchapter B, chapter 63, relating to deficiency procedures) to any tax imposed by the Code shall be deemed also to refer to the interest imposed by section 6601 on such tax. Interest on a tax may be assessed and collected at any time within the period of limitation on collection after assessment of the tax to which it relates. For rules relating to the period of limitation on collection after assessment, see section 6502.

PAR. 15. Section 301.6611-1 is amended by revising paragraph (g) and subdivisions (i) and (ii) (b) of paragraph (h)(2). These amended provisions read as follows:

§ 301.6611-1 INTEREST ON OVERPAYMENTS.

(g) *Period for which interest allowable in case of refunds.*—If an overpayment of tax is refunded, interest shall be allowed from the date of the overpayment to a date determined by the district director or the director of the regional service center, which shall be not more than 30 days prior to the date of the refund check. The acceptance of a refund check shall not deprive the taxpayer of the right to make a claim for any additional overpayment and interest thereon, provided the claim is made within the applicable period of limitation. However, if a taxpayer does not accept a refund check, no additional interest on the amount of the overpayment included in such check shall be allowed.

(h) *Period for which interest allowable in case of credits.*—* * *

(2) *Determination of due date.*—(i) *In general.*—The term “due date”, as used in this section, means the last day fixed by law or regulations for the payment of the tax (determined without regard to any extension of time), and not the date on which the district director or the director of the regional service center makes demand for the payment of the tax. Therefore, the due date of a tax (other than an additional assessment subject to the special rule provided by subdivision (iv) of this subparagraph) is the date fixed for the payment of the tax or the several installments thereof.

(ii) *Tax payable in installments.*— * * *

(b) *Delinquent installment.*—If the taxpayer is delinquent in payment of an installment of tax and a notice and demand has been issued for the payment of the delinquent installment and the remaining installments, the due date of each remaining installment shall then be the date of such notice and demand.

PAR. 16. Paragraph (a) of § 301.6651-1 is amended by revising subparagraphs (1) and (3) to read as follows:

§ 301.6651-1 FAILURE TO FILE TAX RETURN.—(a) *Addition to the tax.*—(1) *In general.*—In case of failure to file a return required under authority of—

(i) Subchapter A, chapter 61, of the Code, relating to returns and records (other than sections 6015 and 6016, relating to declarations of estimated tax, and part III thereof, relating to information returns);

(ii) Subchapter A, chapter 51, of the Code, relating to distilled spirits, wines, and beer;

(iii) Subchapter A, chapter 52, of the Code, relating to tobacco, cigars, cigarettes, and cigarette paper and tubes; or

(iv) Subchapter A, chapter 53, of the Code, relating to machine guns and certain other firearms;

and the regulations thereunder, on or before the date prescribed for filing (determined with regard to any extension of time for such filing), there shall be added to the tax required to be shown on the return the amount specified below unless the failure to file the return within the prescribed time is shown to the satisfaction of the district director or the director of the regional service center to be due to reasonable cause and not to willful neglect. (See subparagraph (3) of this paragraph.) The amount to be added to the tax is 5 percent thereof if the failure is for not more than one month, with an additional 5 percent for each additional month or fraction thereof during which the failure continues, but not to exceed 25 percent in the aggregate.

* * * * *

(3) *Showing of reasonable cause.*—A taxpayer who wishes to avoid the addition to the tax for failure to file a tax return must make an affirmative showing of all facts alleged as a reasonable cause for his failure to file such return on time in the form of a written statement containing a declaration that it is made under penalties of perjury. Such statement should be filed with the district director with whom the return is required to be filed. If the district director or the director of the regional service center 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.

PAR. 17. Paragraph (a) of § 301.6652-1 is amended to read as follows:

§ 301.6652-1 FAILURE TO FILE CERTAIN INFORMATION RETURNS.—(a) *Additional amount.*—(1) *In general.*—In case of each failure to file a statement, with respect to a payment to another person, required under authority of—

(i) Section 6041, relating to information at source,

(ii) Section 6042(1), relating to payments of corporate dividends,

(iii) Section 6044, relating to patronage dividends, or

(iv) Section 6051(d), relating to information returns with respect to income tax withheld or the employee tax under the Federal Insurance Contributions Act,

and the regulations under such sections, within the time prescribed for filing such statement (determined with regard to any extension of time for filing), there shall be paid by the person who failed to file such statement \$1 for each such statement not filed. However, the total amount imposed on the delinquent

person for all such failures during any calendar year shall not exceed \$1,000. The additional amount imposed for such failures shall be paid in the same manner as tax upon the issuance of a notice and demand therefor.

(2) *Showing of reasonable cause.*—The penalty imposed by section 6652 shall not apply if it is established to the satisfaction of the district director or the director of the regional service center that such failure to file was due to a reasonable cause and not to willful neglect. An affirmative showing of reasonable cause must be made in the form of a written statement, containing a declaration that it is made under the penalties of perjury, setting forth all the facts alleged as a reasonable cause.

PAR. 18. Paragraph (a) of § 301.6656-1 is amended to read as follows:

§ 301.6656-1 FAILURE TO MAKE DEPOSIT OF TAXES.—(a) *Penalty.*—(1) In case of failure by any person required by the Code or regulations prescribed thereunder to deposit any tax in a government depository, as is authorized under section 6302(c), within the time prescribed therefor, a penalty shall be imposed on such person unless such failure is shown to the satisfaction of the district director or the director of the regional service center to be due to reasonable cause and not to willful neglect. The penalty shall be one percent of the amount of the underpayment if the failure is for not more than one month, with an additional one percent for each additional month or fraction thereof during which failure continues, not to exceed 6 percent in the aggregate. For purposes of this section, the term “underpayment” means the amount of tax required to be deposited less the amount, if any, which was deposited on or before the date prescribed therefor, and the term “month” shall have the same meaning assigned to such term in paragraph (a) (2) of § 301.6651-1.

(2) A taxpayer who wishes to avoid the penalty for failure to deposit must make an affirmative showing of all facts alleged as a reasonable cause in a written statement containing a declaration that it is made under the penalties of perjury, which should be filed with the district director for the district in which the return with respect to the tax is required to be filed. If the district director or the director of the regional service center determines that the delinquency was due to a reasonable cause, and not to willful neglect, the penalty will not be imposed.

PAR. 19. Paragraph (a) of § 301.6657-1 is amended to read as follows:

§ 301.6657-1 BAD CHECKS.—(a) *In general.*—Except as provided in paragraph (b) of this section, if a check or money order is tendered in the payment of any amount receivable under the Code, and such check or money order is not paid upon presentment, a penalty of one percent of the amount of the check or money order, in addition to any other penalties provided by law, shall be paid by the person who tendered such check or money order. If, however, the amount of the check or money order is less than \$500, the penalty shall be \$5 or the amount of the check or money order, whichever amount is the lesser. Such penalty shall be paid in the same manner as tax upon the issuance of a notice and demand therefor.

PAR. 20. Paragraph (a) of § 301.6671-1 is amended to read as follows:

§ 301.6671-1 RULES FOR APPLICATION OF ASSESSABLE PENALTIES.—(a) *Penalty assessed as tax.*—The penalties and liabilities provided by subchapter B, chapter 68, of the Code (sections 6671 to 6675, inclusive) shall be paid upon notice and demand by the district director or the director of the regional service center and shall be assessed and collected in the same manner as taxes. Except as otherwise provided, any reference in the Code to “tax” imposed thereunder shall also be deemed to refer to the penalties and liabilities provided by subchapter B of chapter 68.

PAR. 21. Section 301.6673-1 is amended to read as follows:

§ 301.6673-1 DAMAGES ASSESSABLE FOR INSTITUTING PROCEEDINGS BEFORE THE TAX COURT MERELY FOR DELAY.—Any damages awarded to the United States by the Tax Court under section 6673 against a taxpayer for instituting proceedings before the Tax Court merely for delay shall be assessed at the same time as the

deficiency and shall be paid upon notice and demand from the district director or the director of the regional service center and shall be collected as a part of the tax.

PAR. 22. Section 301.6861-1 is amended by revising paragraphs (d) and (e), and revising subparagraphs (1) and (2) of paragraph (f), to read as follows:

§ 301.6861-1 JEOPARDY ASSESSMENTS OF INCOME, ESTATE, AND GIFT TAXES.

(d) *Payment and collection of jeopardy assessment.*—After a jeopardy assessment has been made, the district director is required to send notice and demand to the taxpayer for the amount of the jeopardy assessment. Regardless of whether the taxpayer has filed a petition with the Tax Court, he is required to make payment of the amount of such assessment (to the extent that it has not been abated) within 10 days after the sending of notice and demand by the district director, unless before the expiration of such 10-day period he files with the district director a bond as provided in section 6863. Section 6331 provides that, if the district director makes a finding that the collection of the tax is in jeopardy, he may make demand for immediate payment of the amount of the jeopardy assessment and, in such case, the taxpayer shall immediately pay such amount or shall immediately file the bond provided in section 6863. If a petition is not filed with the Tax Court within the period prescribed in section 6213(a), the district director will be so advised, and, if collection of the deficiency has been stayed by the timely filing of a bond as provided in section 6863, he should then give notice and make demand for payment of the amount assessed plus interest. After the Tax Court has rendered its decision and such decision has become final, the district director will be notified of the action taken. He will then send notice and demand for payment of the unpaid portion of the amount determined by the Tax Court, the collection of which has been stayed by the bond. If the amount of the jeopardy assessment is less than the amount determined by the Tax Court, the difference will be assessed and collected as part of the tax upon the issuance of a notice and demand therefor. If the amount of the jeopardy assessment is in excess of the amount determined by the Tax Court, the unpaid portion of such excess will be abated. If any part of the excess amount has been paid, it will be credited or refunded to the taxpayer as provided in section 6402, without the filing of claim therefor.

(e) *Abatement of excessive assessment.*—The district director or the director of the regional service center may, at any time before the decision of the Tax Court is rendered, abate a jeopardy assessment in whole or in part if the district director believes that such assessment is excessive in amount.

(f) *Abatement if jeopardy does not exist.*—(1) The district director or the director of the regional service center may abate a jeopardy assessment in whole or in part, if it is shown to the satisfaction of the district director that jeopardy does not exist. An abatement may not be made under this paragraph after a decision of the Tax Court in respect of the deficiency has been rendered or, if no petition is filed with such court, after the expiration of the period for filing such petition.

(2) After abatement of a jeopardy assessment in whole or in part, a deficiency may be assessed and collected in the manner authorized by law as if the jeopardy assessment or part thereof so abated had not existed. If a notice of deficiency has been sent to the taxpayer before the abatement of the jeopardy assessment in whole or in part, whether such notice was sent before or after the making of the assessment, such abatement will not affect the validity of the notice or of any proceedings for redetermination based thereon. The period of limitation on the making of assessments and the beginning of levy or a proceeding in court for collection in respect of any deficiency shall be determined as if in the jeopardy assessment so abated had not been made, except that the running of such period shall in any event be suspended for the period from the date of such jeopardy assessment until the expiration of the tenth day after the date on which such jeopardy assessment is abated in whole or in part. The provisions of this subparagraph may be illustrated by the following example:

Example. On March 18, 1958, 28 days before the last day of the 3-year period of limitations on assessment, a jeopardy assessment is made in respect of a proposed deficiency. On May 2, 1958, before the mailing of the notice of deficiency provided by section 6861(b), this assessment is abated. By virtue of this sub-

paragraph, the last day of the period of limitations for the making of an assessment is June 9, 1958, that is, the thirty-eighth day after the date of the abatement. If the notice of deficiency provided for in section 6861(b) has been sent before the abatement, the running of the period of limitations on assessment would have been suspended pursuant to the provisions of section 6503(a).

PAR. 23. Paragraph (f) of § 301.6901-1 is amended to read as follows:

§ 301.6901-1 PROCEDURE IN THE CASE OF TRANSFERRED ASSETS.

* * * * *

(f) *Suspension of running of period of limitations.*—In the cases of the income, estate, and gift taxes, if a notice of liability of a transferee or the liability of a fiduciary has been mailed to such transferee or to such fiduciary under the provisions of section 6212, then the running of the statute of limitations shall be suspended for the period during which assessment is prohibited in respect of the liability of the transferee or fiduciary (and in any event, if a proceeding in respect of the liability is placed on the docket of the Tax Court, until the decision of the Tax Court becomes final), and for 60 days thereafter.

PAR. 24. Paragraph (c) of § 301.6903-1 is amended to read as follows:

§ 301.6903-1 NOTICE OF FIDUCIARY RELATIONSHIP.

* * * * *

(c) *Where notice is not filed.*—If the notice of the fiduciary capacity described in paragraph (b) of this section is not filed with the district director before the sending of notice of a deficiency by registered mail or certified mail to the last known address of the taxpayer (see section 6212), or the last known address of the transferee or other person subject to liability (see section 6901(g)), no notice of the deficiency will be sent to the fiduciary. In such a case the sending of the notice to the last known address of the taxpayer, transferee, or other person, as the case may be, will be a sufficient compliance with the requirements of the Code, even though such taxpayer, transferee, or other person is deceased, or is under a legal disability, or, in the case of a corporation, has terminated its existence. Under such circumstances, if no petition is filed with the Tax Court of the United States within 90 days after the mailing of the notice (or within 150 days after mailing in the case of such a notice addressed to a person outside the States of the Union and the District of Columbia) to the taxpayer, transferee, or other person, the tax, or liability under section 6901, will be assessed immediately upon the expiration of such 90-day or 150-day period, and demand for payment will be made. See paragraph (a) of § 301.6213-1 with respect to the expiration of such 90-day or 150-day period.

PAR. 25. Paragraph (a) of § 301.7503-1 is amended to read as follows:

§ 301.7503-1 TIME FOR PERFORMANCE OF ACTS WHERE LAST DAY FALLS ON SATURDAY, SUNDAY, OR LEGAL HOLIDAY.—(a) *In general.*—Section 7503 provides that when the last day prescribed under authority of any internal revenue law for the performance of any act falls on a Saturday, Sunday, or legal holiday, such act shall be considered performed timely if performed on the next succeeding day which is not a Saturday, Sunday, or legal holiday. For this purpose, any authorized extension of time shall be included in determining the last day for performance of any act. Section 7503 is applicable only in case an act is required under authority of any internal revenue law to be performed on or before a prescribed date or within a prescribed period. For example, if the 2-year period allowed by section 6532(a) (1) to bring a suit for refund of any internal revenue tax expires on Thursday, November 22, 1956 (Thanksgiving Day), the suit will be timely if filed on Friday, November 23, 1956, in the Court of Claims, or in a district court. Section 7503 applies to acts to be performed by the taxpayer (such as, the filing of any return of, and the payment of, any income, estate, or gift tax; the filing of a petition with the Tax Court for redetermination of a deficiency, or for review of a decision rendered by such Court; the filing of a claim for credit or refund of any tax) and acts to be performed by the Commissioner, a district director, or the director of a regional service center (such as, the giving of any notice with respect to, or making any demand for the payment of, any tax; the assessment or collection of any tax).

PAR. 26. Section 301.7514-1 is amended by adding at the end of paragraph (a) the following subparagraph:

§ 301.7514-1 SEALS OF OFFICE.—(a) *Establishment of seals.*— * * *

(4) *Director of Atlanta Regional Service Center.*—There is hereby established in and for the office of the Director of Atlanta Regional Service Center, Atlanta, Georgia, an official seal. The seal is described as follows, and illustrated below: A circle within which shall appear that part of the seal of the Treasury Department represented by the shield and side wreaths. Exterior to this circle and within a circumscribed circle in the form of a rope shall appear in the upper part the words "DIRECTOR OF ATLANTA REGIONAL SERVICE CENTER" and in the lower part "Atlanta, Georgia Internal Revenue Service".



PAR. 27. Section 301.7622-1 is amended to read as follows:

§ 301.7622-1 AUTHORITY TO ADMINISTER OATHS AND CERTIFY.—The officers and employees of the Internal Revenue Service designated in paragraph (b) of § 301.7603-1 and the directors of the regional service centers are authorized to administer such oaths or affirmations and to certify to such papers as may be necessary under the internal revenue laws or regulations issued thereunder, except that the authority to certify shall not be construed as applying to those papers or documents the certification of which is authorized by separate order or directive. The authority to administer oaths and to certify may be redelegated only by the Assistant Commissioner (Inspection), regional commissioners, assistant regional commissioners (alcohol and tobacco tax), assistant regional commissioners (intelligence), district directors, directors of regional service centers, and the Director of International Operations, to officers and employees under their jurisdiction.

PAR. 28. Paragraph (b) of § 301.7701-9 is amended to read as follows:

§ 301.7701-9 SECRETARY OR HIS DELEGATE.

* * * * *

(b) In any case in which a function is vested by the Internal Revenue Code of 1954 or any other statute in the Secretary or his delegate, and Treasury regulations or Treasury decisions approved by the Secretary or his delegate provide that such function may be performed by the Commissioner, assistant commissioner, regional commissioner, assistant regional commissioner, district director, director of a regional service center, or by a designated officer or employee in the office of any such officer, such provision in the regulations or Treasury decision shall constitute a delegation by the Secretary of the authority to perform such function to the designated officer or employee. If such authority is delegated to any officer or employee performing services under the supervision and control of the Commissioner, such provision in the regulations or Treasury Decision shall constitute a delegation by the Secretary to the Commissioner of the authority to perform such function and a redelegation thereof by the Commissioner to the designated officer or employee.

Because this Treasury Decision makes only technical changes, it is hereby found that it is unnecessary to issue this Treasury Decision with notice and public procedure thereon under section 4(a) of the Administrative Procedure Act, approved June 11, 1946, or subject to the effective date limitation of section 4(c) of that Act.

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

BERTRAND M. HARDING,
Acting Commissioner of Internal Revenue.

Approved December 21, 1961.

STANLEY S. SURREY,
Assistant Secretary of the Treasury.

(Filed by the Division of the Federal Register on December 27, 1961, 8:49 a.m., and published in the issue of the Federal Register for December 28, 1961, 26 F.R. 12553)

CHAPTER 63.—ASSESSMENT

SUBCHAPTER A.—IN GENERAL

SECTION 6201.—ASSESSMENT AUTHORITY

26 CFR 301.6201-1: Assessment authority.

Amended regulations authorizing directors of regional service centers to make assessments of tax. See T.D. 6585, page 290.

CHAPTER 64.—COLLECTION

SUBCHAPTER A.—GENERAL PROVISIONS

SECTION 6303.—NOTICE AND DEMAND FOR TAX

26 CFR 301.6303-1: Notice and demand for tax.

Amended regulations authorizing directors of regional service centers to issue notices and demands for taxes. See T.D. 6585, page 290.

SUBCHAPTER C.—LIEN FOR TAXES

SECTION 6321.—LIEN FOR TAXES

26 CFR 301.6321-1: Lien for taxes.
(Also Part II, Section 3670.)

Ct. D. 1867

INCOME TAX—INTERNAL REVENUE CODE OF 1954—DECISION OF COURT

1. LIENS—PENALTIES—BANKRUPTCY.

Section 57(j) of the Bankruptcy Act provides, "Debts owing to the United States * * * as a penalty or forfeiture shall not be allowed, except for the amount of pecuniary loss sustained by the act * * * out of which the penalty or forfeiture arose * * *." Section 67(b) of the Bankruptcy Act provides that "* * * statutory liens for taxes and debts owing to the United States * * * may be valid against the trustee, even though arising or perfected while the debtor is insolvent * * *." Penalties, even though secured by a lien, are not allowable in bankruptcy despite section 67(b), since the character of the penalty is not changed by calling it a lien.

2. DECISIONS REVERSED.

Decisions of the United States Court of Appeals for the Ninth Circuit, 287 Fed. (2d) 489 and 491, reversed.

SUPREME COURT OF THE UNITED STATES

No. 83.—October Term, 1961.

Hattiebelle O. Simonson, Trustee in Bankruptcy, etc., et al., petitioners, v. R. C. Granquist, District Director of Internal Revenue, et al., No. 83

On writ of certiorari to the United States Court of Appeals for the Ninth Circuit

[March 5, 1962.]

MR. JUSTICE BLACK delivered the opinion of the Court.

These two cases, consolidated for argument here, involve controversies between the United States and bankruptcy trustees concerning the right of the Government to recover federal tax penalties against the estate of a bankrupt.¹ Because the tax penalties constituted perfected liens on the estate of the bankrupt,² the Court of Appeals for the Ninth Circuit, following one of its own prior decisions which subsequently had been supported by both the Sixth and the Tenth Circuits,³ sustained District Court judgments holding the penalty claims allowable. 287 F. 2d 489, 491. Since the Fourth and Fifth Circuits have held to the contrary,⁴ we granted certiorari to resolve the conflict. 366 U.S. 943.

Two provisions of the Bankruptcy Act, sections 57(j) and 67(b), are asserted to have particular relevance to the question. Section 57(j) provides:

"Debts owing to the United States or any State or any subdivision thereof as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose * * *."⁵

¹ In the first case, *Simonson v. Granquist*, there is another point which we need not reach because of the disposition made here.

² In *Simonson v. Granquist* the liens arose under Int. Rev. Code of 1954, § 6321; in *Harris v. United States*, Int. Rev. Code of 1939, § 3670.

³ In *re Knox-Powell-Stockton Co.* (C.A. 9th Cir.), 100 F. 2d 979; *Kentucky v. Farmers Bank* (C.A. 6th Cir.), 139 F. 2d 266; *United States v. Mighell* (C.A. 10th Cir.), 273 F. 2d 682.

⁴ *United States v. Harrington* (C.A. 4th Cir.), 269 F. 2d 719; *United States v. Phillips* (C.A. 5th Cir.), 267 F. 2d 374.

⁵ 30 Stat. 561, as amended, 11 U.S.C. 93(j).

Section 67(b) provides, however:

"[S]tatutory liens * * * for taxes and debts owing to the United States * * * may be valid against the trustee, even though arising or perfected * * * within four months prior to the filing of the petition initiating a proceeding under this Act by or against him * * *."⁶

Despite the fact that the language of section 57(j) broadly prohibits the allowance of penalty claims in bankruptcy without regard to whether such claims are secured or unsecured, the Government argues that this section should be interpreted to apply to unsecured penalty claims only and that secured claims, even though for penalties, should be allowed under section 67(b). Its argument starts from the fact that the Bankruptcy Act primarily provides a way to gather the unencumbered assets of an insolvent debtor for distribution among his unsecured creditors, but, though containing some provisions applicable to secured creditors, generally leaves those creditors secured by mortgages and liens free to enforce their claims directly against the property by which those claims are secured. From this and a section by section analysis of the Act, the Government reasons that the "claims" referred to in section 57, which governs the "Proof and allowance of claims," are not the claims of secured creditors but only the "claims" of unsecured creditors against the fund created by unencumbered assets, with which the Act primarily deals. On this basis the Government contends that section 57(j), being a part of section 57, must be read as barring only those penalties that have not yet ripened into a lien so as to become a charge upon the bankrupt's property.

We think, however, that the language of section 57(j) is itself a more dependable guide to its meaning than this argument from the general structure of the Bankruptcy Act. Unquestionably that language is broad enough to bar all penalties, whether secured by lien or not, and we think the section was designed to do precisely that. For it plainly manifests a congressional purpose to bar all claims against a bankrupt of any kind except those on account of which the claimant has suffered a "pecuniary" loss. So understood, this section, which has been a part of the Bankruptcy Act since its enactment in 1898, is in keeping with the broad aim of the Act to provide for the conservation of the estates of insolvents to the end that there may be as equitable a distribution of assets as is consistent with the type of claims involved. Moreover, the prohibition of all tax penalties in bankruptcy is wholly consistent with the policy of the penalty provisions themselves. Tax penalties are imposed at least in part as punitive measures against persons who have been guilty of some default or wrong.⁷ Enforcement of penalties against the estates of bankrupts, however, would serve not to punish the delinquent taxpayers, but rather their entirely innocent creditors.

When we turn to the language of section 67(b), we find nothing that indicates a purpose to require the general creditors of a bankrupt to suffer because of penalties designed to be inflicted upon the bankrupt himself. Indeed, there is not a single word in that section regarding penalties, and the plain purpose of the section is merely to prevent certain liens, including statutory tax liens, "arising or perfected * * * within four months prior to the filing of the [bankruptcy] petition," from being set aside and declared invalid under section 60 as preferential.⁸ Thus section 65(b) expressly declares that it is to take precedence over any "provisions of section 60 of this Act to the contrary * * *." Section 67(b) cannot therefore be read as showing a congressional purpose to make penalties allowable contrary to the special and specific language of section 57(j) which makes them not allowable.⁹

The Government argues, however, that the legislative history of the two sections supports the allowance of penalties when they have ripened into liens. Without discussing the varied arguments to this effect in detail, we think the legislative history cited supports no such conclusion.¹⁰ Nor do we think that

⁶ 52 Stat. 876, as amended, 11 U.S.C. 107(b).

⁷ See, e.g., *United States v. Childs*, 266 U.S. 304, 307 [T.D. 3671, C.B. IV-1, 241 (1925)].

⁸ 30 Stat. 562, as amended, 11 U.S.C. 96. See Analysis of H.R. 12889, 74th Cong., 2d Sess. 211, note 1; 4 Collier, Bankruptcy 183, particularly note 12.

⁹ Cf. *Gardner v. New Jersey*, 329 U.S. 565, 580-581.

¹⁰ Indeed what little legislative history there is might well be taken to indicate an intent to bar penalties whether liened or not. Thus, the minority report to the Torrey Bill which eventually became the Bankruptcy Act of 1898 stated as an objection to § 57(j) the fact that although "penalties and forfeitures, when merged into judgment, . . . are liens upon the debtor's estate, this bill treats them as worthless and forbids their payment." H.R. Rep. No. 1674, 52d Cong., 1st Sess., pt. 2, pp. 13-14.

any inference can be drawn from the failure of Congress to amend the Act for although some courts have held liened penalty claims allowable, others have held precisely the opposite.¹¹

It is true that the United States has long had an absolute priority for debts due from insolvent debtors and that the Bankruptcy Act generally accords secured creditors a preferred position. But section 57(j) places penalties in a category quite different from ordinary debts, one not favored in bankruptcy, and the character of a penalty is by no means changed by calling it a lien.

Reversed.

MR. JUSTICE FRANKFURTER, whom MR. JUSTICE HARLAN joins, dissenting.

SECTION 6323.—VALIDITY AGAINST MORTGAGEES, PLEDGEES, PURCHASERS, AND JUDGMENT CREDITORS

26 CFR 301.6323-1: Validity of lien against mortgagees, pledgees, purchasers, and judgment creditors.

Validity of a tax lien filed in a United States District Court against a subsequently recorded mortgage where state law required a description of the land as a condition to filing in a state office. See Ct. D. 1869, page 328.

CHAPTER 65.—ABATEMENTS, CREDITS, AND REFUNDS

SUBCHAPTER A.—PROCEDURE IN GENERAL

SECTION 6402.—AUTHORITY TO MAKE CREDITS OR REFUNDS

26 CFR 301.6402-2: Claims for credit or refund.

Amended regulations authorizing directors of regional service centers to make credits or refunds. See T.D. 6585, page 290.

SUBCHAPTER B.—RULES OF SPECIAL APPLICATION

SECTION 6416.—CERTAIN TAXES ON SALES AND SERVICES

Rev. Rul. 62-91

Where a retailer sells a diamond ring on credit and pays the applicable retailers excise tax but subsequently repossesses the ring because of the purchaser's failure to make any payment, the retailer may be allowed a credit or refund of the tax under the provisions of section 6416(b) (1) of the Internal Revenue Code of 1954.

¹¹ Compare, e.g., *In re Knox-Powell-Stockton Co.*, 100 F. 2d 979 and *Kentucky v. Farmers Bank*, 139 F. 2d 266 with *United States v. Phillips*, 267 F. 2d 374 and *In re Burch*, 89 F. Supp. 249. In 1960 Congress passed an Act containing a provision applying § 57(j) to penalties "whether or not secured by a lien," but this was vetoed by the President. 106 Cong. Rec. 19168.

Advice has been requested as to the allowability of a credit or refund of the retailers excise tax under the circumstances described below.

A retailer sold a diamond ring on an open charge account and paid to the Government the applicable retailers excise tax. However, the purchaser failed to make any payment, and the ring was repossessed by the retailer six months after the date of sale.

Section 6416(b) (1) of the Internal Revenue Code of 1954, relating to special cases in which retailers or manufacturers excise tax payments may be considered overpayments, provides that when the price on which a tax was based is readjusted by reason of the return or repossession of an article, a credit or refund may be allowed, with respect to the article, in the amount of that part of the tax proportionate to the part of the price which is repaid or credited to the purchaser.

Where an article subject to retailers excise tax is in fact and in law repossessed by the taxpayer for failure by the customer to make appropriate payment on his account covering such article, a credit or refund is allowable in the amount of tax paid which is proportionate to the amount of the price credited or repaid to the customer. In such repossession cases, the allowability of a credit or refund under the provisions of section 6416(b) (1) of the Code will be determined without regard to the period of time that has elapsed since the delivery of such article to the purchaser.

Accordingly, it is held that when a diamond ring is repossessed under the circumstances set forth above, the retailer is entitled to a credit or refund of the excise tax paid on the sale, provided he files a claim for credit or refund within the time limit specified in section 6511(a) of the Code, which relates to the period of limitations on filing claims for credit or refund of an overpayment of any tax imposed by the Internal Revenue Code in respect of which the taxpayer is required to file a return.

26 CFR 330.1-2: Readjustments of price for purposes of manufacturers excise taxes.

Computation of the manufacturers excise tax where an article is sold otherwise than through an arm's length transaction at less than the fair market price. See Rev. Rul. 62-68, page 216.

CHAPTER 66.—LIMITATIONS

SUBCHAPTER A.—LIMITATIONS ON ASSESSMENT AND COLLECTION

SECTION 6501.—LIMITATIONS ON ASSESSMENT AND COLLECTION

26 CFR 301.6501(g)-1: Certain income tax returns of corporations.

Rev. Rul. 62-10

The filing of an information return on Form 990, Form 990-A or Form 990-P, under section 6033 of the Internal Revenue Code of

1954, by an organization exempt from income tax under section 501(a) of the Code does not start the running of the statute of limitations on assessment of the unrelated business income tax imposed by section 511 of the Code and required to be reported on Form 990-T.

Advice has been requested whether, in view of section 6501(g) (2) of the Internal Revenue Code of 1954, the filing of an information return on Form 990, Form 990-A or Form 990-P, pursuant to the provisions of section 6033 of the Code, by an exempt organization will start the running of the statute of limitations on assessment of the unrelated business income tax which is imposed by section 511 of the Code and required to be reported on Form 990-T.

Section 6501 of the Code, relating to limitations on assessment and collection, provides, in part, as follows:

(a) GENERAL RULE.—Except as otherwise provided in this section, the amount of any tax imposed by this title [Internal Revenue Title] shall be assessed within 3 years after the return was filed (whether or not such return was filed on or after the date prescribed) * * * and no proceeding in court without assessment for the collection of such tax shall be begun after the expiration of such period.

* * * * *

(g) * * *

(2) EXEMPT ORGANIZATIONS.—If a taxpayer determines in good faith that it is an exempt organization and files a return as such under section 6033, and if such taxpayer is thereafter held to be a taxable organization for the taxable year for which the return is filed, such return shall be deemed the return of the organization for purposes of this section.

Section 6033(a) of the Code provides that every organization exempt from taxation under section 501(a) of the Code, with certain exceptions, shall file an annual return stating specifically the items of gross income, receipts and disbursements and such other information for the purpose of carrying out the provisions of subtitle A as the Secretary of the Treasury or his delegate may by forms or regulations prescribe.

Section 6033(b) provides that every organization described in section 501(c) (3) which is subject to the requirements of subsection (a) shall furnish annually information, at such time and in such manner as the Secretary or his delegate may by forms and regulations prescribe, setting forth its gross income, its expenses, its disbursements, its accumulation of income, its aggregate accumulations of income at the beginning of the year, its disbursements out of principal, a balance sheet showing its assets, liabilities and net worth, and the total of contributions and gifts received by it during the year.

Section 1.6033-1(a) of the Income Tax Regulations provides, in part, that (1) every organization exempt from tax under section 501(a), and required to file a return under section 6033 and this section, other than those described in sections 401(a), 501(c) (3), and 501(d), shall file its annual return on Form 990; (2) every organization described in section 501(c) (3), which is exempt from tax under section 501(a), and which is required to file a return under section 6033 and this section, shall file its annual return on Form 990-A; and (3) every employees' trust described in section 401(a), which is exempt from tax under section 501(a), shall file an annual return on Form 990-P.

Section 1.6033-1(i) of the regulations provides that in addition to the other requirements of this section, certain organizations otherwise exempt from tax under section 501(a) and described in section 501(c) (2), (3), (5) or (6) or section 401(a), which are subject to tax on unrelated business taxable income, are also required to file returns on Form 990-T. The section then refers to paragraph (a) of regulations section 1.6012-2 and paragraph (a)(5) of section 1.6012-3 for requirements with respect to such returns.

Section 1.6012-2(e) of the regulations pertains to charitable and other organizations with unrelated business income and provides that such an organization "shall make a return on Form 990-T for each taxable year if it has gross income, included in computing unrelated business taxable income for such taxable year, of \$1,000 or more." It adds that the filing of a return of unrelated business income does not relieve the organization of the duty of filing other required returns.

The foregoing provisions of the statutes and regulations, taken together, make it clear that an exempt organization which is subject to the unrelated business income tax may be required to file two returns, an information return on either Form 990, Form 990-A, or Form 990-P, depending on the type of organization, and an unrelated business income tax return on Form 990-T.

Section 6501(g)(2) of the Code provides that if a taxpayer determines in good faith that it is an exempt organization and files a return as such under section 6033, and if such taxpayer is thereafter held to be a taxable organization for the taxable year for which the return is filed, such return shall be deemed the return of the organization for purposes of the statute of limitations on assessment and collection.

Section 6501(g)(2) applies to the exempt status of organizations which erroneously file information returns in lieu of proper income tax returns. In this connection see Rev. Rul. 60-144, C.B. 1960-1, 636. In the present situation, the organization's right to an exempt status is not in issue. Moreover, an organization is not entitled to the benefits of section 6501(g)(2) of the Code until it has filed such returns as are required of it under section 6033 of the Code and the regulations applicable thereto. *Cf., Commissioner v. Lane-Wells Co. and Technicraft Engineering Corporation*, 321 U.S. 219, Ct. D. 1602, C.B. 1944, 539, in which the Court held that the filing of a corporate tax return on Form 1120 did not start the statute of limitations running on the time for assessment of personal holding company liability required to be separately reported on Form 1120H.

In view of the foregoing, it is held that the filing of an information return on Form 990, Form 990-A or Form 990-P, pursuant to the provisions of section 6033 of the Code, by an organization exempt from income tax under section 501(a) of the Code does not start the running of the statute of limitation for purposes of assessment of the unrelated business income tax imposed by section 511 of the Code and required to be reported on Form 990-T.

SUBCHAPTER B.—LIMITATIONS ON CREDIT OR REFUND

SECTION 6511.—LIMITATIONS ON CREDIT OR REFUND

26 CFR 301.6511(b)-1: Limitations on allowance of credits and refunds.

Amended regulations relating to authority of directors of regional service centers to allow credits or refunds. See T.D. 6585, page 290.

CHAPTER 67.—INTEREST

SUBCHAPTER A.—INTEREST ON UNDERPAYMENTS

SECTION 6601.—INTEREST ON UNDERPAYMENT, NON-PAYMENT, OR EXTENSIONS OF TIME FOR PAYMENT, OF TAX

26 CFR 301.6601-1: Interest on underpayments. Rev. Rul. 62-96¹

(Also Sections 6651, 6652, 6653, 6654, 6655, 6656, 6657, 6658, 6673, 6674, 6675, 6676; 301.6651-1, 301.6652-1, 301.6653-1, 1.6654-1, 1.6655-1, 301.6656-1, 301.6657-1, 301.6658-1, 301.6673-1, 301.6674-1, 48.6675-1.)

The Internal Revenue Service will not claim non-pecuniary loss penalties in proceedings under the Bankruptcy Act, whether or not secured by Federal tax liens. See 11 U.S.C. 93j. It will not claim post-petition interest (whether or not secured by Federal tax liens) in proceedings under the Bankruptcy Act, or in general receivership or assignment for the benefit of creditor cases.

However, it will claim both penalties and post-petition interest when an estate proves to be solvent or when such liabilities arise in connection with the administration of the estate.

The Service will continue to enforce collection of penalties and post-petition interest from any property or rights to property subject to the Federal tax lien which are not under administration as part of an insolvent taxpayer's estate and from after-acquired property.

Further consideration will be given to the effect of this Revenue Ruling on G.C.M. 21860, C.B. 1940-1, 181, and to the publication of a more comprehensive Revenue Ruling in due time.

Amended regulations authorizing directors of regional service centers to assess and collect interest on underpayments. See T.D. 6585, page 290.

¹ Based on Technical Information Release 381, dated May 9, 1962.

CHAPTER 68.—ADDITIONS TO THE TAX, ADDITIONAL AMOUNTS, AND ASSESSABLE PENALTIES

SUBCHAPTER A.—ADDITIONS TO THE TAX AND ADDITIONAL AMOUNTS

SECTION 6651.—FAILURE TO FILE TAX RETURN

26 CFR 301.6651-1: Failure to file tax return.

Applicability of penalty provisions to deficiencies arising solely by reason of an election under section 4(a) of the Dealer Reserve Income Adjustment Act of 1960. See Rev. Rul. 62-22, page 332.

Claim by the Internal Revenue Service for non-pecuniary loss penalties and post-petition interest in proceedings under the Bankruptcy Act, or in general receivership or assignment for the benefit of creditor cases. See Rev. Rul. 62-96, page 308.

Amended regulations authorizing directors of regional service centers to make determinations of reasonable cause for failure to file tax return. See T.D. 6585, page 290.

SECTION 6652.—FAILURE TO FILE CERTAIN INFORMATION RETURNS

26 CFR 301.6652-1: Failure to file certain information returns.

Claim by the Internal Revenue Service for non-pecuniary loss penalties and post-petition interest in proceedings under the Bankruptcy Act, or in general receivership or assignment for the benefit of creditor cases. See Rev. Rul. 62-96, page 308.

SECTION 6653.—FAILURE TO PAY TAX

26 CFR 301.6653-1: Failure to pay tax.

Applicability of penalty provisions to deficiencies arising solely by reason of an election under section 4(a) of the Dealer Reserve Income Adjustment Act of 1960. See Rev. Rul. 62-22, page 332.

Claim by the Internal Revenue Service for non-pecuniary loss penalties and post-petition interest in proceedings under the Bankruptcy Act, or in general receivership or assignment for the benefit of creditor cases. See Rev. Rul. 62-96, page 308.

SECTION 6654.—FAILURE BY INDIVIDUAL TO PAY ESTIMATED INCOME TAX

26 CFR 1.6654-1: Addition to the tax in the case of an individual.

Claim by the Internal Revenue Service for non-pecuniary loss penalties and post-petition interest in proceedings under the Bankruptcy Act, or in general receivership or assignment for the benefit of creditor cases. See Rev. Rul. 62-96, page 308.

SECTION 6655.—FAILURE BY CORPORATION TO PAY ESTIMATED INCOME TAX

26 CFR 1.6655-1: Addition to the tax in the case of a corporation.

Claim by the Internal Revenue Service for non-pecuniary loss penalties and post-petition interest in proceedings under the Bankruptcy Act, or in general receivership or assignment for the benefit of creditor cases. See Rev. Rul. 62-96, page 308.

SECTION 6656.—FAILURE TO MAKE DEPOSIT OF TAXES

26 CFR 301.6656-1: Failure to make deposit of taxes.

Claim by the Internal Revenue Service for non-pecuniary loss penalties and post-petition interest in proceedings under the Bankruptcy Act, or in general receivership or assignment for the benefit of creditor cases. See Rev. Rul. 62-96, page 308.

SECTION 6657.—BAD CHECKS

26 CFR 301.6657-1: Bad checks.

Claim by the Internal Revenue Service for non-pecuniary loss penalties and post-petition interest in proceedings under the Bankruptcy Act, or in general receivership or assignment for the benefit of creditor cases. See Rev. Rul. 62-96, page 308.

SECTION 6658.—ADDITION TO TAX IN CASE OF JEOPARDY

26 CFR 301.6658-1: Addition to tax in case of jeopardy.

Claim by the Internal Revenue Service for non-pecuniary loss penalties and post-petition interest in proceedings under the Bankruptcy Act, or in general receivership or assignment for the benefit of creditor cases. See Rev. Rul. 62-96, page 308.

SUBCHAPTER B.—ASSESSABLE PENALTIES

SECTION 6673.—DAMAGES ASSESSABLE FOR INSTITUTING PROCEEDINGS BEFORE THE TAX COURT MERELY FOR DELAY

26 CFR 301.6673-1: Damages assessable for instituting proceedings before the Tax Court merely for delay.

Claim by the Internal Revenue Service for non-pecuniary loss penalties and post-petition interest in proceedings under the Bankruptcy Act, or in general receivership or assignment for the benefit of creditor cases. See Rev. Rul. 62-96, page 308.

SECTION 6674.—FRAUDULENT STATEMENT OR FAILURE TO FURNISH STATEMENT TO EMPLOYEE

26 CFR 301.6674-1: Fraudulent statement or failure to furnish statement to employee.

Claim by the Internal Revenue Service for non-pecuniary loss penalties and post-petition interest in proceedings under the Bankruptcy Act, or in general receivership or assignment for the benefit of creditor cases. See Rev. Rul. 62-96, page 308.

SECTION 6675.—EXCESSIVE CLAIMS WITH RESPECT TO THE USE OF CERTAIN GASOLINE

26 CFR 48.6675-1: Excessive claims under section 6420 or 6421.

Claim by the Internal Revenue Service for non-pecuniary loss penalties and post-petition interest in proceedings under the Bankruptcy Act, or in general receivership or assignment for the benefit of creditor cases. See Rev. Rul. 62-96, page 308.

SECTION 6676.—FAILURE TO SUPPLY IDENTIFYING NUMBERS

Claim by the Internal Revenue Service for non-pecuniary loss penalties and post-petition interest in proceedings under the Bankruptcy Act, or in general receivership or assignment for the benefit of creditor cases. See Rev. Rul. 62-96, page 308.

CHAPTER 69.—GENERAL PROVISIONS RELATING TO STAMPS

SECTION 6801.—AUTHORITY FOR ESTABLISHMENT, ALTERATION, AND DISTRIBUTION

26 CFR 47.6801: Statutory provisions; authority for establishment, alteration, and distribution.

Regulations under the Internal Revenue Code of 1954 with respect to meter machines for use in the sale of documentary stamps. See T.D. 6589, page 228.

26 CFR 47.6801-1: Establishment of meter machines and stamps.

Requirements for obtaining authorization to manufacture and lease documentary stamp tax meter machines. See Rev. Proc. 62-15, page 445.

Instructions for use of documentary stamp meters. See Rev. Proc. 62-16, page 451.

SECTION 6802.—SUPPLY AND DISTRIBUTION

26 CFR 47.6802: Statutory provisions; supply and distribution.

Regulations under the Internal Revenue Code of 1954 relating to the supply and distribution of documentary stamps. See T.D. 6589, page 228.

SECTION 6804.—ATTACHMENT AND CANCELLATION

26 CFR 47.6804: Statutory provisions; attachment and cancellation.

Regulations under the Internal Revenue Code of 1954 relating to the use and denominations of documentary stamps. See T.D. 6589, page 228.

CHAPTER 70.—JEOPARDY, BANKRUPTCY AND RECEIVERSHIPS

SUBCHAPTER A.—JEOPARDY

PART II.—JEOPARDY ASSESSMENTS

SECTION 6861.—JEOPARDY ASSESSMENTS OF INCOME, ESTATE, AND GIFT TAXES

26 CFR 301.6861-1: Jeopardy assessments of income, estate, and gift taxes.

Amended regulations authorizing directors of the regional service centers to abate certain jeopardy assessments. See T.D. 6585, page 290.

CHAPTER 74.—CLOSING AGREEMENTS AND COMPROMISES

SECTION 7122.—COMPROMISES

26 CFR 301.7122-1: Compromises.

Procedure for submission and handling of offers in compromise with respect to tobacco products, cigarette papers and tubes, and firearms. See Rev. Proc. 62-11, page 440.

CHAPTER 75.—CRIMES, OTHER OFFENSES, AND FORFEITURES

SUBCHAPTER A.—CRIMES

PART I.—GENERAL PROVISIONS

SECTION 7209.—UNAUTHORIZED USE OR SALE OF STAMPS

26 CFR 47.7209: Statutory provisions; unauthorized use or sale of stamps.

Regulations under the Internal Revenue Code of 1954 relating to the unauthorized use or sale of documentary stamps. See T.D. 6589, page 228.

CHAPTER 77.—MISCELLANEOUS PROVISIONS

SECTION 7510.—EXEMPTION FROM TAX OF DOMESTIC GOODS PURCHASED FOR THE UNITED STATES

26 CFR 45.7510-1: Withdrawal of filled cheese and playing cards from factories, free of tax, for use of the United States.

Whether manufacturers of playing cards may ship cards, free of the excise tax, to representatives of the United States Veterans Administration for gratuitous distribution to members of the Armed Forces of the United States who are patients in hospitals and institutions operated by the governments of the several States and the District of Columbia. See Rev. Rul. 62-18, page 276.

SECTION 7514.—AUTHORITY TO PRESCRIBE OR MODIFY SEALS

26 CFR 301.7514-1: Seals of office.

Amended regulations establishing an official seal of office for the Director of Atlanta Regional Service Center, Atlanta, Georgia. See T.D. 6585, page 290.

CHAPTER 78.—DISCOVERY OF LIABILITY AND ENFORCEMENT OF TITLE

SUBCHAPTER B.—GENERAL POWERS AND DUTIES

SECTION 7622.—AUTHORITY TO ADMINISTER OATHS AND CERTIFY

26 CFR 301.7622-1: Authority to administer oaths and certify.

Amended regulations authorizing directors of regional service centers to administer oaths and certify. See T.D. 6585, page 290.

CHAPTER 79.—DEFINITIONS

SECTION 7701.—DEFINITIONS

26 CFR 301.7701-9: Secretary or his delegate.

Amended regulations authorizing directors of regional service centers to perform delegated functions of the Secretary. See T.D. 6585, page 290.

PART II

RULINGS AND DECISIONS UNDER THE INTERNAL REVENUE CODE OF 1939, THE FEDERAL FIREARMS ACT, AND OTHER PUBLIC LAWS

SUBPART A.—RULINGS AND DECISIONS UNDER THE INTERNAL REVENUE CODE OF 1939

Rulings and decisions published in Part II, Subpart A, of the Internal Revenue Bulletin are based on the applications of provisions of the Internal Revenue Code of 1939 and unless otherwise noted therein are published without consideration to any application of the provisions of the Internal Revenue Code of 1954, the Federal Firearms Act, or other public laws.

SUBTITLE A.—TAXES SUBJECT TO THE JURISDICTION OF THE BOARD OF TAX APPEALS

CHAPTER 1.—INCOME TAX

SUBCHAPTER B.—GENERAL PROVISIONS

PART II.—COMPUTATION OF NET INCOME

SECTION 23(1).—DEDUCTIONS FROM GROSS INCOME: DEPRECIATION

REGULATIONS 111, SECTION 29.23(1)-1:
Depreciation.

Rev. Rul. 62-59 ¹

The Internal Revenue Service will follow the decision of the United States Court of Appeals for the First Circuit in *Boston & Maine Railroad v. Commissioner*, 206 Fed. (2d) 617 (1953).

The Court held that the retirement method of accounting was a form of depreciation accounting and came under section 23(1) of the Internal Revenue Code of 1939, rather than section 23(f).

Where a taxpayer has consistently employed the retirement method of accounting and has maintained continuously a regular and consistent practice of handling retirements, the opinion of the Court here

¹ Based on Technical Information Release 373, dated March 27, 1962.

with respect to the time of deduction will be followed in the absence of indications of bad faith or abuse.

SECTION 23(m).—DEDUCTIONS FROM GROSS INCOME: DEPLETION

REGULATIONS 111, SECTION 29.23(m)-1: Depletion of mines, oil and gas wells, other natural deposits, and timber; depreciation of improvements.

Extent to which the reduction in size of stone will be considered an ordinary treatment process for purposes of computing gross income from the property. See Rev. Rul. 62-5, page 88.

REGULATIONS 118, SECTION 39.23(m)-1: Depletion of mines, oil and gas wells, other natural deposits, and timber; depreciation of improvements.

Extent to which the reduction in size of stone will be considered an ordinary treatment process for purposes of computing gross income from the property. See Rev. Rul. 62-5, page 88.

PART V.—RETURNS AND PAYMENT OF TAX

SECTION 55.—PUBLICITY OF RETURNS

26 CFR 458.324: Inspection of returns by committees of Congress other than those enumerated in section 55(d) of the Internal Revenue Code of 1939.

Inspection of certain returns by the Senate Committee on the Judiciary. See E.O. 10981, page 288.

Inspection of certain returns by the Senate Committee on Armed Services. See E.O. 11020, page 289.

SUBCHAPTER C.—SUPPLEMENTAL PROVISIONS

SUPPLEMENT B.—COMPUTATION OF NET INCOME

SECTION 112(a).—RECOGNITION OF GAIN OR LOSS: GENERAL RULE

REGULATIONS 118, SECTION 39.112(a)-1: Sales
or exchanges.

An exchange of stock for stock plus cash in the absence of a statutory reorganization. See Ct. D. 1868, below.

SECTION 112(c).—RECOGNITION OF GAIN OR LOSS: GAIN FROM EXCHANGES NOT SOLELY IN KIND

REGULATIONS 118, SECTION 39.112(c)-1: Receipt of other property or money in tax-free exchange not connected with corporate reorganization. Ct. D. 1868

(Also Section 112(a); Regulations 118, Section 39.112(a)-1.)

(Also Part I, Sections 356, 1002; 26 CFR 1.356-1, 1.1002-1.)

INCOME TAX—INTERNAL REVENUE CODE OF 1939—DECISION OF COURT

1. GAIN OR LOSS—EXCHANGE OF STOCK FOR STOCK PLUS CASH—ACTUAL "REORGANIZATION" MUST EXIST BEFORE SEC. 112(c) (1) CAN APPLY.

In the absence of a "reorganization" as that term is defined in section 112(g) (1) (B) and used in section 112(b) (3) of the Internal Revenue Code of 1939, the gain on an exchange of stock for stock plus cash is to be recognized in full and not only to the extent of the cash received. The transfer in 1952 by taxpayers of all of the outstanding stock of a Nevada corporation in exchange for a minor percentage of stock in a New York corporation and cash (approximately 30 per centum in stock and 70 per centum in cash) is not a "reorganization" as defined in section 112(g) (1) (B), section 112(c) (1) does not apply, and gain on the exchange is recognized in full.

2. JUDGMENT AFFIRMED.

Judgment of the United States Court of Appeals for the Ninth Circuit, 286 Fed. (2d) 669 (1960), affirmed.

SUPREME COURT OF THE UNITED STATES

No. 60.—October Term, 1961

Grover D. Turnbow and Ruth H. Turnbow, petitioners v. Commissioner of Internal Revenue

On writ of certiorari to the United States Court of Appeals for the Ninth Circuit

[December 18, 1961.]

MR. JUSTICE WHITTAKER delivered the opinion of the Court.

This case involves and turns on the proper interpretation and interaction of sections 112(g) (1) (B), 112(b) (3) and 112(c) (1) of the Internal Revenue

Code of 1939.¹ Specifically the question presented is whether, in the absence of a "reorganization," as that term is defined in section 112(g)(1)(B) and used in section 112(b)(3), the gain on an exchange of stock for stock *plus cash* is to be recognized in full, or, because of the provisions of section 112(c)(1), is to be recognized only to the extent of the cash.

The facts are simple and undisputed. Petitioner² owned all of the 5,000 shares of outstanding stock of International Dairy Supply Company ("International"), a Nevada corporation. In 1952, petitioner transferred all of the International stock to Foremost Dairies, Inc. ("Foremost"), a New York corporation, in exchange for 82,375 shares (a minor percentage) of Foremost's common (voting) stock of the fair market value of \$15 per share or \$1,235,625 *plus cash* in the amount of \$3,000,000. Petitioner's basis in the International stock was \$50,000, and his expenses in connection with the transfer were \$21,933.06. Petitioner therefore received for his International stock property and money of a value exceeding his basis and expenses by \$4,163,691.94.

In his income tax return for 1952, petitioner treated his gain as recognizable only to the extent of the cash he received. The Commissioner concluded that the whole of the gain was recognizable and accordingly proposed a deficiency. On the taxpayer's petition for redetermination, the Tax Court, following its earlier decision in *Luther Bonham*, 33 B.T.A. 1100, 1104,³ and the opinion of the Seventh Circuit in *Howard v. Commissioner of Internal Revenue*, 238 F. 2d 943, 948,⁴ held that the gain was recognizable only to the extent of the cash. 32 T.C. 646. On the Commissioner's appeal, the Ninth Circuit disagreed with the Tax Court and with the Seventh Circuit's decision in the *Howard* case, *supra*, and reversed. 286 F. 2d 669. To resolve this conflict, on a matter of importance to the proper interpretation and uniform application of the Internal Revenue laws, we granted certiorari. 366 U.S. 923.

Because of the arbitrary and technical character, and of the somewhat "hodge-podge" form, of the statutes involved, the interpretation problem presented is highly complicated; and although both parties rely upon the "plain words" of these statutes, they arrive at diametrically opposed conclusions. That plausible arguments can be and have been made in support of each conclusion must be admitted; and, as might be expected, they have hardly lightened our inescapable burden of decision.

The starting point of our analysis must be the "General rule" stated in section 112(a). It provides:

"General rule. Upon the sale or exchange of property the entire amount of the gain or loss * * * shall be recognized, except as hereinafter provided in this section."

¹ Unless otherwise stated, all references to Code sections are to the Internal Revenue Code of 1939 (26 U.S.C., 1952 ed.).

² Grover D. Turnbow will be referred to as though he were the sole petitioner, his wife being a party only because a joint return was filed.

³ The Tax Court concluded "that *but for* the cash received by petitioner * * * the exchange would have met the 'solely' requirement of section 112(g)(1)(B) and fallen within section 112(b)(3). *Howard v. Commissioner, supra*, p. 948. Therefore, under section 112(c)(1) the gain to petitioner may not be recognized in an amount in excess of [the cash received]." 32 T.C., at 652-653.

⁴ In the *Howard* case, *supra*, the acquiring corporation obtained 80.19% of the stock of the acquired corporation by transferring to the holders, including petitioners, a part of its voting stock in exchange for their stock in the acquired corporation, and acquired the remaining 19.81% of the acquired corporation's stock from other holders for an agreed price in cash. As stated, petitioners received only stock and no cash. The Commissioner determined that the gain realized by petitioners on their exchange solely of stock for stock should be recognized under the General rule of sec. 112(a) of the Code. The Seventh Circuit, following this Court's decision in *Helvering v. Southwest Consolidated Corp.*, 315 U.S. 194 [Ct. D. 1544, C.B. 1942-1,218], held "that because of the cash payment the transaction in question fails to meet the 'solely' requirement of sec. 112(g)(1)(B) of the 1939 Code. Hence it does not fall within the ambit of sec. 112(b)(3)." 238 F. 2d, at 947. But, turning to and relying on sec. 112(c)(1), it also held that "*but for* the cash received [by others than petitioners] in exchange for 19.81% of the common stock of Binkley, the transaction would have met the 'solely' requirement of sec. 112(g)(1)(B) and fallen within the scope of sec. 112(b)(3). To the extent that 'boot' was received, gain would be recognized under our interpretation of the application of sec. 112(c)(1). However, no cash was received by the taxpayers in question, and as a consequence thereof, no gain at the time of the transaction ever arose." 238 F. 2d, at 948.

Various exceptions, dealing with exchanges solely in kind, are stated in subsections (b) (1) through (b) (6).⁵ The exception claimed to be relevant here is contained in subsection (b) (3). It provides:

"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."

By definition, contained in section 112(g) (1) (B), the term "reorganization" means "the acquisition by one corporation, in exchange *solely* for all or a part of its voting stock, of at least 80 per centum of the * * * stock of another corporation."⁶ (Emphasis added.) This type of reorganization is commonly called a "(B) reorganization."

There is no dispute between the parties about the fact that the transaction involved was not a "reorganization," as defined in section 112(g) (1) (B), because "the acquisition by" Foremost was not "in exchange *solely* for * * * its voting stock," but was partly for such stock and partly for cash. *Helvering v. Southwest Consolidated Corp.*, 315 U.S. 194 [Ct. D. 1544, C.B. 1942-1.218]. Nor is there any dispute that the transaction was not actually within the terms of section 112(b) (3), because the exchange was not of "stock * * * in * * * a party to a reorganization," "in pursuance of [a] plan of reorganization," nor "for stock * * * in another corporation [which was] a party to the reorganization."

But, petitioner contends that section 112(c) (1) authorizes the indulging of assumptions, contrary to the actual facts, hypothetically to supply the missing elements that are necessary to make the exchange a "reorganization," as defined in section 112(g) (1) (B) and as used in section 112(b) (3), and the case turns on whether that is so. Section 112(c) (1) provides:

"Gains from exchanges not solely in kind. (1) If an exchange would be within the provisions of subsection (b) (1), (2), (3), or (5), or within the provisions of subsection (1), of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph or by subsection (1) to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient 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."

Centering upon this section, and upon the Seventh Circuit's interpretation of it in the *Howard* case, *supra*,⁷ petitioner argues that "if it were not for the fact

⁵ The various exceptions, respecting exchanges solely in kind, contemplated by sec. 112(b), are the following:

Sec. 112(b) (1): The exchange of tangible property, held for productive use or investment, "solely" for property "of a like kind."

Sec. 112(b) (2): The exchange of stock "solely" for stock in the same corporation.

Sec. 112(b) (3): The exchange of stock in a party to a "reorganization," as defined in sec. 112(g) (1), "solely" for stock or securities in the same corporation or in another corporation which is a party to the reorganization.

Sec. 112(b) (4): The exchange by a corporation, a party to a reorganization, of "property," in pursuance of the plan of reorganization, "solely" for stock or securities in another corporation which is a party to the reorganization.

Sec. 112(b) (5): The transfer of property to a controlled corporation in exchange "solely" for stock or securities of that corporation.

Sec. 112(b) (6): The receipt by a corporation of property in complete liquidation of another corporation.

See also sec. 112(1) which provides a similar exception in respect to: The exchange of stock or securities "solely" for stock or securities of a successor corporation pursuant to a court-approved plan in debtor or insolvency proceedings.

⁶ Section 112(g) (1) provides:

"(g) Definition of reorganization. As used in this section * * *

"(1) The term 'reorganization' means (A) a statutory merger or consolidation, or (B) the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of another corporation, or (C) the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of substantially all of the properties of another corporation, but in determining whether the exchange is solely for voting stock the assumption by the acquiring corporation of a liability of the other, or the fact that property acquired is subject to a liability, shall be disregarded, or (D) a transfer by a corporation of all or part of its assets to another corporation if immediately after the transfer the transferor or its shareholders or both are in control of the corporation to which the assets are transferred, or (E) a recapitalization, or (F) a mere change in identity, form, or place of organization, however effected."

⁷ See note 4.

that the property [he] received in [the] exchange" consisted not only of voting stock—"property permitted [by section 112(b)(3)] to be received [if in a corporation which is a party to a reorganization] without the recognition of gain"—but also of cash, the exchange *would have been* a "reorganization," as defined in section 112(g)(1)(B), because, in that case, "the acquisition by" Foremost would have been "in exchange *solely* for * * * its voting stock"; and the exchange also *would have been* within the terms of section 112(b)(3) because, in that case, the exchange would have been of "stock * * * in * * * a party to a reorganization," "in pursuance of [a] plan of reorganization," and "for stock * * * in another corporation [which was] a party to the reorganization." Petitioner then argues that inasmuch as his transaction *would have been* a "reorganization," as defined in section 112(g)(1)(B) and used in section 112(b)(3), and hence "would [have been] within the provisions of subsection (b) * * * (3)," "if it were not for the fact that the property [he] received" consisted "not only of" voting stock "but also of * * * money," section 112(c)(1) authorizes the *assumption*, as respects the Foremost stock he received, that the exchange *was* a "reorganization," as defined in section 112(g)(1)(B) and used in permitted by [section 112(b)(3)] * * * to be received without the recognition of the * * * money" he received.

But, we cannot agree that section 112(c)(1) authorizes the assumption, contrary to the actual facts, of a "reorganization," as defined in section 112(g)(1)(B) and used in section 112(b)(3). To indulge such an assumption would actually be to permit the negation of Congress' carefully composed definition and use of "reorganization" in those subsections, and to permit nonrecognition of gains on what are, in reality, only sales, the full gain from which is immediately recognized and taxed under the General rule of section 112(a). To the contrary, we think that an actual "reorganization," as defined in section 112(g)(1) and used in section 112(b)(3), must exist before section 112(c)(1) can apply thereto. We are also agreed that section 112(c)(1) can apply only if the exchange actually consists *both* of "property permitted by [subsection (b)(1), (2), (3), or (5), or subsection (1) of section 112] * * * to be received without the recognition of gain" *and* "other property or money." And we think it is clear that the "property permitted by [section 112(b)(3)] * * * to be received without the recognition of gain" is "stock or securities in * * * a party to a reorganization," "in pursuance of [a] plan of reorganization," and "for stock * * * in such corporation or in another corporation [which is] a party to the reorganization." Since, as is admitted, none of the property involved in this exchange actually met that description, none of it was "property permitted by [section 112(b)(3)] * * * to be received without the recognition of gain," and therefore section 112(c)(1) does not apply to postpone recognition of petitioner's gain from the Foremost stock.⁸

This, of course, is not to say that section 112(c)(1) is without purpose or function. It is to say only that it does not apply unless some part, at least, of the property exchanged *actually* meets the particular description contained in the applicable section or subsection of the Code. But, inasmuch as section 112(g)(1)(B) defines "reorganization" to mean "the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of at least 80 per centum of the * * * stock of another corporation," an exchange of stock *and* cash—approximately 30 per centum in stock and 70 per centum in cash—for "at least 80 per centum of the * * * stock of another corporation" cannot be a "reorganization," as defined in section 112(g)(1)(B), nor hence of "stock * * * in * * * a party to a reorganization" as required by section 112(b)(3), and thus section 112(c)(1) cannot be applicable to petitioner's transaction. That holding determines this case and is all we decide.

Collaterally, petitioner argues that tax "loopholes" will be opened under other sections of the Code unless his interpretation is adopted. The Commissioner answers that "loopholes" will be opened under the sections involved and other sections only if petitioner's interpretation is adopted. Inasmuch as what we have said decides the case, we have no need or occasion to follow the parties into, or to decide, collateral questions.

Affirmed.

MR. JUSTICE HARLAN concurs in the result.

⁸ The legislative history, much of which is set forth in the opinion of the Court of Appeals, though tending to support our decision, is inconclusive, and no more can fairly be said of the Commissioner's Regulations. See Treas. Regs. 118, secs. 39.112(c)-1(e), 39.112(g)-4, 39.112(g)-1(c).

SECTION 117(m).—CAPITAL GAINS AND LOSSES: COLLAPSIBLE CORPORATIONS

REGULATIONS 118, SECTION 39.117(m)-1:

Rev. Rul. 62-12¹

Collapsible corporations.

(Also Part I, Section 341, 26 CFR 1.341-2.)

The Internal Revenue Service will not follow the decision of the United States Court of Appeals for the Fifth Circuit in *Commissioner v. James B. Kelley, et al.*, 293 Fed. (2d) 904 (1961).

In the *Kelley* case a real estate development corporation, prior to the time its taxpayer-stockholders had sold their stock in the corporation, had realized one-third of the total net income it might expect to derive from its property.

The Service contended that the taxpayer-stockholders should have reported the gain from the sale of their stock as ordinary income and not capital gain since the corporation was a collapsible one under section 117(m) of the Internal Revenue Code of 1939.

The Service's position is that a corporation is collapsible under section 117(m) (2) (A) of the 1939 Code and section 341(b) (1) (A) of the Internal Revenue Code of 1954 if prior to the sale of the stock by the shareholders there remains a substantial part of the net income yet to be derived from the property. See the decision of the United States Court of Appeals for the Third Circuit in the case of *J. D. Abbott, et al. v. Commissioner*, 258 Fed. (2d) 537 (1958).

The Service contended in the *Kelley* case since a substantial amount (two-thirds) of the net income remained to be derived prior to the sale of stock, the corporation was collapsible. However, the court held that the phrase "substantial part" appearing in section 117(m) (2) (A) of the 1939 Code, which defines a collapsible corporation, has reference to that part of the total anticipated net income to be derived from the property which had already been realized at the time of the stock sale, and since one-third of the income realized by the corporation prior to the sale of the stock is a substantial part of the total net income to be derived from the property, the corporation was not collapsible.

Although review by the Supreme Court of the United States was not requested in the *Kelley* case, the decision will not be followed as a precedent in the disposition of similar cases, and the Internal Revenue Service position will be maintained pending further clarification of the issue.

SECTION 125(b).—AMORTIZABLE BOND PREMIUM: AMOUNT

REGULATIONS 118, SECTION 39.125(b)-1: Bond

Ct. D. 1870

premium and amortizable bond premium.

(Also Part I, Section 171, 26 CFR 1.171-2.)

INCOME TAX—INTERNAL REVENUE CODE OF 1939—DECISION OF COURT

1. DEDUCTIONS FROM GROSS INCOME—AMORTIZABLE BOND PRE- MIUM—GENERAL CALL PRICE VS. SPECIAL CALL PRICE.

Where taxpayers purchased corporate bonds at a premium in 1953, which bonds were callable at the option of the issuer on 30

¹ Based on Technical Information Release 349, dated December 11, 1961.

days' notice at a general call price (payable from general funds) or at a special call price (payable from specially designated funds), taxpayers were entitled to a deduction for bond premium amortization computed with reference to the lesser special redemption price and the 30-day redemption period appearing in the bond indentures. Under section 125 of the Internal Revenue Code of 1939 the amount of premium amortizable is determined with reference to the amount payable on maturity "or on earlier call date," which means that a bondholder may amortize bond premium with reference to any date named in the bond indenture at which the bond might be called. The Court held that there was no basis in the statute or its legislative history for a distinction between reference to a general or special call price in computing amortizable bond premium under the 1939 Code. Congress enacted section 125 of the 1939 Code with full realization of the existence and operation of special call provisions, but chose not to make any distinction between them and general redemption rights.

2. JUDGMENT REVERSED.

Judgment of the United States Court of Appeals for the Second Circuit, 289 Fed. (2d) 69 (1961), reversed.

SUPREME COURT OF THE UNITED STATES

No. 224.—October Term, 1961

The Hanover Bank, executor, et al., petitioner v. Commissioner of Internal Revenue

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

[May 21, 1962]

MR. CHIEF JUSTICE WARREN delivered the opinion of the Court.

Despite the seemingly complex factual composition of the two cases consolidated herein,¹ this opinion deals with a relatively simple question of taxation: The extent to which a taxpayer may deduct, through amortization under the Internal Revenue Code of 1939, the premium he has paid in purchasing corporate bonds. In 1953, prior to December 1, the petitioners purchased fully taxable utility bonds at a premium above maturity value.² The bonds were callable at the option of the issuer at either a general or special call price, and at either price they were callable upon 30 days' notice. The term "general call price" is used to designate the price at which the issuer may freely and unconditionally redeem all or any portion of the outstanding bonds from its general funds. The lower, "special call price," is the amount the issuer would pay if the bonds were redeemed with cash from certain specially designated funds.³

¹ We have before us two cases which originated in the Tax Court: *Gourielli v. Commissioner*, 33 T.C. 357, and *Goldfarb v. Commissioner*, 33 T.C. 568. The cases were consolidated on appeal to the Court of Appeals for the Second Circuit, and one opinion was filed by that court. *Estate of Gourielli v. Commissioner*, 289 F. 2d 69. Petitioner Hanover Bank is the executor of the estate of Mr. Gourielli, who passed away since the commencement of this action.

² The bonds involved in the *Gourielli* case were Appalachian Electric Power Company, 1981 series, bonds, which decedent and his wife purchased for \$117.50 per \$100 face value, and which were later sold for \$115.50. The bonds in *Goldfarb* were Arkansas Power & Light Company, 30-year, Eighth Series, bonds, which petitioners purchased at an average price of \$110.50 per \$100 face amount, and which were later sold at an average price of \$105.40. The total purchases in the two cases were \$540,000 (*Gourielli*) and \$500,000 (*Goldfarb*) face amount; the purchase prices were paid in cash in both cases.

³ In addition to a "sinking fund" into which the indenture required Appalachian to deposit during each annual period an amount (in cash or property additions of an equivalent amount) equal to one percent of the bond issue, the special funds in the case of the Appalachian bonds were: (1) a released property and insurance fund, to which deposits were required only upon a loss by casualty or by a release of mortgaged properties securing the bonds; and (2) a maintenance fund, to which deposits were required only when Appalachian failed to expend a stated percentage of its revenues on maintenance or improvements. The special funds in the case of the Arkansas bonds were made up from the same-type contributions as above, plus additions made to an eminent domain fund if and when mortgaged property was taken from the company by eminent domain proceedings.

In computing net income, the 1939 Code permits a taxpayer to deduct, through amortization, the premium he has paid in purchasing corporate bonds.⁴ Section 125 of the Code, set forth in pertinent part in the margin,⁵ provides that the amount of bond premium to be amortized "shall be determined * * * with reference to the amount payable on maturity or on earlier call date." Pursuant to this Section, the petitioners elected to claim on their 1953 income tax returns a deduction for bond premium amortization computed with reference to the special redemption price and to the 30-day redemption period appearing in the bond indentures. The respondent did not question the petitioners' use of the 30-day amortization period, but he disallowed the computation based upon the special redemption price and recomputed the amount of bond premium using the higher, general call price.⁶ The Court of Appeals for the Second Circuit affirmed the Tax Court's orders sustaining the Commissioner's deficiency determination. 289 F. 2d 69. However, in cases presenting the identical legal issue, the Courts of Appeals for the Third (*Evans v. Dudley*, 295 F. 2d 713) and Sixth (*United States v. Parnell*, 272 F. 2d 943, affirming 187 F. Supp. 576) Circuits allowed amortization taken with reference to the special redemption prices.⁷ To resolve this conflict, we granted certiorari. 368 U.S. 812.

⁴ Internal Revenue Code of 1939 (26 U.S.C., 1952 ed.) :

"Section 23. DEDUCTIONS FROM GROSS INCOME.

"In computing net income there shall be allowed as deductions :

* * * * *

"(v) [as added by § 126(a), Revenue Act of 1942, c. 619, 56 Stat. 798] BOND PREMIUM DEDUCTION.—In the case of a bondholder, the deduction for amortizable bond premium provided in section 125."

⁵ This Section was also added by the Revenue Act of 1942, *supra*, note 4, sec. 126(b). Entitled "Amortizable Bond Premium," it reads in pertinent part as follows:

"(a) GENERAL RULE.—In the case of any bond, as defined in subsection (d), the following rules shall apply to the amortizable bond premium (determined under subsection (b)) on the bond for any taxable year beginning after December 31, 1941 :

* * * * *

"(b) AMORTIZABLE BOND PREMIUM.

"(1) AMOUNT OF BOND PREMIUM.—For the purposes of paragraph (2), the amount of bond premium, in the case of the holder of any bond, shall be determined with reference to the amount of the basis (for determining loss on sale or exchange) of such bond, and with reference to the amount payable on maturity or on earlier call date with adjustments proper to reflect unamortized bond premium with respect to the bond, for the period prior to the date as of which subsection (a) becomes applicable with respect to the taxpayer with respect to such bond.

"(2) AMOUNT AMORTIZABLE.—The amortizable bond premium of the taxable year shall be the amount of the bond premium attributable to such year.

"(3) METHOD OF DETERMINATION.—The determinations required under paragraphs (1) and (2) shall be made—

"(A) in accordance with the method of amortizing bond premium regularly employed by the holder of the bond, if such method is reasonable ;

"(B) in all other cases, in accordance with regulations prescribing reasonable methods of amortizing bond premium, prescribed by the Commissioner with the approval of the Secretary."

⁶ At the time of the deduction in *Gourietti*, the schedule appearing in the Appalachian bond indenture provided that the bonds could be redeemed at a general call price of 105% or a special call price of 102%. The petitioners' basis was \$117.50 (see *supra*, note 2) and therefore amortization of premium with reference to the two prices would result in a deduction of \$64,831.07 or \$83,056.07, respectively. The difference in these amounts, \$18,225.00, was the amount disallowed by the respondent. By a similar recomputation with reference to the schedule of redemption prices appearing in the Arkansas bond indenture (105.36 as compared to 101.36), the respondent reduced the deduction in *Goldfarb* by \$27,175.00. The actual tax deficiency in each case was considerably less (\$14,200.92 and \$14,708.16, respectively), of course, because disallowance of the larger premium resulted in a corresponding increase in the petitioners' basis which had been adjusted pursuant to Section 113(b)(1)(H) of the Code when the premium was amortized. This increase in basis resulted in a smaller short-term capital gain (the petitioners held the bonds less than six months) than had been reported by petitioners in their 1953 returns. The decrease in tax due on the capital gain was offset against the amount of amortization disallowed to arrive at the petitioners' actual tax deficiencies in issue here.

⁷ In addition to the Third and Sixth Circuits' cases, the First and Seventh Circuits have also allowed deductions of bond premium amortization taken with reference to special redemption prices. In the First Circuit: *Fabreeka Products Co. v. Commissioner*, 294 F. 2d 876, reversing *Fabreeka Products Co. v. Commissioner*, 34 T.C. 290; *Sherman v. Commissioner*, 34 T.C. 303; and *Friedman v. Commissioner*, 34 T.C. 456. In the Seventh Circuit: *Gallun v. Commissioner*, 297 F. 2d 455, reversing 1960-104 T.C. Memo.; and *Maysteel Products, Inc. v. Commissioner*, 287 F. 2d 429, reversing 33 T.C. 1021. In each of these cases the taxpayer had purchased bonds at a premium, amortized that premium to the special call price, and thereafter made a distribution of the bonds which entailed a double tax deduction (e.g., a gift to charity). In each case the Court of Appeals allowed the double deduction. Although the precise issue presented in the instant case was not expressly decided in these later cases, due to the fact that the Commissioner did not choose to challenge the use of the special call price as against the general call price for determining the amount of the premium, the allowance of the amortization to the special redemption price impliedly places the First and Seventh Circuits in accord with the Third and Sixth Circuits.

Bond premium is the amount a purchaser pays in buying a bond that exceeds the face or call value of the bond.⁸ When a bond sells at a premium, it is generally because the interest it bears exceeds the rate of return on similar securities in the current market. For the right to receive this higher interest rate the purchaser of a bond pays a premium price when making the investment. However, interest is taxable to the recipient, and when a premium has been paid the actual interest received is not a true reflection of the bond's yield, but represents in part a return of the premium paid. It was to give effect to this principle that Congress in 1942 enacted Section 125 of the 1939 Code,⁹ which for the first time provided for amortization of bond premium for tax purposes.

By providing that amortization could be taken with reference to the "amount payable on maturity or on *earlier call date*" (emphasis added), Congress recognized that bonds are generally subject to redemption by the issuer prior to their maturity. In electing to allow amortization with reference to the period the bonds might actually be outstanding, Congress, through the words to which we have lent emphasis, provided that a bondholder could amortize bond premium with reference to any date named in the indenture at which the bond might be called.¹⁰

A bond indenture might contain any number of possible call dates, but we need only to be concerned in this case with the issuer's right to call the bonds on 30 days' notice at either a general or special call price. Unquestionably, both general and special redemption provisions have a legitimate, though distinct, business purpose, and both were in widespread use well before the enactment of Section 125. The general call price is employed when the issuer finds that the current rate of interest on marketable securities is substantially lower than what it is paying on an outstanding issue. The issuer may then call the bonds at the general price and, following redemption, may refinance the obligation at the lower, prevailing rate of interest. In contrast, the provision for special funds from which bonds may be redeemed at the special call price, serves an entirely different purpose. Bond indentures normally require the issuer to protect the underlying security of the bonds by maintaining the mortgaged property and by insuring that its value is not impaired. This is done, first, through the maintenance of a special sinking fund, to which the issuer is obligated to make periodic payments, and, secondly, through the maintenance of other special funds, to which are added the proceeds from a sale or destruction of mortgaged property, or from its loss through a taking by eminent domain.¹¹ Although the issuer nor-

⁸ See the authorities collected in *Commissioner v. Korell*, 339 U.S. 619, 627, n. 10 [Ct. D. 1732, C.B. 1950-2, 44]. The Court in *Korell*, a case also involving an interpretation of Section 125 (see discussion, p. 11, *infra*), concluded (339 U.S., at 627): "We adopt the view that 'bond premium' in § 125 means any extra payment regardless of the reason therefor * * *."

⁹ *Commissioner v. Korell*, 339 U.S. 619, 621. See 1 Hearings before House Committee on Ways and Means on Revenue Revisions of 1942, 77th Cong., 2d Sess. 90 (1942). The House Committee noted the recommendation made in the hearings that the difference between yield and the actual interest rate be treated as a return of capital and not as a capital loss (H.R. Rep. No. 2333, 77th Cong., 2d Sess. 47):

"Under existing law, bond premium is treated as a capital loss sustained by the owner of the bond at the time of disposition or maturity and periodical payments on the bond at the nominal or coupon rate are treated in full as interest. The want of statutory recognition of the sound accounting practice of amortizing premium leads to incorrect tax results which in many instances are so serious that provision should be made for their avoidance."

However, in rejecting the Government's argument in *Korell*, *supra*, that Congress intended to confine the deduction only to premium paid for a higher-than-market interest rate, the Court stated (339 U.S., at 626-627):

"At most, [the Commissioner's] presentation of the legislative materials suggests that Congress may have had the bondholder who was seeking a higher interest rate primarily in mind; but it does not establish that Congress in fact legislated with reference to him exclusively. [Citation omitted.] Congress, and the Treasury in advising Congress, may well have concluded that the best manner of affording him relief and correcting the inequitable treatment of bondholders whose interest receipts were taxable, was to define the scope of the amendment by reference to types of bonds rather than causes of premium payment."

¹⁰ Congress' intent in this regard was expressly noted by the respondent in enacting Treas. Reg. 118, § 39.125(b)-2:

"*Callable and Convertible Bonds.* (a) The fact that a bond is callable * * * does not, in itself, prevent the application of section 125 * * *. The earlier call date may be the earliest call date specified in the bond as a day certain, the earliest interest payment date if the bond is callable at such date, the earliest date at which the bond is callable at par, or such other call date, prior to maturity, specified in the bond as may be selected by the taxpayer * * *."

¹¹ See generally *Evans v. Dudley*, 295 F. 2d 713, 715; *Estate of Gourielli v. Commissioner*, 289 F. 2d 69, 73; *Parnell v. United States*, 187 F. Supp. 576, 577, aff'd, 272 F. 2d 943. See also Badger, *Investment Principles and Practices* (5th ed. 1961), 46-47, 114-115, 129; I Dewing, *Financial Policy of Corporations* (5th ed. 1953), 186-188, 247-249.

mally reserves an alternative to maintaining these special funds with cash, circumstances may dictate that the only attractive option from a business standpoint is the payment of cash and, to prevent the accumulation of this idle money, the indenture provides that the issuer may use it to redeem outstanding bonds at a special call price. It is evident that just as prevailing market conditions may render redemption at the special call price unlikely at a given time, the same or different market conditions may also cause redemption at the general call price equally unlikely,¹² particularly in an expanding industry such as utilities. During the period the petitioners held their bonds, none were called at either price, but the risk incurred that they would be called was present with equal force as to both the general and special call provisions. The market for bonds reflects that risk, and the Section of the Code we are asked to interpret takes cognizance of that market reality.

Turning to the specific problem in the instant case, we are asked to determine whether the special price at which the bonds may be redeemed by the issuer from the limited sinking fund account and from the other special funds made available upon the occurrence of certain contingent events (see note 3, *supra*) is an "amount payable * * * on earlier call date" within the meaning of Section 125. For the reasons stated below, we answer this question affirmatively and hold that there is no basis either in the statute, in the legislative history, or in the respondent's own prior interpretations of the statute, for a distinction between reference to a general or special call price in computing amortizable bond premiums under the 1939 Code.

First, we note that the Government has made certain important concessions which lighten considerably the task before us. It does not question the right of the petitioners to amortize bond premium with reference to the 30-day call period, nor does it question amortization to the general call price.¹³ In addition, in requesting a rule which will apply to the "generality of cases,"¹⁴ it professes to have abandoned its argument below which became the rationale of the Second Circuit in holding against the taxpayers, that the statute calls for an analysis into the "likelihood of redemption" before amortization at a special call price will be permitted.¹⁵ Moreover, the Government does not contend that the transactions entered into by the petitioners were a sham without any business

¹² Hence, the occurrence of a redemption at the general call price is dependent upon one set of events—the fluctuation in the interest market; the occurrence of a redemption at the special call price is dependent upon another set of events—deposits in the sinking fund by the issuer over one or more years, takings by governmental agencies through eminent domain, destruction of the property securing the bonds, etc. In either case, the events could happen. In fact, the petitioners point out in their brief here that in recent years more bonds have been called at the special redemption price than at the general price. See also *Evans v. Dudley*, 295 F. 2d 713, 716.

¹³ Allowing a 30-day amortization period is in accord with the decision of the Court in *Korell* where, although the point was not argued by the Government, the taxpayer had amortized the premium with reference to the 30-day period provided in the indenture. In its brief in the instant case the Government states:

"* * * [W]e concede that it is now too late to challenge the amortization of the premium on bonds subject to an unlimited right of redemption on 30 days' notice. Not only has the consistent administrative practice, culminating in a published ruling, been to allow such amortization, but Congress, in narrowing such deductions in the 1954 Code and prohibiting them entirely after 1957, expressly acknowledged that the prior law permitted that treatment. * * * Accordingly, we did not challenge in the lower courts and do not challenge here petitioners' right to amortization of the premium on the basis of the general right of the issuer to redeem the bonds at any time upon 30 days' notice."

See also Int. Rev. Rul. 56-398, 1956-2 Cum. Bull. 984, where the respondent, in a published ruling, acquiesced in a 30-day amortization period under the 1939 Code.

¹⁴ This concession also conforms to the pronouncement in *Korell* (339 U.S., at 625): "Congress was legislating for the generality of cases." See also *Evans v. Dudley*, 295 F. 2d 713, 716; *Parnell v. United States*, 187 F. Supp. 576, 579, aff'd, 272 F. 2d 943.

¹⁵ The Court of Appeals for the Second Circuit stated (289 F. 2d 69, 74): "We do not think that * * * in § 125 of the Code * * * [Congress] meant to include an amount payable on a call at a 'special' price of which there was no real possibility during the period for which the amortization is being taken and the deduction claimed." And (289 F. 2d, at 72): "* * * [T]he hazard that any significant number of petitioners' bonds would be called during [the] period was infinitesimal." In so holding, the Court accepted the Government's argument below that "[t]he taxpayer is not entitled to compute his amortizable bond premium deduction * * * with reference to the 'special' call price * * * because * * * such a call was so contingent and unlikely that there was no realistic call date at the 'special' call price. * * *"

In contrast, the Government states in its brief here: "* * * [O]ur position is not dependent upon the particular market conditions or the actual probabilities that a right of redemption will be exercised. * * * [W]e agree with petitioners that the question should * * * not be dependent upon a finding in each case of the actual 'likelihood' that any particular redemption right will be exercised." As to the futility in attempting to apply a "likelihood of redemption" standard, see note 12, *supra*.

purpose except to gain a tax advantage.¹⁶ Rather, the Government's position in this Court is that before an "earlier call date" is established with reference to the special call price, the taxpayer must show that "there is an ascertainable date on which the issuer will become entitled to redeem [a particular] bond at its option." The Government asserts that it is not enough that the issuer has the right to call some bonds at the special redemption price. Rather, "[i]t must have the right to call the particular bond for which amortization is claimed, for otherwise *that* bond has no 'earlier call date.'" The Government's primary reason for urging this interpretation of Section 125 is that the statute has created a tax loophole of major dimension that should be closed short of allowing the deduction sought in this case. While this assertion might have been persuasive in securing enactment of the amendments to the statute made subsequent to the time the transactions involved here took place (see discussion, *infra*), it may not, of course, have any impact upon our interpretation of the statute under review. We are bound by the meaning of the words used by Congress, taken in light of the pertinent legislative history. In neither do we find support for the Government's interpretation.

This Court was first called upon to construe Section 125 in 1950 in *Commissioner v. Korell*, 339 U.S. 619 [Ct. D. 1732, C.B. 1950-2, 44]. The taxpayer there had purchased bonds at a premium which reflected in large part not a higher yield of interest, but rather, the attractiveness of the convertible feature of the bonds. The bonds were callable on 30 days' notice and the taxpayer amortized the premium accordingly. In contesting the deduction thus taken the Commissioner contended that Section 125, in establishing a deduction for "amortizable bond premium," did not include premium paid for the conversion privilege. In rejecting this contention, the Court made it clear that Section 125 was not enacted solely to enable a bondholder to amortize "true premium," but that by "the clear and precise avenue of expression actually adopted by the Congress" (339 U.S., at 625), the legislation was adopted with "no distinctions based upon the inducements for paying the premium." (*Id.*, at 628.)

The decision in *Korell* led to congressional re-examination of Section 125, and the enactment of Section 217 (a) of the Revenue Act of 1950 (64 Stat. 906), which eliminated amortization of bond premiums attributable to a conversion feature. However, response to the *Korell* decision was specifically limited to the convertible bond situation; no further change was made in the statute which would reflect on its interpretation in the case before us.¹⁷

In 1954, in enacting the successor to Section 125, Section 171 of the Internal Revenue Code of 1954 (26 U.S.C. 1954 ed.), Congress again took cognizance of the tax benefit in question, and determined to eliminate the abuses inherent in permitting amortization with reference to 30-day call periods. Thus Congress further narrowed the loophole by providing that the premium on callable bonds could be amortized to the nearest call date only if such date was more than three years from the date of the original issue of the securities. With particular relevance to the Government's argument in the instant case, it is worthy of note that Congress understood the operation of the statute to the taxpayer's advantage, but limited correction of the abuses inherent in it to elimination of the quick write-off. The House Report accompanying H.R. 8300, which was to become the Internal Revenue Code of 1954, stated (H.R. Rep. No. 1337, 83d Cong., 2d Sess. 26):

"Under existing law, a bond premium may be amortized with reference to the amount payable on maturity or on earlier call date, at the election of the taxpayer. In the case of bonds with a very short call feature, such as those providing for call at any time on 30-day notice, the entire premium may be deducted in the year of purchase.

¹⁶ Cf. *Knetsch v. Commissioner*, 364 U.S. 361 [Ct. D. 1858, C.B. 1961-1, 34]; *Gregory v. Helvering*, 293 U.S. 465 [Ct. D. 911, C.B. XIV-1, 193 (1935)].

¹⁷ The legislation simply provided:

"In no case shall the amount of bond premium of a convertible bond include any amount attributable to the conversion features of the bond."

Where, as in the case before us, a question of interpretation of Section 125 is presented lying outside the scope of the 1950 Amendment, *Korell* retains its full vitality. Thus, it is worth noting that the Government's "right to call" approach advocated in the case at bar would result in a *sub silentio* overruling of *Korell* to the extent that in the latter case the right of the bondholder to exercise his conversion option at any time through the expiration of the notice period of a call defeated completely the issuer's "right" to call and redeem even a single bond. In the instant case, however, neither party disputes the fact that at least some of the bonds could have been called at the special price and that if the issuer exercised his right so to call them the bondholder would have had no choice but to turn over the bonds and forfeit the premium paid for them.

"This provision has given rise to the tax-avoidance opportunities. Substantial bond issues have been made subject to a 30-day call, permitting the purchaser to take an immediate deduction for the entire premium against ordinary income. *When the call feature is nominal or inoperative*, this permits a deduction for an unreal loss, since the market value of the bonds ordinarily remains fairly stable over considerable periods. The bonds may then be resold after 6 months subject to long-term capital gain treatment. The write off of premium thus affords a gratuitous tax saving, equivalent to the conversion of a corresponding amount of ordinary income into capital gain. This process may be repeated indefinitely.

"To curb this type of abuse, your Committee's bill provides that the premium on callable bonds may be amortized to the nearest call date only if such date is more than 3 years from the date of original issue of the securities. *This provision will apply only to bonds issued after January 22, 1951, and acquired after January 22, 1954.*" (Emphasis added.)

Not only did Congress fail to make the distinction between general and special call provisions urged by the respondent, but it expressly recognized that deductions could be taken under Section 125 with reference to a call date that was "nominal or inoperative." It did not remotely imply that a showing of a right to call all or any part of the outstanding bonds was necessary for operation of the statute. Furthermore, the change that it did adopt was to operate prospectively only.

Finally, in 1958, by adoption of Section 13 of the Technical Amendments Act of 1958, 72 Stat. 1610 [C.B. 1958-3, 254], Congress eliminated entirely the right to amortize to call date, permitting amortization to be taken only over the period to maturity.¹⁸ Again, the legislative change was prospective only and again no distinction was made with respect to general and special call dates or with respect to a right to call all or a part of the outstanding bonds.

Persuasive evidence that we are correct in our interpretation of Section 125, as bolstered by its legislative history and subsequent amendments, may be found in the respondent's own prior construction of the statute. As is true with the language of the statute itself, the respondent's regulations contained not the slightest hint of the distinction urged upon us here. The Commissioner defined "earlier call date" in Treas. Reg. 118, Section 39.125(b)-2 (see note 10, *supra*) as any call date, prior to maturity, specified in the bond. The regulations in effect in 1953 give no support to the Government's present contention that the taxpayer must show an unconditional right in the issuer to call the outstanding bonds at a particular redemption price before amortization with reference to that price would be permitted. Furthermore, although the petitioners are not entitled to rely upon unpublished private rulings which were not issued specifically to them,¹⁹ such rulings do reveal the interpretation put upon the statute by the agency charged with the responsibility of administering the revenue laws. And, because the Commissioner ruled, in letters addressed to taxpayers requesting them, that amortization with reference to a special call price was proper under the statute,²⁰ we have further evidence that our construction of allowable bond premium amortization is compelled by the language of the statute.²¹

¹⁸ The 1958 Amendment literally permits amortization to an earlier call date but only if it results in a smaller amortization deduction than would amortization to maturity, which, for all practical purposes, effectively eliminates the privilege of calling to an earlier call date.

¹⁹ See, e.g., *Commissioner v. P. G. Lake, Inc.*, 356 U.S. 260, 265-266, n. 5 [Ct. D. 1823, C.B. 1958-1, 516]; *Automobile Club v. Commissioner*, 353 U.S. 180 [Ct. D. 1807, C.B. 1957-1, 513]; *Helvering v. New York Trust Co.*, 292 U.S. 455, 467-468 [Ct. D. 840, C.B. XIII-1, 188 (1934)].

²⁰ For example, the record in the instant case contains a copy of the following letter to a taxpayer from the respondent's office (we quote the relevant portion):

"Gentlemen:

* * * * *

"The Appalachian Electric Power Company 3% bonds, 1981 Series, are callable in whole or in part through May of 1953 at 105%. They are also callable for sinking fund through funds derived from maintenance or sale of property at any time upon thirty days notice through May 31, 1954, at 102%. You request to be advised whether the above-mentioned ruling of July 30, 1952, means that such bonds may be amortized down to 102% or whether it means that they can only be amortized down to 105% through May of 1953.

"Upon the basis of the information on file in this office, it is the opinion of this office that a taxpayer electing to amortize the premium on Appalachian Electric Power Company bonds in accordance with section 125 of the Code may use the regular redemption price of 105% or the special redemption price of 102%.

"Very truly yours, [etc.] * * *

²¹ In 1956, three years after the deductions in the present case were taken, the Commissioner—reversing the position he had previously and uniformly adhered to in a series

A firmly established principle of statutory interpretation is that "the words of statutes—including revenue acts—should be interpreted where possible in their ordinary, everyday senses." *Crane v. Commissioner*, 331 U.S. 1, 6 [Ct. D. 1684, C.B. 1947-1, 97].²² The statute in issue here, in plain and ordinary language, evidences a clear congressional intent to allow amortization with reference to any call date named in the indenture. Under such circumstances we are not at liberty, notwithstanding the apparent tax-saving windfall bestowed upon taxpayers, to add to or alter the words employed to effect a purpose which does not appear on the face of the statute. Moreover, the legislative history, too, is persuasive evidence that the statute, as it appeared in 1953 when these deductions were taken, allowed the deduction refused these taxpayers. Simply stated, an informed Congress enacted Section 125 with full realization of the existence and operation of special call provisions, but chose not to make any distinction between them and general redemption rights. Neither did the Commissioner. Nevertheless, the Government now urges this Court to do what the legislative branch of the Government failed or elected not to do. This, of course, is not within our province.²³

The judgments are reversed.

MR. JUSTICE FRANKFURTER took no part in the decision of this case.

MR. JUSTICE WHITE took no part in the consideration or decision of this case.

CHAPTER 36.—COLLECTION

SUBCHAPTER B.—LIEN FOR TAXES

SECTION 3670.—PROPERTY SUBJECT TO LIEN

Whether Federal tax penalties can be recovered against the estate of a bankrupt where the penalties constitute liens perfected before bankruptcy. See Ct. D. 1867, page 302.

SECTION 3672.—VALIDITY AGAINST MORTGAGEES, PLEDGEEs, PURCHASERS, AND JUDGMENT CREDITORS

(Also Part I, Section 6323; 26 CFR 301.6323-1.)

Ct. D. 1869

INCOME TAX—INTERNAL REVENUE CODE OF 1939—DECISION OF COURT

1. LIENS—VALIDITY AGAINST MORTGAGEE—NOTICE FILED IN U.S. DISTRICT COURT WHERE STATE LAW REQUIRED DESCRIPTION OF LAND AS CONDITION TO FILING.

A notice of lien for Federal income taxes which was filed in the office of the clerk of the United States district court for the judicial district in which real property belonging to taxpayer was situated

of private rulings—for the first time announced that amortization of bond premium under Section 125 of the 1939 Code was to be limited to premium in excess of a general call price and could not include premium in excess of a lower special call price, except where an actual call was made at the latter price. Int. Rev. Rul. 56-398, 1956-2 Cum. Bull. 984.

²² See also *Korell v. Commissioner*, 339 U.S. 619, 627-628, 1956-2 Cum. Bull. 984, 289 U.S. 109, 111 [Ct. D. 662, C.B. XII-1, 171 (1933)]; *Old Colony R. Co. v. Commissioner*, 284 U.S. 552, 560 [Ct. D. 456, C.B. XI-1, 274 (1932)].

²³ We believe the Court of Appeals for the First Circuit was correct when it said in *Fabreeka Products Co. v. Commissioner*, 294 F. 2d 876, 879: "Granting the government's proposition that these taxpayers have found a hole in the dike, we believe it one that calls for the application of the Congressional thumb, not the court's." See also *Evans v. Dudley*, 295 F. 2d 713, 715, where the Third Circuit quotes this language from Judge Aldrich's opinion in *Fabreeka Products*.

was effective to make the tax lien superior to the rights of a mortgagee to the property, where (1) the notice of lien was filed in the United States district court before the mortgage was executed and (2) the registrar of deeds for the county in which the property was located was authorized by Michigan law to accept for recording only those notices of Federal tax lien which contained a description of the land upon which the lien was claimed. A state law which imposes a condition regarding form or content of a notice of Federal tax lien, as here, fails to authorize a state office for filing within the meaning of section 3672(a)(1) of the Internal Revenue Code of 1939.

2. JUDGMENT REVERSED.

Judgment of the Michigan Supreme Court, 361 Mich. 283, 105 N.W. (2d) 196 (1960), reversed.

SUPREME COURT OF THE UNITED STATES

No. 52.—October Term, 1961

United States, petitioner, v. Union Central Life Insurance Company

On writ of certiorari to the Supreme Court of Michigan

[December 18, 1961.]

MR. JUSTICE BLACK delivered the opinion of the Court.

Robert G. Peters, Jr., and his wife, of Oakland County, Michigan, failed to pay their 1952 federal income taxes. In January 1954 an assessment for this delinquency was filed in the Internal Revenue Collector's Office at Detroit, Michigan, at which time a lien arose "in favor of the United States upon all property" of the two delinquent taxpayers.¹ Some 10 months after the Government's tax lien arose, the Peters executed a mortgage on real property they owned in Oakland County to secure an indebtedness to the respondent Union Central Life Insurance Company. The Peters defaulted in payment of the mortgage, and Union Central filed this action to foreclose in the Circuit Court of Oakland County, joining the United States as a party defendant because of its asserted lien.

The company claimed priority for its mortgage over the earlier created federal lien because no notice of the federal lien had been filed with the registrar of deeds in Oakland County as then required by Michigan law.² For this alleged priority the company relied on section 3672(a)(1) of the 1939 Internal Revenue Code providing that a federal tax lien shall not be valid as against any mortgagee until notice has been filed "In the office in which the filing of such notice is authorized by the law of the State or Territory in which the property subject to the lien is situated, whenever the State or Territory has by law authorized the filing of such notice in an office within the State or Territory." The Government, however, claimed that Michigan had not "authorized" filing within the meaning of the statute and that the case should be governed by section 3672(a)(2) which provides that "whenever the State * * * has not by law authorized the filing of such notice in an office within the State," the notice may be filed in "the office of the clerk of the United States district court for the judicial district in which the property subject to the lien is situated." Since the federal lien had been filed in the District Court months before the mortgage was executed and filed in the county register of deed's office, the Government claimed that its lien had priority. The Government's contention that Michigan had not "authorized" a state office for filing the federal tax notice was based on the fact that the Michigan law purporting to authorize such filing expressly required that a federal tax lien notice contain "a description of the land upon which a lien is claimed," even though the form long used for filing federal tax lien notices in the District Courts throughout the United States does not contain a description of any particular property upon which the lien is asserted. In support of its contention the Government pointed to the fact that in 1953 the Michigan Attorney General ruled that federal tax lien notices not containing such a description are

¹ Sections 3670 and 3671 of the Internal Revenue Code of 1939, in effect at that time.

² Act 104, Public Acts of Michigan of 1923, repealed August 13, 1956, by Act 107, Public Acts of Michigan of 1956.

not entitled to recordation, and it is stipulated that from the time of that ruling, up to 1956,³ "it was the policy of the office of the Register of Deeds for said County of Oakland not to accept for recording notices of Federal tax liens which did not contain a legal description of any land."

Because the United States had not filed a notice complying with the Michigan law, the Michigan Circuit and Supreme Courts held the federal lien to be subordinate to the mortgage, 361 Mich. 283, 105 N.W. 2d 196. While this holding is in accord with *Youngblood v. United States*, 141 F. 2d 912 (C.A. 6th Cir.), it conflicts with *United States v. Rasmuson*, 253 F. 2d 944 (C.A. 8th Cir.). In order to settle this conflict and because of the importance of the question in the administration of the revenue laws, we granted certiorari. 365 U.S. 858.

The Michigan requirement that notice of the federal tax lien be filed in Michigan is, of course, not controlling unless Congress has made it so, for the subject of federal taxes, including "remedies for their collection, has always been conceded to be independent of the legislative action of the States." *United States v. Snyder*, 149 U.S. 210, 214. While section 3672(a) (1) unquestionably requires notice of a federal lien to be filed in a state office when the State authoritatively designates an office for that purpose, the section does not purport to permit the State to prescribe the form or the contents of that notice. Since such an authorization might well result in radically differing forms of federal tax notices for the various States, it would run counter to the principle of uniformity which has long been the accepted practice in the field of federal taxation. Moreover, a required compliance with Michigan law would mean that the federal tax lien would be superior to all those entitled to notice only as to the property described in the notice even though § 3670 broadly creates a lien "upon all property and rights to property, whether real or personal, belonging to" a taxpayer. This language has been held to include in the lien all property owned by the delinquent taxpayer both at the time the lien arises and thereafter until it is paid.⁴ It seems obvious that this expansive protection for the Government would be greatly reduced if to enforce it government agents were compelled to keep aware at all times of all property coming into the hands of its tax delinquents. Imposition of such a task by the Michigan law could seriously cripple the Government in the collection of its taxes, and to attribute to Congress a purpose so to weaken the tax liens it has created would require very clear language. The history of § 3672 belies any such congressional purpose.

In 1893 this Court decided in *United States v. Snyder*, 149 U.S. 210, that the federal tax lien could be enforced against bona fide purchasers who had no notice of the lien, despite a state law attempting to defeat the lien unless it has been recorded. In order to grant relief from the *Snyder* rule, Congress in 1913 passed an Act requiring, much as the 1939 Revenue Code did, that the tax liens should not be "valid as against any mortgagee, purchaser, or judgment creditor" until notice was filed with the clerk of an appropriate District Court or, whenever a State authorized such filing, in the office of a county recorder of deeds.⁵ This statute was amended in 1928 by adding that the lien would not be valid until notice was filed "in accordance with the law of the State or Territory in which the property subject to the lien is situated, whenever the State or Territory has by law provided for the filing of such notice * * *." (Emphasis supplied.) Following this in *United States v. Maniaci*, 36 F. Supp. 293, aff'd, 116 F. 2d 935, both a United States District Court and a Court of Appeals refused to enforce a federal tax lien on Michigan property because the notice of lien, although filed both in a District Court and in the office of the proper Michigan register of deeds, did not contain the description of the property required by Michigan law. In this holding emphasis was placed on the clause added in 1928, requiring notice to be filed "in accordance with the law of the State or Territory in which the property subject to the lien is situated * * *."

Less than two years after the *Maniaci* holding Congress again amended the lien notice provisions, struck out "in accordance with the law of the State or Territory" and substituted the language in the section here controlling that notice was not valid until filed "In the office in which the filing of such notice is authorized by the law of the State or Territory."⁷ The reports of the House

³ Act 104 was repealed August 13, 1956.

⁴ *Glass City Bank v. United States*, 326 U.S. 265. [Ct. D. 1651, C.B. 1945, 330].

⁵ 37 Stat. 1016.

⁶ 45 Stat. 876.

⁷ 56 Stat. 957, sec. 3672(a) (1) of the Internal Revenue Code of 1939, as amended [C.B. 1942-2,498].

and Senate Committees reporting this amendment point strongly to a purpose to get away from the ruling in the *Maniaci* case and make it clear, that while notice of a federal lien must be filed in a state office where authorized by a State, the notice is sufficient if given in the form long used by the Department "without regard to other general requirements with respect to recording prescribed by the law of such State or Territory."⁸ The Department never accepted the *Maniaci* case and its practice has been to use forms which do not contain a particular description of any property owned by a delinquent taxpayer. The notice provisions were once more amended in the 1954 Code, this time providing that the notice shall be valid if in the Department form "notwithstanding any law of the State or Territory regarding the form or content of a notice of lien."⁹ The House Report stated that this amendment was merely "declaratory of the existing procedure and in accordance with the long-continued practice of the Treasury Department."¹⁰

The Michigan law authorizing filing only if a description of the property was given placed obstacles to the enforcement of federal tax liens that Congress had not permitted, and consequently no state office was "authorized" for filing within the meaning of the federal statute. It was therefore error for the Michigan courts to fail to give priority to the Government's lien here, notice of which had been filed in the District Court in accordance with federal law.

The judgment of the Michigan Supreme Court is reversed and the cause is remanded to that court for proceedings not inconsistent with this opinion.

Reversed and remanded.

MR. JUSTICE DOUGLAS dissents.

⁸ H.R. Rep. No. 2333, 77th Cong., 2d Sess. 173. See also S. Rep. No. 1631, 77th Cong., 2d Sess. 248. [C.B. 1942-2,686].

⁹ Section 6323(b) of the Internal Revenue Code of 1954.

¹⁰ H.R. Rep. No. 1337, 83d Cong., 2d Sess. A-406 to A-407.

SUBPART B.—RULINGS AND DECISIONS UNDER OTHER PUBLIC LAWS

Rulings and decisions published in Part II, Subpart B, of the Internal Revenue Bulletin are based on the application of provisions of other public laws on internal revenue matters, except those relating to the various alcohol taxes, which appear in Part III.

DEALER RESERVE INCOME ADJUSTMENT ACT OF 1960

26 CFR 1.9002-1: Purpose, applicability Rev. Rul. 62-22
and definitions.

(Also Part I, Sections 6651, 6653;
301.6651-1, 301.6653.1.)

If a taxpayer is subject to a penalty under either section 6651 or 6653 of the Internal Revenue Code of 1954 for a prior taxable year or years and, as the result of the taxpayer's election under section 4(a) of the Dealer Reserve Income Adjustment Act of 1960, additional tax is determined to be due for such prior taxable year or years, the provisions of section 6651 or 6653, whichever is applicable, will also be imposed upon the tax due by reason of the section 4(a) election.

However, a deficiency arising solely by reason of the application of the provisions of section 4(a) of the Act will not of itself give rise to the imposition of any of the penalties described in sections 6651 and 6653 of the Code.

Advice has been requested whether the provisions of sections 6651 and 6653 of the Internal Revenue Code of 1954, relating respectively to additions to tax imposed for delinquent filing of returns and to additions to tax imposed for failure to pay tax, are applicable to increases in tax arising by reason of an election under section 4(a) of the Dealer Reserve Income Adjustment Act of 1960, Public Law 86-459, C.B. 1960-1, 795.

The Dealer Reserve Income Adjustment Act of 1960 provided eligible taxpayers, who elected to have its provisions apply, with two alternatives for accounting for the adjustments to income resulting from a change to a proper method of reporting dealer reserve income.

Under section 3(a) of the Act, a taxpayer could elect to have such change treated as a change in method of accounting not initiated by the taxpayer to which the provisions of section 481 of the Code applied. If an election was made under section 3(a) of the Act, any necessary adjustments required by section 481 of the Code were taken into account only in the year of change. Thus, there would be no additions to tax for prior years on the basis of an increase resulting from an election under section 3(a) of the Act.

However, under section 4(a) of the Act, a taxpayer could elect to have the change treated as not to be a change in method of accounting to which the provisions of section 481 of the Code applied. If such an election was made, the taxpayer was required to redetermine separately the tax for each year affected by the election by taking into account adjustments needed to reflect the change to proper treatment

of dealer reserve income and to file amended income tax returns reflecting the increase or decrease in tax attributable to the election for each of such years.

Section 6651 of the Code imposes additions to tax for failure to file a return on the date prescribed where there is no reasonable cause for delay. The penalty is computed on the net amount of tax due, *i.e.*, the amount required to be shown on the return as tax less tax paid and applicable credits. Thus, the penalty is imposed, not only on the net tax due as shown on the return when delinquent filed, but also on any deficiency subsequently determined.

Section 6653 of the Code imposes both negligence and fraud penalties for failure to pay tax. The penalties are for wilfulness, fraud or negligence amounting to wilfulness and are founded upon the existence of an underpayment of tax. Section 301.6653-1(c)(1)(i) of the Regulations on Procedure and Administration provides, in part, that an "underpayment" is "The total amount of all deficiencies as defined in section 6211, if a return was filed on or before the last date (determined with regard to any extension of time) prescribed for filing such return, * * *."

The Dealer Reserve Income Adjustment Act of 1960 recognizes that reasonable cause normally existed for the failure of a taxpayer to include "dealer reserve income" in income of earlier years. See Senate Report No. 1045, Eighty-sixth Congress, C.B. 1960-1, 286, at 827 and 828.

Accordingly, it is held that if a penalty is imposed on a taxpayer under section 6651 of the Code for a prior year or years for failure to file his return at the time prescribed and additional tax is determined to be due for such year or years by reason of an election under section 4(a) of the Act, the penalty prescribed by section 6651 would also be imposed upon this deficiency since that penalty is computed on the net amount due on the return. Similarly, if a penalty is applicable under section 6653 of the Code for a prior year or years for failure to pay tax, or for underpayment of tax, and additional tax is determined to be due for such year or years by reason of an election under section 4(a) of the Act, the penalties prescribed by section 6653 would also be imposed upon this deficiency since the penalty is computed on the total amount of all deficiencies. See, for example, Rev. Rul. 60-215, C.B. 1960-1, 642.

However, a deficiency arising solely by reason of the application of the provisions of section 4(a) of the Act will not of itself give rise to the imposition of any of the penalties described in sections 6651 and 6653 of the Code.

SECTION 2.—DEALER RESERVE INCOME ADJUSTMENT ACT OF 1960

26 CFR 1.9002-1: Purpose, applicability,
and definitions.

Rev. Rul. 62-30

A taxpayer who, after June 22, 1959, filed an amended Federal income tax return for the taxable year ending December 31, 1958, which corrected his method of reporting dealer reserve income for "his most recent taxable year," is not thereby precluded from making a valid election under section 4 of the subsequently enacted

Dealer Reserve Income Adjustment Act of 1960 with respect to taxable years 1956 and 1957.

Advice has been requested whether a taxpayer who filed an amended Federal income tax return for the taxable year ended December 31, 1958, after June 22, 1959, the date of the decision in *Commissioner v. John R. Hansen, et ux.*, 360 U.S. 446, Ct.D. 1838, C.B. 1959-2, 460, correcting his method of reporting dealer reserve income for "his most recent taxable year," is thereby precluded from making a valid election under section 4 of the subsequently enacted Dealer Reserve Income Adjustment Act of 1960, 74 Stat. 124, C.B. 1960-1, 795.

The taxpayer files his Federal income tax returns on a calendar-year basis and computes his taxable income on the accrual method of accounting, except for the taxable year 1958 and prior years, when the taxpayer reported dealer reserve income when it was actually received.

On June 22, 1959, the Supreme Court of the United States, in the case of *John R. Hansen, et ux.*, held that amounts retained by finance companies and credited to the reserve accounts of dealers constitute "income to these accrual basis dealers at the time the withheld amounts were entered on the books of the finance companies as liabilities to the dealers."

On December 7, 1959, the taxpayer filed an amended 1958 tax return and reported the dealer reserve income under the proper method.

On May 13, 1960, the Dealer Reserve Income Adjustment Act of 1960 (hereafter referred to as the Act) was approved. Among other things, the Act provides for installment payment privileges for deficiencies resulting from the change in reporting dealer reserve income for persons to whom the Act applies.

The taxpayer in the instant case filed a timely statement, intended as an election under section 4 of the Act, requesting installment payment privileges with respect to tax deficiencies, plus interest, for the taxable years 1956 and 1957.

Section 2 of the Act provides, in part, as follows:

This Act shall apply to any person who, for his most recent taxable year ending on or before June 22, 1959—

* * * * *

(2) treated any dealer reserve income, which should have been taken into account (under the accrual method of accounting) for such taxable year, as accruable for a subsequent taxable year, * * *

Section 1.9002-1(b) of the Income Tax Regulations provides, in part, that, in order to be eligible to make any of the elections provided by the Act, a taxpayer must have, for his most recent taxable year ending on or before June 22, 1959, treated dealer reserve income which should have been taken into account (under the accrual method of accounting) for such most recent taxable year as accruable for a subsequent taxable year. Thus, the elections provided by the Act are not available to a person who, for his most recent taxable year ending on or before June 22, 1959, reported dealer reserve income under a method proper under the accrual method of accounting.

The specific issue involved is whether the filing of an amended return after the *Hansen* decision, which corrected the method of re-

porting dealer reserve income for the "most recent taxable year," means that the taxpayer "treated" his dealer reserve income on a proper accrual method "for his most recent taxable year ending on or before June 22, 1959."

The Act was prompted by the decision in the *John R. Hansen* case, the effect of which would, but for the Act, require all dealers to make a transition to the proper method of reporting dealer reserve income in one taxable year. The "bunching" of dealer reserve income in one year, as a result of that decision, would have worked a hardship on those dealers who, prior thereto, relied on the many lower court decisions which held that the reserves were not accruable until the year of the withdrawal of the reserve. See S. Report No. 1045, Eighty-Sixth Congress, C.B. 1960-1, 826, and 827.

In view of the foregoing, it is clear that the Act was prompted by the *Hansen* decision and is directed at taxpayers' treatment of dealer reserve income prior to the date of such decision.

Accordingly, it is held that the taxpayer is not precluded from making a valid election under section 4 of the Act by reason of having filed an amended Federal income tax return for the taxable year ended December 31, 1958, resulting in the correction of his method of reporting dealer reserve income.

ACT OF SEPTEMBER 26, 1961 (PUBLIC LAW 87-321)

26 CFR 1.9005: Statutory provisions; section 2
of the Act of September 26, 1961 (Public
Law 87-321, 75 Stat. 683).

T. D. 6583 ¹

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

Regulations under section 2 of the Act of September 26, 1961
(Public Law 87-321, 75 Stat. 683).

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

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

On November 2, 1961, notice of proposed rulemaking with respect to the regulations under section 2 of the Act of September 26, 1961 (Public Law 87-321, 75 Stat. 683 [C.B. 1961-2, 341]), relating to the election for prior taxable years in the case of quartzite and clay used in the production of refractory products, was published in the Federal Register (26 F.R. 10283). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the following regulations are hereby adopted:

¹ The publication of this Treasury Decision in 26 F.R. 12077, dated December 16, 1961, contains (1) instructions for modifying the notice of proposed rulemaking published in 26 F.R. 10283, dated November 2, 1961, and (2) the full context of the regulations with such modifications. As here published, the Treasury Decision reflects the full context of such regulations, with modifications. The individual instructions have been omitted.

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§ 1.9005 STATUTORY PROVISIONS; SECTION 2 OF THE ACT OF SEPTEMBER 26, 1961 (PUBLIC LAW 87-321, 75 STAT. 683).

SEC. 2. ELECTION FOR QUARTZITE AND CLAY USED IN THE PRODUCTION OF REFRACTORY PRODUCTS.

(a) **ELECTION FOR PAST YEARS.**—If an election is made under subsection (c), in the case of quartzite and clay used by the mine owner or operator in the production of refractory products, for the purpose of applying section 613(c) of the Internal Revenue Code of 1954 (and corresponding provisions of the Internal Revenue Code of 1939) for each of the taxable years with respect to which the election is effective—

(1) The term "ordinary treatment processes" shall include crushing, grinding, and separating the mineral from waste, but shall not include any subsequent process; and

(2) The gross income from mining for each short ton of such quartzite or clay used in the production of all refractory products sold during the taxable year shall be equal to 87½ percent of the lesser of—

(A) The average lowest published or advertised price, or

(B) The average lowest actual selling price,

at which, during the taxable year, the mine owner or operator offered to sell, or sold, such quartzite or clay (in the form and condition of such products after the application of only the processes described in paragraph (1) and before transportation from the plant in which such processes were applied). For purposes of this paragraph, exceptional, unusual, or nominal sales or selling prices shall be disregarded. If the mine owner or operator makes no sales of, or makes only exceptional, unusual, or nominal sales of, such quartzite or clay after application of only the processes described in paragraph (1), then in lieu of the price provided for in subparagraph (A) or (B) there shall be used the average lowest recognized selling price for the taxable year for such quartzite or clay in the marketing area of the mine owner or operator published in a trade journal or other industry publication.

(b) **YEARS TO WHICH APPLICABLE.**—An election made under subsection (c) to have the provisions of this section apply shall be effective on and after January 1, 1951, for all taxable years beginning before January 1, 1961, in respect of which—

(1) The assessment of a deficiency,

(2) The refund or credit of an overpayment, or

(3) The commencement of a suit for recovery of a refund under section 7405 of the Internal Revenue Code of 1954.

is not prevented on the date of the enactment of this Act by the operation of any law or rule of law. Such election shall also be effective on and after January 1, 1951, for any taxable year beginning before January 1, 1961, in respect of which an assessment of a deficiency has been made but not collected on or before the date of the enactment of this Act.

(c) **TIME AND MANNER OF ELECTION.**—An election to have the provisions of this section apply shall be made by the taxpayer on or before the 60th day after the date of publication in the Federal Register of final regulations issued under authority of subsection (f), and shall be made in such form and manner as the Secretary of the Treasury or his delegate shall prescribe by regulations. Such election, if made, may not be revoked.

(d) **STATUTES OF LIMITATIONS.**—Notwithstanding any other law, the period within which an assessment of a deficiency attributable to the election under subsection (c) may be made with respect to any taxable year for which such election is effective, and the period within which a claim for refund or credit of an overpayment attributable to the election under such subsection may be made with respect to any such taxable year, shall not expire prior to one year after the last day for making an election under subsection (c). An election by a taxpayer under subsection (c) shall be considered as a consent to the application of the provisions of this subsection.

(e) **TERMS; APPLICABILITY OF OTHER LAWS.**—Except where otherwise distinctly expressed or manifestly intended, terms used in this section shall have the same meaning as when used in the Internal Revenue Code of 1954 (or corresponding provisions of the Internal Revenue Code of 1939) and all provisions of law shall apply with respect to this section as if this section were a part of such Code (or corresponding provisions of the Internal Revenue Code of 1939).

(f) **REGULATIONS.**—The Secretary of the Treasury or his delegate shall prescribe such regulations as may be necessary to carry out the provisions of this section.

§ 1.9005-1 **ELECTION RELATING TO THE DETERMINATION OF GROSS INCOME FROM THE PROPERTY FOR TAXABLE YEARS BEGINNING PRIOR TO 1961 IN THE CASE OF CLAY AND QUARTZITE USED IN MAKING REFRACTORY PRODUCTS.**—(a) *In general.*—Section 2 of the Act of September 26, 1961 (Public Law 87-321, 75 Stat. 683), provides that certain taxpayers may elect to apply the provisions of such section to all taxable years beginning before January 1, 1961, with respect to which the election is effective. Section 2 of the Act prescribes special rules for the application of section 613(c) of the Internal Revenue Code of 1954 (and corresponding provisions of the Internal Revenue Code of 1939) in the case of quartzite and clay used by the mine owner or operator in the production of refractory products.

(b) *Election.*—The election to apply the provisions of section 2 of the Act may be made only in the case of quartzite and clay used in the production of products generally recognized as refractory products by the refractories industry. Examples of such products are clay firebrick, silica brick, and refractory bonding mortars. The election may be made only by a taxpayer who both mined the clay or quartzite and used it in the production of refractory products. The election must be made in accordance with § 1.9005-4 on or before February 14, 1962, and the election shall become irrevocable on that date.

(c) *Years to which the election is applicable.*—If the election described in paragraph (b) of this section is made by the taxpayer, the provisions of section 2 of the Act shall be effective on and after January 1, 1951, for all taxable years beginning before January 1, 1961, in respect of which the—

(1) Assessment of a deficiency,

(2) Refund or credit of an overpayment, or

(3) Commencement of a suit for recovery of a refund under section 7405 of the Internal Revenue Code of 1954, was not prevented on September 26, 1961, by the operation of any law or rule of law. The election is also effective on and after January 1, 1951, for any taxable year beginning before January 1, 1961, in respect of which an assessment of a deficiency has been made but not collected on or before September 26, 1961.

§ 1.9005-2 EFFECT OF ELECTION.—(a) *In general.*—If a taxpayer makes the election described in paragraph (b) of § 1.9005-1, he shall be deemed to have consented to the application of section 2 of the Act with respect to all the clay and quartzite described in that paragraph for all taxable years for which the election is effective whether or not the taxpayer is litigating the issue for any of such years. Thus, in applying section 613(c) of the Internal Revenue Code of 1954 (and corresponding provisions of the Internal Revenue Code of 1939) to those years—

(1) The term “ordinary treatment processes” shall include crushing, grinding, and separating the mineral from waste, but shall not include any subsequent process; and

(2) The gross income from mining for each short ton of quartzite or clay mined by the taxpayer and used by him in the production of all refractory products sold during the taxable year shall be equal to 87½ percent of the lesser of—

(i) The average lowest published or advertised price, or

(ii) The average lowest actual selling price,

at which the mine owner or operator offered to sell or sold any such quartzite or clay during the taxable year.

(b) *Rules for applying paragraph (a).*—(1) The price described in paragraph (a) (2) of this section and any price described in this paragraph shall be determined with reference to quartzite or clay in the form and condition of such products after the application of only the processes described in paragraph (a) (1) of this section and before transportation from the plant in which such processes were applied.

(2) If quartzite and clay were mined and used by the taxpayer in the production of refractory products, a separate price shall be used with respect to each mineral.

(3) There shall be used for each mineral the lowest price at which it was sold or offered for sale by the taxpayer during the taxable year. Thus, only one price shall be used with respect to each mineral regardless of variations in type or grade.

(4) For purposes of this paragraph, exceptional, unusual, or nominal sales of quartzite or clay shall be disregarded. Thus, for example, if the taxpayer made an accommodation sale during the taxable year at other than the regular price, such sale is to be disregarded.

(5) If the taxpayer made no sales during the taxable year of quartzite or clay in the form and condition described in subparagraph (1) of this paragraph, or if his sales were exceptional, unusual, or nominal, there shall be used the lowest recognized selling price for the taxpayer’s marketing area for quartzite or clay (of the same grade and type as that used by him) which was published for the taxable year in a trade journal or other industry publication.

(6) If subparagraph (5) of this paragraph does not apply for the reason that there is no recognized selling price published in a trade journal or other industry publication for the taxpayer’s marketing area, there shall be used the lowest price at which quartzite or clay comparable to that used by the taxpayer was sold or offered for sale during the taxable year in that area by other producers similarly circumstanced as the taxpayer or, if appropriate, the lowest price paid by the taxpayer for purchased quartzite or clay.

(7) If the lowest selling price otherwise applicable under the preceding provisions of this paragraph fluctuated during the taxable year, the two or more lowest selling prices shall be averaged according to the number of days during the taxable year that each such price was in effect.

(c) The provisions of paragraphs (a) and (b) of this section may be illustrated by the following examples:

Example (1). (i) *Facts.*—Taxpayer A, a calendar year taxpayer, mined quartzite and clay and used them in the production of recognized refractory products. During the taxable year, the lowest price for which A sold clay after the application of crushing and grinding was \$13.75 per short ton. He also sold some ground clay of a different type at \$20 per short ton. A sold quartzite after the application of crushing and grinding for various prices, depending upon type, ranging from \$14 per short ton to \$20 per short ton. During the taxable year, the prices for the various types of ground clay and quartzite did not change. None of the sales by A of ground clay or quartzite were exceptional, unusual, or nominal.

(ii) *Determination of gross income from mining.*—If A makes the election described in paragraph (b) of § 1.9005-1, the gross income from mining per short ton of clay mined by A and used in the production of refractory products sold during the taxable year is \$12.03 (87½ percent of \$13.75), and the gross income from mining per short ton of quartzite mined by A and used in the production of refractory products sold during the taxable year is \$12.25 (87½ percent of \$14). To determine his gross income from mining, A must compute the sum of—

(a) \$12.03 multiplied by the number of short tons of clay which were mined by A (whether or not during the taxable year) and which were used by A in the production of refractory products (refractory bonding mortar, fire brick, etc.) sold during the taxable year; plus

(b) \$12.25 multiplied by the number of short tons of quartzite which were mined by A (whether or not during the taxable year) and which were used by A in the production of refractory products sold during the taxable year.

Example (2). Assume the same facts as in example (1) except that on October 1 of the taxable year A's lowest price for clay after the application of crushing and grinding increased to \$14.40 per short ton. In this case, the average lowest price for which A sold ground clay during the taxable year must be determined by taking into account the price adjustment of October 1. Under these circumstances, the average lowest price for the ground clay would be \$13.91, that is $\$13.75 \times \frac{273}{365}$ plus $\$14.40 \times \frac{92}{365}$.

(d) *Effect on depletion rates and other items.*—The election shall have no effect on the applicable rate of percentage depletion for the taxable years for which the election is effective. In applying the election to the years affected there shall be taken into account the effect that any adjustments resulting from the election shall have on other items affected thereby, such as charitable contributions, foreign tax credit, net operating loss, and the effect that adjustments to any such items shall have on other taxable years. The provisions of

section 2 of the Act are applicable with respect to taxable years subject to the Internal Revenue Code of 1939 for purposes of applying sections 450 and 453 of that Code. The election shall have no effect on the determination of the treatment processes which are to be considered as mining or on the determination of gross income from mining for any taxable year beginning after December 31, 1960.

§ 1.9005-3 STATUTES OF LIMITATION.—Notwithstanding any provision of law to the contrary, the period within which the assessment of any deficiency attributable to the election may be made, or within which the credit or refund of any overpayment attributable to the election may be made, shall not expire sooner than 1 year after the last day for making the election. Thus, if assessment of a deficiency or credit or refund of an overpayment, whichever is applicable, was not prevented on September 26, 1961, the time for making assessment or credit or refund shall not expire for at least 1 year after the last day for making the election. Even though assessment of a deficiency was prevented on September 26, 1961, if commencement of a suit for recovery of a refund under section 7405 of the Internal Revenue Code of 1954 may have been made on such date, then any deficiency resulting from the election may be assessed at any time within 1 year after the last day for making the election. If a taxpayer makes the election, he shall be deemed to have consented to the application of the provisions of section 2 of the Act extending the time for assessing a deficiency attributable to the election. Section 2 of the Act does not shorten the period of limitations otherwise applicable. An agreement may be entered into under section 6501(c)(4) of the Internal Revenue Code of 1954 and corresponding provisions of prior law to extend the period for assessment.

§ 1.9005-4 MANNER OF EXERCISING ELECTION.—(a) *By whom election is to be made.*—Generally, the taxpayer whose tax liability is affected by the election shall make the election. In the case of a partnership, or a corporation electing under the provisions of subchapter S, chapter 1 of the Internal Revenue Code of 1954, the election shall be exercised by the partnership or such corporation, as the case may be.

(b) *Time and manner of making election.*—The election shall be made on or before February 14, 1962, by filing a statement with the district director with whom the taxpayer's income tax return for the taxable year in which the election is made is required to be filed. The statement shall include the following:

(1) A clear indication that an election is being made under section 2 of the Act, and

(2) The taxable years to which the election applies.

Amended income tax returns reflecting any increase or decrease in tax attributable to the election shall be filed for the taxable years to which the election applies. In the case of partnerships and electing small business corporations under subchapter S, chapter 1 of the Internal Revenue Code of 1954, amended returns shall be filed by the partnership or electing small business corporation, as well as by the partners or shareholders, as the case may be. Any amended return shall be filed with the office of the district director with whom the taxpayer files his income tax return for the taxable year in which

the election is made, and, if practicable, on the same date the statement of election is filed, but amended returns shall be filed in no event later than May 31, 1962, unless an extension of time is granted under section 6081 of the Internal Revenue Code of 1954. Whenever the amended returns do not accompany the statement of election, a copy of the statement shall be submitted with the amended returns. The amended returns shall be accompanied by payment of the additional tax (together with interest thereon) resulting from the election.

§ 1.9005-5 TERMS; APPLICABILITY OF OTHER LAWS.—All other terms which are not otherwise specifically defined shall have the same meaning as when used in the Internal Revenue Code of 1954 (or the corresponding provisions of prior law) except where otherwise distinctly expressed or manifestly intended to the contrary. Further, all provisions of law contained in the Code (or the corresponding provisions of prior law) shall apply to the extent that they can apply. Thus, all the provisions of subtitle F of the Code (and the corresponding provisions of prior law) shall apply to the extent they can apply, including the provisions of law relating to assessment, collection, credit or refund, and limitations. For purposes of this section and §§ 1.9005-1 to 1.9005-4, inclusive, the term "Act" means the Act of September 26, 1961 (Public Law 87-321, 75 Stat. 683 [C.B. 1961-2, 341]).

(This Treasury Decision is issued under the authority contained in subsection (f) of section 2 of the Act of September 26, 1961 (Public Law 87-321, 75 Stat. 683).)

MORTIMER M. CAPLIN,
Commissioner of Internal Revenue.

Approved December 13, 1961.

STANLEY S. SURREY,
Assistant Secretary of the Treasury.

(Filed by the Division of the Federal Register on December 15, 1961, 8:49 a.m., and published in the issue of the Federal Register for December 16, 1961, 26 F.R. 12077)

PART III

ALCOHOL TAX RULINGS AND DECISIONS

SUBPART A.—RULINGS AND DECISIONS UNDER THE INTERNAL REVENUE CODE OF 1954

Rulings and decisions published in Part III, Subpart A, of the Internal Revenue Bulletin are based on the application of provisions of the Internal Revenue Code of 1954 and, unless otherwise noted therein, are published without consideration as to any application of the provisions of the Internal Revenue Code of 1939, the Federal Alcohol Administration Act, or other public laws.

SUBTITLE E.—ALCOHOL, TOBACCO, AND CERTAIN OTHER EXCISE TAXES

CHAPTER 51.—DISTILLED SPIRITS, WINES, AND BEER

SUBCHAPTER A.—GALLONAGE AND OCCUPATIONAL TAXES

PART I.—GALLONAGE TAXES

Subpart A.—Distilled Spirits

SECTION 5004.—LIEN FOR TAX

26 CFR 201.117: Continuity of premises.

Rev. Rul. 62-35

Areas of a distilled spirits plant not otherwise subject to the lien imposed by section 5004(b)(1) of the Internal Revenue Code of 1954, and which are traversed by a pipeline for the conveyance of spirits in bond, need not be bonded or designated as a part of the bonded premises of the plant. However, the pipeline itself is considered a part of the bonded premises.

Advice has been requested whether areas traversed by pipelines for the conveyance of spirits in bond between separated areas of the bonded premises of a distilled spirits plant must be bonded, or designated as a part of the bonded premises subject to the lien imposed by section 5004 of the Internal Revenue Code of 1954.

The proprietor of a distilled spirits plant uses a pipeline for transferring spirits in bond from his distilled spirits plant proper to the dockside facilities of the plant. The strip of land which the pipeline traverses between the two separated areas of the plant is not a part of the plant and is not under the proprietor's control, except for an easement for passage of the pipeline.

Section 5004 of the Code imposes a lien for the tax on distilled spirits on the bonded premises (as described in the application for registration) of the distilled spirits plant at which such spirits are produced and on any building containing any part of the bonded premises. The lien also applies to the stills, vessels, and fixtures located on the production facilities of such plant.

Senate Report No. 2090, 85th Cong., C.B. 1958-3, 584, at 678, in discussing section 5004 of the Code states, in part, as follows:

It is not intended that the term "building" as used in the penultimate sentence of this paragraph be construed to extend the lien to premises not heretofore considered to be a part of a building to which the lien applies. For example, a bonded wine cellar separated from a distilled spirits plant by a vertical common wall would not be considered to be in the same building as the distilled spirits plant and therefore would not be subject to the lien on the distilled spirits plant. It is also not intended that this paragraph be construed to make the lien applicable to premises not otherwise subject to lien, merely because of the passage of pipelines over such premises.

Section 201.117 of the Distilled Spirits Plants Regulations provides that the continuity of the plant shall be unbroken except for separations by public waterways, thoroughfares, or carrier rights-of-way. Where there are other separations of the plant premises and all parts of the plant premises are in the same general location, the registration of the plant may be approved if the Assistant Regional Commissioner, Alcohol and Tobacco Tax, finds that the separated areas can be supervised economically and effectively and the Director, Alcohol and Tobacco Tax Division, finds that the revenue will not be jeopardized thereby.

Accordingly, it is held that where pipelines for the conveyance of spirits (or denatured spirits) in bond cross areas of a distilled spirits plant not otherwise subject to the lien imposed by section 5004 of the Code, or where such pipelines cross areas separating different parts of the same distilled spirits plant, as contemplated in section 201.117 of the regulations, the strips of land, or the buildings, over which such pipelines cross, need not be bonded, or designated as part of the bonded premises on the application for registration, Form 2607, Registration of Distilled Spirits Plant.

However, the pipelines themselves must be fully and accurately described in the application for registration as being a part of the bonded premises and, as such, are subject to the operating bond, Form 2601, Distilled Spirits Bond and to any lien which might attach to such bonded premises under section 5004 of the Code. The descriptions of such pipelines on the Form 2607 and the plat of the premises should include identification of their points of origin and termination and of the areas and proprietorship of the premises they traverse.

See also Revenue Ruling 61-49, C.B. 1961-1, 789, which states, in part, that the penal sum of Form 3A, Indemnity Bond, must always be in the full appraised value of all of the property subject to lien under section 5004(b) (1) of the Code, since no lien, under this section, attaches to any of the property within the term of such bond.

SECTION 5008.—ABATEMENT, REMISSION, REFUND, AND ALLOWANCE FOR LOSS OR DESTRUCTION OF DISTILLED SPIRITS

26 CFR 201.482: Allowable losses.

Rev. Rul. 62-37

Where a custom bottler of distilled spirits collects the full amount of tax determined at the time of regauge from a purchaser and allows no credit or refund to the purchaser of the spirits for losses incurred in bottling operations, the allowance of the bottler's claim for credit or refund of tax for such losses is precluded by section 5008(c) (2) (A) of the Internal Revenue Code of 1954.

Advice has been requested whether a custom bottler of distilled spirits, who collects the full amount of tax determined at the time of regauge and makes no adjustment or refund of tax to his customer for losses incurred in the bottling operations, may receive an allowance of tax credit or refund in view of the limitation in section 5008(c) (2) (A) of the Internal Revenue Code of 1954.

Section 5008(c) (2) (A) of the Code provides that no abatement, remission, credit or refund of taxes shall be made where the claimant is indemnified or recompensed for the tax.

Section 201.482 of the Distilled Spirits Plants Regulations provides, in part, that abatement, remission, credit, or refund of tax shall not be made in respect of losses to the extent that the claimant is indemnified or recompensed for the tax.

Revenue Ruling 60-201, C.B. 1960-1, 712, precludes the allowance of a claim for refund or credit of tax where a brewer does not allow a credit to his customer for beer removed from the market. The brewer is considered indemnified by the customer through payment for the beer.

Accordingly, it is held that where a bottler of distilled spirits collects from his customer the full amount of tax determined at the time of regauge and allows no credit to the purchaser of the spirits for losses incurred in bottling operations, the bottler is considered recompensed for the tax, and an allowance of the bottler's claim for credit is precluded by section 5008(c) (2) (A) of the Code. If a bottler of distilled spirits does not make a practice of passing on to the persons, who advance money to pay the tax on the distilled spirits withdrawn from bond, an appropriate amount in respect of allowable loss under section 5008(c) of the Code, he must bear the burden of establishing the amount of allowable loss in respect of which he was not recompensed.

However, where the bottler has a systematic and regular procedure for crediting or refunding an appropriate amount in respect of allowable loss to the persons who advanced the money to pay the tax, such practice or procedure may be accepted by the Service as meeting the requirements of section 5008(c) (2) (A) of the Code if the claimant states in the claim that he has followed (or in the case of an interim claim that he will follow) such practice or procedure with respect to the claim.

This Revenue Ruling is applicable only to custom bottling operations and not to regular bottling operations where the full amount of the tax determined at the time of regauge is not paid to the bottler by a customer.

Subpart E.—General Provisions

SECTION 5062.—REFUND AND DRAWBACK IN CASE OF EXPORTATION

26 CFR 201.469: Domestically bottled spirits for export. Rev. Rul. 62-80
(Also Section 5205; 201.467.)

Section 201.467 of the Distilled Spirits Plants Regulations provides that all bottles containing spirits bottled on bottling premises for export shall have securely affixed thereto a label showing certain information, including the words "For Export" and the plant number. Section 201.469 of the regulations provides, under certain conditions, that taxpaid spirits originally bottled for domestic use may be exported with benefit of drawback without rebottling and further provides that the words "For Export" may be shown on the neck or similar strip label affixed to the bottles.

Held, the lithographing of the plant number and the words "For Export" on the lids of eight-ounce tinplate containers is considered as being in substantial compliance with the provisions of section 201.467 and the lithographing of the words "For Export" on the lids of like containers is also considered as meeting the requirements of section 201.469(c) of the regulations, provided, in each case, that all other required information is also lithographed on such "liquor bottles." However, such words must be so placed on the containers that they will not be obscured by the strip stamp.

26 CFR 252.21: General.
(Also Section 252.193.)

T.D. 6588¹

TITLE 26—INTERNAL REVENUE.—CHAPTER I. SUBCHAPTER E, PART 252.—EXPORTATION OF LIQUORS

Miscellaneous amendments

DEPARTMENT OF THE TREASURY,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
OFFICE OF COMMISSIONER OF CUSTOMS,

Washington 25, D.C.

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

On November 7, 1961, a notice of proposed rule making to amend 26 CFR Part 252 was published in the Federal Register (26 F.R. 10484). In accordance with the notice, interested persons were given an opportunity to submit written comments or suggestions pertaining thereto.

All comments and suggestions received within the prescribed period were carefully considered but no changes were made in the proposed amendments, and the amendments as published in the Federal Register are hereby adopted.

¹ 27 F.R. 773.

§ 252.21 [Amendment]

Section 252.21 is amended by inserting “, or between Hawaii and any other part of the United States or between Alaska and any other part of the United States” immediately after “possessions”, wherever it appears in paragraphs (b), (c), (e), and (f).

§ 252.122 [Amendment]

The second sentence of paragraph (a) of § 252.122 is amended to read: “Where the exporter is the proprietor of the bonded wine cellar from which the wine is to be withdrawn he shall, at the time of withdrawal of the wine, prepare a notice of the withdrawal and shipment, on Form 206, in quadruplicate.”

§ 252.123 [Amendment]

Section 252.123 is amended by changing that portion of the section preceding paragraph (a) to read as follows: “In addition to the marks and brands required to be placed on packages and cases at the time they are filled under the provisions of Part 240 of this chapter, the proprietor shall place additional marks, as herein specified, on each such container before removal from the bonded premises:”.

§ 252.154 [Amendment]

Section 252.154 is amended by changing that portion of the section preceding paragraph (a) to read as follows: “In addition to the marks and brands required to be placed on packages and cases at the time they are filled under the provisions of Part 201 of this chapter, the proprietor shall place additional marks, as herein specified, on each such container before removal from the bonded premises:”.

§ 252.193 [Amendment]

Section 252.193 is amended by changing that portion of the section preceding paragraph (a) to read as follows: “In addition to the marks and brands required to be placed on packages and cases at the time they are filled under the provisions of Part 201 of this chapter, the proprietor of the export storage shall place additional marks, as herein specified, on each such container before removal from export storage for export, for use on vessels or aircraft, or for transfer to a foreign-trade zone:”.

§ 252.213 [Revoked]

Section 252.213 is revoked.

§ 252.216 [Amendment]

Section 252.216 is amended by changing that portion of the section preceding paragraph (a) to read as follows: “In addition to the marks and brands required to be placed on each package and case under the provisions of Parts 201, 231, or 240, of this chapter, each such container removed under the provisions of this subpart shall have stenciled or otherwise marked thereon, in durable and legible letters and figures of not less than three-fourths of an inch in height, additional information, as specified below:”.

§ 252.223 [Amendment]

Section 252.223 is amended by changing that portion of the section preceding paragraph (a) to read as follows: “In addition to the marks and brands prescribed in Part 245 of this chapter, each

keg, barrel, case, crate, or other package containing beer removed under the provisions of this subpart shall have stenciled or otherwise marked thereon, in durable and legible letters and figures of not less than three-fourths of an inch in height, additional information as specified below :".

This Treasury Decision shall be effective on the first day of the first month that begins not less than 30 days after the date of publication in the Federal Register.

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

MORTIMER M. CAPLIN,
Commissioner of Internal Revenue.
PHILIP NICHOLS, JR.,
Commissioner of Customs.

Approved January 19, 1962.

STANLEY S. SURREY,
Assistant Secretary of the Treasury.

(Filed by the Division of the Federal Register on January 25, 1962, 8:45 a.m. and published in the issue of the Federal Register for January 26, 1962, 27 F.R. 773)

26 CFR 252.193: Export marks.

Clarification of type of container on which marks are to be placed before removal from export storage. See T.D. 6588, page 346.

PART II.—OCCUPATIONAL TAX

Subpart D.—Wholesale Dealers

SECTION 5113.—EXEMPTIONS

26 CFR 201.34: Exemption from liquor dealer's occupational tax.

Rev. Rul. 62-73

The proprietor of a distilled spirits plant operating a wholesale liquor dealer business on the general premises of the plant does not incur liability for the special tax as a wholesale liquor dealer by reason of the sale of beer which at the time of sale is stored on such premises. However, liability for the special tax is incurred where "drop shipments" of distilled spirits, wines, or beer are made.

Advice has been requested whether the proprietor of a distilled spirits plant operating a wholesale liquor dealer business on the general premises of a distilled spirits plant incurs liability for the special tax as a wholesale liquor dealer under the circumstances described below.

The proprietor of a distilled spirits plant operates a wholesale liquor dealer business on the general premises of his plant. He sells distilled spirits, wines, and beer to retail dealers from stocks stored

at his distilled spirits plant. "Drop shipment" sales are also made. They are shipments sent directly from another distilled spirits plant to the proprietor's customers.

Section 5113(a) of the Code provides, in part, that no proprietor of a distilled spirits plant shall be required to pay special tax under section 5111 or section 5121 of the Code on account of the sale at his principal office of distilled spirits, wines, or beer, which, at the time of sale, are stored at his distilled spirits plant, or had been removed from such premises to a taxpaid storeroom operated in connection therewith and stored therein. However, no such proprietor shall have more than one place of sale that shall be exempt from special tax.

Section 201.34 of the Distilled Spirits Plants Regulations states that the exemption from liquor dealer's occupational tax applies to the sale of spirits or wines which, at the time of sale, are stored at the proprietor's plant or had been removed from such plant to a taxpaid storeroom, the operations of which are integrated with the operations of such plant.

Revenue Ruling 60-383, C.B. 1960-2, 559, holds that the proprietor of a distilled spirits plant may conduct the business of a wholesale liquor dealer on the "general" premises of such plant as "other business" under section 201.67 of the regulations upon approval of his application by the Assistant Regional Commissioner, Alcohol and Tobacco Tax, pursuant to section 201.73 of the regulations.

Section 201.34 of the regulations, relating to exemptions from the wholesale liquor dealer tax, mentions only spirits or wines and not beer. However, these regulations are concerned principally with the operations of a distilled spirits plant as they affect the plant's bonded and bottling premises. Since beer cannot be taken onto either bonded (except as provided in section 201.262 of the regulations) or bottling premises of a distilled spirits plant, the exemption provided by section 201.34 of the regulations is restricted to spirits or wines which are held at such plants or in a facility closely integrated with the operation of the plants.

However, the provisions of section 5113(a) of the Code afford an exemption from the wholesale liquor dealer tax for the sale of distilled spirits, wines, or beer which, at the time of sale, are stored on the general premises of a distilled spirits plant.

Accordingly, the proprietor of a distilled spirits plant operating a wholesale liquor dealer business on the general premises of a distilled spirits plant does not incur liability for special tax by reason of the sale of beer which, at the time of sale, is stored on such premises, provided an application submitted pursuant to the provisions of section 201.73 of the regulations and Revenue Ruling 60-383 has been approved by the Assistant Regional Commissioner, Alcohol and Tobacco Tax, to include the storage and sale of beer.

However, a proprietor making "drop shipments" of distilled spirits, wines, or beer incurs liability for the special tax since "drop shipments" do not constitute a sale of spirits, wines, or beer which at the time of sale had been stored at the plant or had been removed from the plant to a taxpaid storeroom as required by section 201.34 of the regulations.

The proprietor of a distilled spirits plant operating a wholesale liquor dealer business might handle distilled spirits only, wines only,

or both distilled spirits and wines, or distilled spirits, wines, and beer. Therefore, the application to conduct "other business" on the distilled spirits plant premises must specifically and entirely describe the operations involved and the building and equipment to be used.

SUBCHAPTER C.—OPERATION OF DISTILLED SPIRITS PLANTS

PART I.—GENERAL PROVISIONS

SECTION 5201.—REGULATION OF OPERATIONS

26 CFR 201.278: Spirits content of chemicals produced.

Approved methods for testing certain chemicals, including chemical by-products, for spirits content. See Rev. Proc. 62-3, page 422.

26 CFR 201.422: Form 27-B Supplemental. Rev. Rul. 62-24

Section 5201(a) of the Internal Revenue Code of 1954 provides, in part, that proprietors of distilled spirits plants shall conduct their rectification operations under such regulations as the Secretary of the Treasury or his delegate shall prescribe. Section 201.422 of the Distilled Spirits Plants Regulations provides, in part, that every rectifier shall file with the Director, Alcohol and Tobacco Tax Division, on Form 27-B Supplemental, Formula and Process for Rectified Products, a statement of each formula and process by which he intends to rectify spirits or wines. A rectifier shall not use a formula or process in the manufacture of any rectified product until he has received approval therefor.

Held, where there is a change in the proprietorship of the distilled spirits plant and the incoming (successor) proprietor desires to adopt the previously approved rectified products formulas on the Form 27-B supplemental of the outgoing proprietor, in lieu of filing new formulas for each product, the successor proprietor may file an application, in quadruplicate, for approval by the Director. The application should list the formulas for adoption by (1) formula number, (2) name of product, (3) rate of tax, and (4) date of approval. It should be clearly shown in the application that the outgoing proprietor has authorized the use of its previously approved formulas by the successor proprietor.

26 CFR 201.466: Rebottling, relabeling, and restamping of bottled spirits.

Records and reports covering use of red strip stamps by proprietors of distilled spirits plants. See Rev. Proc. 62-4, page 425.

SECTION 5205.—STAMPS

26 CFR 201.467: Labels for export spirits.

Lithographing the words "For Export" on eight-ounce tinplate containers. See Rev. Rul. 62-80, page 346.

26 CFR 201.624: Daily strip stamp record.

Records and reports covering use of red strip stamps by proprietors of distilled spirits plants. See Rev. Proc. 62-4, page 425.

SECTION 5207.—RECORDS AND REPORTS

26 CFR 201.632: Daily reports.

Records and reports covering use of red strip stamps by proprietors of distilled spirits plants. See Rev. Proc. 62-4, page 425.

26 CFR 201.633: Monthly Reports.

Records and reports covering use of red strip stamps by proprietors of distilled spirits plants. See Rev. Proc. 62-4, page 425.

SECTION 5207.—RECORDS AND REPORTS

26 CFR 201.634: Semiannual report of spirits in warehouse, Form 332.

Reporting data on Form 332, for statistical purposes, of spirits of 190 degrees or more of proof. See Rev. Proc. 62-14, page 445.

PART II.—OPERATIONS ON BONDED PREMISES

Subpart A.—General

SECTION 5214.—WITHDRAWAL OF DISTILLED SPIRITS FROM BONDED PREMISES FREE OF TAX OR WITHOUT PAYMENT OF TAX

26 CFR 211.147: Bulk shipments.

Rev. Rul. 62-69

Specially denatured alcohol, proprietary solvents, and chemicals may be shipped simultaneously in separate compartments of the same bulk conveyance.

Revenue Ruling 56-428, C.B. 1956-2, 1039, amplified.

Reconsideration has been given to Revenue Ruling 56-428, C.B. 1956-2, 1039, in view of the general revision of the distilled spirits provisions of chapter 51 of the Internal Revenue Code of 1954 by the Excise Tax Technical Changes Act of 1958, Public Law 85-859, C.B. 1958-3, 92.

Revenue Ruling 56-428 holds that shipments of specially denatured alcohol and proprietary solvents may be made simultaneously in separate compartments of the same tank truck.

Section 211.147(a) of the Distribution and Use of Denatured Alcohol and Rum Regulations provides, in part, that bonded dealers may ship specially denatured spirits in bulk conveyances; that specially denatured alcohol or specially denatured rum from only one consignor may be placed in any one compartment of a bulk conveyance; and that not less than the entire contents of any one compartment may be delivered to any one consignee at any one premises.

Based on the provisions of the above regulations, it is held that specially denatured alcohol, proprietary solvents, and chemicals may be shipped simultaneously in separate compartments of the same tank car or tank truck. This holding is not applicable to the shipment of distilled spirits which have not been denatured.

The bulk conveyances to be used for the shipment of specially denatured alcohol from the distilled spirits plant must conform to the requirements of section 201.510 of the Distilled Spirits Plants Regulations and must be marked as provided by section 201.525 of the regulations. Customers must have suitable facilities for receiving specially denatured alcohol in compartment tank cars. The compartments of the bulk conveyances containing proprietary solvents must bear the markings prescribed by section 211.177 of the Distribution and Use of Denatured Alcohol and Rum Regulations. The compartments containing chemicals must be appropriately marked to identify the contents, quantities and the producer's name and address.

Accordingly, Revenue Ruling 56-428 is hereby amplified to the extent that chemicals, as well as specially denatured alcohol and proprietary solvents, may be shipped simultaneously in separate compartments of the same tank truck or tank car.

26 CFR 213.104: Hospital, blood banks, and
sanitariums.

Eligibility of clinics to furnish medicines made with tax-free alcohol to patients for use off the clinic premises. See Rev. Rul. 62-36, below.

26 CFR 213.105: Clinics.
(Also 213.104, 213.108.)

Rev. Rul. 62-36

Clinics operated for charity and not for profit may furnish medicines made with tax-free alcohol to their patients for use off the premises of such clinics, even though the patients are required to pay a registration fee, or a similar fee, entitling them to use all the services of the clinic.

Clinics operated by colleges, universities and hospitals are considered, under certain conditions, to be clinics operated for charity and not for profit.

Revenue Ruling 54-464, C.B. 1954-2, 509, and Revenue Ruling 55-664, C.B. 1955-2, 703, revoked.

Advice has been requested whether a clinic operated for charity and not for profit, which charges a fee to its patients entitling them to the services of the clinic, would, by reason of its charging such a fee, be precluded by section 5214(a) (3) of the Internal Revenue Code of 1954 from furnishing medicines made with tax-free alcohol to its patients for use off the clinic premises.

In resolving the above issue, it has also been necessary for the Internal Revenue Service to study the question of whether a clinic operated by a college, university, or hospital can be considered to be a clinic "operated for charity and not for profit" within the purview of section 5214(a) (3) (D) of the Code.

In the particular case in question, a university, which holds a permit to procure and use tax-free alcohol, operates a clinic wherein it provides medical facilities to its students for the treatment of all ills not requiring major surgery. All students entering the university are charged a set fee entitling them to the use of the clinic. No other charge is made to the students for clinic services, but no student is exempt from the payment of the set fee.

It is customary for the clinic of this university to furnish medicines made with tax-free alcohol to its students without charge for their use, either on or off the university campus.

Section 5214(a) (3) of the Code, as contained in Public Law 85-859, C.B. 1958-3, 92, at 178, authorizes clinics operated for charity and not for profit to withdraw alcohol from the bonded premises of distilled spirits plants free of tax and, among other purposes, to use such alcohol "in the compounding of bona fide medicines for treatment outside of such clinics of patients thereof." However, such clinics are restrained by other language in this section of the Code from selling such alcohol or using it in the manufacture of any product for sale. The above provisions of section 5214(a) (3) of the Code are substantially the same as those of section 5310(c) of the Code before amendment by Public Law 85-859.

Revenue Ruling 54-464, C.B. 1954-2, 509, and Revenue Ruling 55-664, C.B. 1955-2, 703, interpreted section 182.661 of the Industrial Alcohol Regulations (now superseded by sections 213.104, 213.105, and 213.108 of the Tax-Free Alcohol Regulations) to mean that the acceptance or collection of a fee by a clinic from its patients precluded that clinic from furnishing medicines made with tax-free alcohol to such patients for use off the clinic premises.

The pertinent restraining provisions of those sections of the Tax-free Alcohol Regulations which have superseded section 182.661 of the Industrial Alcohol Regulations are purposely stated in broader and more liberal terms than the superseded section. They provide that clinics operated for charity and not for profit may furnish medicines made with tax-free alcohol to their patients "for use off the premises if such medicine is not sold and no fee or other charge is exacted *by reason of the furnishing of the medicine to the patient.*" [Emphasis supplied.]

Accordingly, it is held that if no part of a fee can be separately identified as a charge for medicines, an amount charged to the patients of a clinic as a registration fee or as a fee entitling the patients to the

use of all the services of the clinic is not considered to be a charge "exacted by reason of the furnishing of medicines" to such patients.

Therefore, clinics operated for charity and not for profit may furnish medicines made with tax-free alcohol to their patients for use off the premises of such clinics, even though the patients may pay a registration fee to the clinics. This holding applies to the furnishing of any bona fide medicine compounded with tax-free alcohol, including rubbing alcohol compound, provided any rubbing alcohol compound so furnished is of approximately the same consistency and is denatured to as great a degree as rubbing alcohol compound manufactured with specially denatured alcohol under the Distribution of Denatured Alcohol Regulations.

Except for those institutions which are maintained for the private profit of their owners, colleges, universities, and hospitals are charitable organizations, notwithstanding the fact that they charge fees to their students or patients. Therefore, any clinic operated by and as an integral part of such an institution is a clinic operated for charity and not for profit for purposes of section 5214 of the Code. Within the limits stated above, any such clinic may furnish medicines made with tax-free alcohol to its patients for use off the premises. This applies whether the clinic has qualified for the procurement and use of tax-free alcohol under paragraph (D) of section 5214(a) (3) of the Code, in its limited capacity as a clinic, or whether its authority for such procurement and use is by virtue of its being a part of an institution which has so qualified under paragraph (A) or (C) of that section of the Code.

However, any hospital or clinic, whether operated for charity or for profit, which desires to use alcohol in the manufacture of medicines which it will sell to its patients, must obtain taxpaid alcohol for such purpose. Upon compliance with the pertinent provisions of the Drawback on Distilled Spirits Used in Manufacturing Non-beverage Products Regulations, such hospital or clinic may claim drawback of tax at the authorized rate on the alcohol so used. In this connection, see also Revenue Ruling 54-173, C.B. 1954-1, 324, and Revenue Ruling 59-188, C.B. 1959-1, 725.

Revenue Ruling 54-464, C.B. 1954-2, 509, and Revenue Ruling 55-664, C.B. 1955-2, 703, are hereby revoked.

26 CFR 213.108: Prohibited usage of tax-free alcohol.

Eligibility of clinics to furnish medicines made with tax-free alcohol to patients for use off the clinic premises. See Rev. Rul. 62-36, page 352.

Subpart C.—Storage

**SECTION 5234.—MINGLING AND BLENDING OF
DISTILLED SPIRITS**

26 CFR 201.297: Mingling of homogeneous spirits.

Determination of homogeneity of spirits by chemical analysis for purpose of mingling. See Rev. Rul. 62-7, below.

26 CFR 201.437: Treatment of spirits and wine.
(Also 201.297, 201.447.)

Rev. Rul. 62-7

Section 201.437(a) of the Distilled Spirits Plants Regulations provides that the rectification tax imposed by section 5021 of the Internal Revenue Code of 1954 will apply in the case of "the mingling of spirits produced by different distillers or at different distilleries, or of different ages (except as provided in section 201.447), or which differ in kind, or which are otherwise not homogeneous." These provisions, are based on long established construction of the statutes and are intended to be applied in all cases. *Held*, in respect of the mingling of spirits of different ages under the provisions of section 5234(a)(1)(C) of the Code, the specific limitations as to the periods of storage set forth in sections 201.297(b) and 201.447(b) of the regulations will in general continue to be applied in determining the presumption of homogeneity. However, in any case where there is doubt as to homogeneity with respect to age characteristics, resort may be had to evidence adduced by chemical analysis in resolving the determination as to homogeneity or likeness in character as provided by the last sentence of section 201.447 of the regulations. Such determination may be made both as to spirits which are within and spirits which are beyond the limitations as to periods of storage prescribed in sections 201.297(b) and 201.447(b) of the regulations.

26 CFR 201.447: Mingling of homogeneous spirits.

Determination of homogeneity of spirits by chemical analysis for purpose of mingling. See Rev. Rul. 62-7, above.

SUBCHAPTER D.—INDUSTRIAL USE OF DISTILLED SPIRITS

**SECTION 5273.—SALE, USE, AND RECOVERY OF
DENATURED DISTILLED SPIRITS**

26 CFR 211.108: Approval or disapproval of
samples, formulas, processes, labels, and
advertising matter.
(Also 211.199.)

Rev. Rul. 62-15

Section 211.108 of the Denatured Alcohol and Rum Regulations provides, in part, that the Director, Alcohol and Tobacco Tax Division,

may, in approving Forms 1479-A, Formula for Article made with Specially Denatured Alcohol or Rum, specify thereon the size of containers in which any article may be sold and the maximum quantity that may be sold to any person at one time and may restrict the sale of articles to a specific class of Vendee and for a specific use.

Held, in approving Form 1479-A, the quantity and package size of laboratory reagents and stains which may be authorized will be limited to the following:

1. Unlimited sale in containers of thirty-two fluid ounces or less.
2. Sales in containers larger than thirty-two fluid ounces but not larger than two gallons limited to thirty gallons per month per person.
3. Sales in five gallon containers limited to fifty gallons per month per person. Reagents and stains packaged in five-gallon containers may be shipped only to the person using the article in laboratory analysis. Sales records shall be kept by the permittee and submitted quarterly to the Assistant Regional Commissioner, Alcohol and Tobacco Tax.

This Revenue Ruling is not applicable to reagent alcohol which is covered under section 211.199 of the Denatured Alcohol and Rum Regulations.

26 CFR 211.199: Reagent alcohol.

Size and sales of stains and reagents in containers. See Rev. Rul. 62-15, page 355.

SECTION 5275.—RECORDS AND REPORTS

26 CFR 213.171: Records.

Records covering receipt and use of tax-free alcohol. See Rev. Proc. 62-10, page 437.

SUBCHAPTER F.—BONDED AND TAXPAID WINE PREMISES

PART II.—OPERATIONS

SECTION 5361.—BONDED WINE CELLAR OPERATIONS

Allowance of claim for refund or credit of tax on wine removed from the market as unmerchantable. See Rev. Rul. 62-25, below.

SECTION 5371.—INSURANCE COVERAGE, ETC.

26 CFR 240.809: Insurance coverage.
(Also Section 5361.)

Rev. Rul. 62-25

Where the proprietor of a bonded wine cellar does not allow a credit or refund to a customer returning unmerchantable wine, the proprietor's claim for credit or refund of tax for such wine is not allowable. A claim may be filed by the proprietor of any bonded wine cellar where wine has been returned whether or not the proprietor is the one who paid the tax on the unmerchantable wine.

Advice has been requested whether a claim for credit or refund is allowable to the proprietor of the wine cellar to which the wine has been returned for destruction in those cases where the proprietor does not give credit, for the tax paid, to the customer returning the wine.

Wine, produced and taxpaid in California, was shipped to the premises of a taxpaid wine bottling house in Kansas City, Missouri. The wine was found to be contaminated by the Food and Drug Administration of the Department of Health, Education, and Welfare. Thereafter, the wine was sent from the bottling house to a bonded wine cellar in Kansas City to be destroyed. After the wine had been destroyed, a claim for credit or refund of tax was then filed by the proprietor of the bonded wine cellar in Kansas City. However, the proprietor did not give credit or refund to the bottler for the wine or tax attributable thereto.

Section 5044 of the Internal Revenue Code of 1954 provides that in the case of any wine produced in the United States and returned to bond as unmerchutable under section 5361 of the Code, any tax imposed by section 5041 of the Code shall, if paid, be refunded or credited, without interest, to the proprietor of the bonded wine cellar to which such wine is delivered, under such regulations as the Secretary of the Treasury or his delegate may prescribe.

Section 5361 of the Code provides, in part that the proprietor of a bonded wine cellar may receive unmerchutable taxpaid wine for destruction.

Section 5371 of the Code provides that any refund or credit of, or other relief from, taxes on wines or wine spirits authorized by law shall be allowed only to the extent that the claimant is not indemnified or recompensed for the tax.

A claim for credit or refund of tax for unmerchutable wine returned to a bonded wine cellar may be filed by the proprietor of any bonded wine cellar where wine has been returned. The proprietor filing the claim need not be the one who paid the tax on the unmerchutable wine. The burden of proof that the wine has been taxpaid lies with the claimant proprietor.

Revenue Ruling 60-201, C.B. 1960-1, 712, relating to claims for refund or credit of tax on beer removed from the market, holds that where a brewer does not allow credit to a customer, the brewer is indemnified by the customer through payment for the beer and that for this reason the brewer's claim for credit must be disallowed.

In the instant case, the proprietor of the bonded wine cellar to which the unmerchutable wine was returned was not the taxpayer and did not purchase the wine at a price reflecting the tax, or allow to the person returning the wine a credit in an amount equal to the tax paid on such wine. To allow the proprietor credit or refund of the tax in such a case would constitute unjust enrichment since he neither directly nor indirectly bore the burden of the tax. Thus, he is in the same position as a person who has been indemnified for the tax. Accordingly, since it was not the intent of the statute to provide relief to a person who did not bear the burden of the tax, claims for credit or refund in such cases are not allowable.

PART III.—CELLAR TREATMENT AND CLASSIFICATION OF WINE

SECTION 5382.—CELLAR TREATMENT OF NATURAL WINE

26 CFR 240.524: Finishing of wine.
(Also 240.1051, 240.1052.)

Rev. Rul. 62-29

The use of anion exchange resin "Amberlite IRA-400" and cation exchange resins "Amberlite IRC-50" and "Amberlite XE-89," in a continuous column process, to treat wines to remove excess oxidized color, foreign flavors and odors, and to stabilize wines by removal of heavy molecules and proteinaceous material is considered as being consistent with good commercial practice. The restrictions imposed on non-ionic and conditioning resins by section 240.1051 of the Wine Regulations are applicable with respect to the use of such anion and cation exchange resins. Applications filed by winemakers for the use of these materials, as authorized herein, may be approved by Assistant Regional Commissioners, Alcohol and Tobacco Tax, pursuant to the provisions of section 240.1052 of the regulations.

(Also 240.1051, 240.1052.)

Rev. Rul. 62-47

The use of pectolytic enzymes "Pectinol 41-P" and "Pectinol 42-E" derived from *Bacillus Subtilis*, *Aspergillus Flavus Oryzae*, or *Aspergillus Niger*, to clarify wine, in amounts not exceeding one pound per 1000 gallons of wine, within the general limitations of section 240.524 of the Wine Regulations, is considered as being consistent with good commercial practice.

Winemakers desiring to use these products in the clarification of wine may obtain approval of the Assistant Regional Commissioner, Alcohol and Tobacco Tax, by filing notice pursuant to the provisions of section 240.1052 of the regulations.

(Also 240.1051, 240.1052.)

Rev. Rul. 62-63

The use of "Pectinol 100-D" to clarify wine, in amounts not exceeding ten pounds per 1000 gallons of wine, within the general limitations of section 240.524 of the Wine Regulations, is considered as being consistent with good commercial practice. Winemakers desiring to use "Pectinol 100-D" in the clarification of wine may obtain the approval of the Assistant Regional Commissioner, Alcohol and Tobacco Tax, by filing notice pursuant to the provisions of section 240.1052 of the regulations.

26 CFR 240.1051: Materials authorized for treatment of wine.

Use of Amberlite IRA-400, Amberlite IRC-50, and Amberlite XE-89, in treatment of wines. See Rev. Rul. 62-29, above.

The use of pectolytic enzymes "Pectinol 41-P" and "Pectinol 42-E" to clarify wine. See Rev. Rul. 62-47, page 358.

The use of "Pectinol 100-D" to clarify wine. See Rev. Rul. 62-63, page 358.

26 CFR 240.1052: Notice.

Use of Amberlite IRA-400, Amberlite IRC-50, and Amberlite XE-89, in treatment of wines. See Rev. Rul. 62-29, page 358.

The use of pectolytic enzymes "Pectinol 41-P" and "Pectinol 42-E" to clarify wine. See Rev. Rul. 62-47, page 358.

The use of "Pectinol 100-D" to clarify wine. See Rev. Rul. 62-63, page 358.

SUBTITLE F.—PROCEDURE AND ADMINISTRATION

CHAPTER 74.—CLOSING AGREEMENTS AND COMPROMISES

SECTION 7122.—COMPROMISES

26 CFR 301.7122-1: Compromises.

Procedure for submission and handling of offers in compromise with respect to alcoholic liquors. See Rev. Proc. 62-11, page 440.

CHAPTER 80.—GENERAL RULES

SUBCHAPTER A.—APPLICATION OF INTERNAL REVENUE LAWS

SECTION 7805.—RULES AND REGULATIONS

26 CFR 301.7805-1: Rules and regulations. Rev. Rul. 62-75

List of 168 obsolete Revenue Rulings, concerning distilled spirits, wines, and beer, published in C.B. 1953-2, through C.B. 1961-1.

In view of the numerous changes in law and regulations relating to the products and occupations subject to tax under Chapter 51 of the Internal Revenue Code of 1954, a review has been made of the Revenue Rulings issued with respect to such products and occupations from 1953 to date. A review has also been made of Revenue Rulings

issued with respect to the Federal Alcohol Administration Act and regulations thereunder.

Particular consideration has been given to the effect of the Excise Tax Technical Changes Act of 1958, 26 U.S.C. 5001, C.B. 1958-3, 91, which substantially revised the provisions of Chapter 51 of the Code, and to the regulations issued, reissued, or amended as a result of the enactment of this law.

Subsequent to the enactment of the Excise Tax Technical Changes Act of 1958 and pursuant to Treasury Decision 6373, C.B. 1959-1, 712, effective July 1, 1959, all instructions and interpretative rulings in effect with respect to regulations issued pursuant thereto, as of June 30, 1959, were, to the extent that such instructions or rulings were not inconsistent with Chapter 51 of the Code as amended by the above Act or with regulations in effect after such date, continued in effect as instructions and rulings pursuant to the applicable provisions of the Code as so amended, or pursuant to the regulations in effect after July 1, 1959.

On the basis of the review which has been made, it has been determined that the following Revenue Rulings have no application to the laws and regulations as now in effect, or they are unnecessary since the subject matter of the ruling is now specifically covered by regulations. These Revenue Rulings are therefore found to be no longer in effect, and are hereby declared to be obsolete, as follows:

<i>Revenue Ruling number</i>	<i>Cumulative Bulletin citation</i>	<i>Revenue Ruling number</i>	<i>Cumulative Bulletin citation</i>
205-----	C.B. 1953-2, 381	54-477-----	C.B. 1954-2, 459
54-79-----	C.B. 1954-1, 331	54-478-----	C.B. 1954-2, 463
54-128-----	C.B. 1954-1, 332	54-493-----	C.B. 1954-2, 472
54-150-----	C.B. 1954-1, 332	54-508-----	C.B. 1954-2, 492
54-173-----	C.B. 1954-1, 324	54-511-----	C.B. 1954-2, 584
54-184-----	C.B. 1954-1, 303	54-514-----	C.B. 1954-2, 560
54-185-----	C.B. 1954-1, 304	54-525-----	C.B. 1954-2, 461
54-187-----	C.B. 1954-1, 309	54-542-----	C.B. 1954-2, 480
54-188-----	C.B. 1954-1, 315	54-560-----	C.B. 1954-2, 460
54-201-----	C.B. 1954-1, 325	54-562-----	C.B. 1954-2, 563
54-202-----	C.B. 1954-1, 331	54-589-----	C.B. 1954-2, 460
54-215-----	C.B. 1954-1, 305	54-591-----	C.B. 1954-2, 477
54-216-----	C.B. 1954-1, 319	54-605-----	C.B. 1954-2, 443
54-217-----	C.B. 1954-1, 323	55-40-----	C.B. 1955-1, 570
54-218-----	C.B. 1954-1, 333	55-56-----	C.B. 1955-1, 569
54-237-----	C.B. 1954-1, 314	55-100-----	C.B. 1955-1, 565
54-249-----	C.B. 1954-1, 336	55-101-----	C.B. 1955-1, 566
54-266-----	C.B. 1954-2, 474	55-102-----	C.B. 1955-1, 569
54-289-----	C.B. 1954-2, 467	55-114-----	C.B. 1955-1, 573
54-290-----	C.B. 1954-2, 469	55-116-----	C.B. 1955-1, 576
54-291-----	C.B. 1954-2, 473	55-129-----	C.B. 1955-1, 595
54-292-----	C.B. 1954-2, 479	55-130-----	C.B. 1955-1, 603
54-293-----	C.B. 1954-2, 564	55-169-----	C.B. 1955-1, 612
54-301-----	C.B. 1954-2, 565	55-181-----	C.B. 1955-1, 594
54-302-----	C.B. 1954-2, 510	55-217-----	C.B. 1955-1, 604
54-322-----	C.B. 1954-2, 473	55-218-----	C.B. 1955-1, 606
54-334-----	C.B. 1954-2, 478	55-345-----	C.B. 1955-1, 606
54-335-----	C.B. 1954-2, 514	55-346-----	C.B. 1955-1, 607
54-336-----	C.B. 1954-2, 557	55-361-----	C.B. 1955-1, 575
54-352-----	C.B. 1954-2, 475	55-490-----	C.B. 1955-2, 701
54-353-----	C.B. 1954-2, 477	55-491-----	C.B. 1955-2, 711
54-354-----	C.B. 1954-2, 457	55-492-----	C.B. 1955-2, 723
54-388-----	C.B. 1954-2, 469	55-493-----	C.B. 1955-2, 730
54-436-----	C.B. 1954-2, 463	55-510-----	C.B. 1955-2, 698
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SUBPART B.—RULINGS AND DECISIONS UNDER THE FEDERAL ALCOHOL ADMINISTRATION ACT

Rulings and decisions published in Part III, Subpart C, of the Internal Revenue Bulletin are based on the application of provisions of the Federal Alcohol Administration Act.

SECTION 5.—UNFAIR COMPETITION AND UNLAWFUL PRACTICES

27 CFR 7.26: Alcoholic content.

Rev. Rul. 62-95

Section 5(e) of the Federal Alcohol Administration Act, 27 U.S.C. 205(e), provides, in part, that statements of, or statements likely to be considered as statements of, alcoholic content of malt beverages on labels are prohibited unless required by state law.

Section 7.26 of the Malt Beverages Labeling and Advertising Regulations provides that the alcoholic content and the percentage and quantity of the original extract shall not be stated on labels unless required by state law.

Held, unless the law or regulations having the force and effect of law, of the state into which malt beverages are shipped specifically require a statement of alcoholic content on the label, it is illegal under Federal law to ship malt beverages in interstate commerce under labels bearing alcoholic content statements. In order to avoid violations under the Federal Alcohol Administration Act, brewers and others concerned should give particular attention to state law and to those regulations having the force and effect of law. In those cases where no specific requirement for the labeling of malt beverages with an alcoholic content statement exists, shipments of malt beverages so labeled should be discontinued.

See Revenue Procedure 62-13, page 444, for specific restriction on shipment of malt beverages labeled with statements of alcoholic content into the State of Washington.

Labeling of malt beverages for sale in Washington State. See Rev. Proc. 62-13, page 444.

SECTION 5(e).—UNFAIR COMPETITION AND UNLAWFUL PRACTICES: LABELING

27 CFR 4.24: Generic, semi-generic, and non-generic designation of geographic significance.

No future importations of sparkling wine labeled as "Spanish Champagne" will be permitted entry into the United States. See Rev. Proc. 62-12, page 443.

27 CFR 5.21: The standards of identity.

T. D. 6597

TITLE 27—INTOXICATING LIQUORS.—CHAPTER I. PART 5.—LABELING AND
ADVERTISING OF DISTILLED SPIRITS

Amendments relating to barreling proof of whisky.

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

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

Notice of public hearing to be held in Washington, D.C., on February 27, 1962, with respect to certain proposals to amend 27 CFR Part 4 Relating to Labeling and Advertising of Wine and 27 CFR Part 5 Relating to Labeling and Advertising of Distilled Spirits, was published in the Federal Register on January 27, 1962 (27 F.R. 832). Upon the conclusion of the said hearing and after consideration of relevant material submitted by interested persons in connection therewith regarding the proposals, the following amendments to 27 CFR Part 5 are hereby adopted:

PARAGRAPH 1. In order to increase the maximum barreling proof of whisky from 110° proof to 125° proof:

(A) The first paragraph of section 5.21(b) is amended by deleting the words "withdrawn from the distillery at not more than 110° and not less than 80° proof, whether or not such proof is further reduced prior to bottling to not less than 80° proof" and inserting in lieu thereof the following wording:

withdrawn at not more than 125° proof for bottling without storage in barrels, or reduced to not more than 125° proof prior to storage in barrels, and bottled at not less than 80° proof

(B) Subparagraph (2) of section 5.21(b) is amended by deleting the wording "at not exceeding 160° proof and withdrawn from the distillery at not more than 110° and not less than 80° proof, whether or not such proof is further reduced prior to bottling to not less than 80° proof" and inserting in lieu thereof the following wording:

distilled at not exceeding 160° proof, reduced to not more than 125° proof prior to storage in barrels, and bottled at not less than 80° proof

Because these amendments relieve restrictions presently contained in the regulations, it is found that it is unnecessary to issue this Treasury decision subject to the effective date limitations of section 4(c) of the Administrative Procedure Act, approved June 11, 1946. Accordingly, this Treasury decision shall become effective on the date of publication in the Federal Register.

(This Treasury Decision is issued pursuant to and under the authority contained in 49 Stat. 981, as amended; 27 U.S.C. 205.)

JOHN W. S. LITTLETON,
Acting Commissioner of Internal Revenue

Approved April 17, 1962.

STANLEY S. SURREY,
Assistant Secretary of the Treasury.

(Filed by the Division of the Federal Register on April 19, 1962, 8:46 a.m., and published in the issue of the Federal Register for April 20, 1962, 27 F.R. 3800)

27 CFR 5.73: Standards of fill.

T. D. 6601

TITLE 27—INTOXICATING LIQUORS.—CHAPTER I, PART 5.—LABELING AND
ADVERTISING OF DISTILLED SPIRITS

Amendments relating to standards of fill for distilled spirits.

DEPARTMENT OF THE TREASURY,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
*Washington 25, D.C.**Officers and Employees of the Internal Revenue Service and Others
Concerned:*

Notice of public hearing to be held in Washington, D.C., on July 27, 1960, with respect to certain proposals to amend 27 CFR Part 5 Relating to Labeling and Advertising of Distilled Spirits, was published in the Federal Register on July 2, 1960 (25 F.R. 6292). Upon the conclusion of the said hearing and after consideration of relevant material submitted by interested persons in connection therewith regarding the proposals, the following amendments to 27 CFR Part 5 are hereby adopted:

PARAGRAPH 1. In order to authorize the use of $\frac{4}{5}$ pint containers for the packaging of all classes and types of distilled spirits:

(A) Section 5.73(a)(1) is amended by inserting " $\frac{4}{5}$ pint" immediately below "1 pint".

(B) Section 5.73(a) is amended by deleting subparagraph (3). This Treasury Decision shall become effective 30 days after the date of publication in the Federal Register.

(This Treasury Decision is issued pursuant to and under the authority contained in 49 Stat. 981, as amended; 27 U.S.C. 205.)

MORTIMER M. CAPLIN,
Commissioner of Internal Revenue.

Approved May 29, 1962.

STANLEY S. SURREY,
Assistant Secretary of the Treasury.

(Filed by the Division of the Federal Register on June 4, 1962, 8:49 a.m., and published in the issue of the Federal Register for June 5, 1962, 27 F.R. 5259)

SECTION 7.—PENALTIES

Procedure for submission and handling of offers in compromise with respect to the Federal Alcohol Administration Act. See Rev. Proc. 62-11, page 440.

PART IV **LEGISLATION AND TREATIES**

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PART IV

LEGISLATION AND TREATIES

SUBPART A.—TAX CONVENTIONS

UNITED STATES-UNITED KINGDOM INCOME TAX CONVENTION

T.D. 5569, C.B. 1947-2, 100, Section 7.516:

Rev. Rul. 62-31

Scope of convention with respect to determination of "industrial or commercial profits."

(Also Part I, Section 882; 26 CFR 1.882-1.)

The maintenance of a sales office or showroom in the United States, by a foreign corporation managed and controlled in the United Kingdom, used by a group of salesmen for sales promotion constitutes engaging in trade or business in the United States through a permanent establishment situated therein within the meaning of the provisions of the United States-United Kingdom income tax convention. Accordingly, income derived by the corporation from sources within the United States is subject to United States income tax.

Revenue Ruling 54-588, C.B. 1954-2, 657, revoked.

A foreign corporation has inquired whether the opening of an office in the United States, under the circumstances indicated below, will constitute engaging in trade or business in the United States through a permanent establishment therein within the meaning of the income tax convention between the United States and the United Kingdom, Treasury Decision 5569, C.B. 1947-2, 100.

The corporation, managed and controlled in the United Kingdom, opened an office in the United States for the purpose of promoting its sales of British merchandise. The employees in the United States office, consisting of salesmen and general clerks, are empowered only to run the office, to arrange for the appointment of distributing agents for the merchandise offered by the corporation, and to solicit orders generally. These employees do not have the authority to negotiate and conclude contracts on behalf of the corporation, nor do they have a stock of merchandise from which to fill orders on its behalf. Any negotiations entered into are under the corporation's instructions and subject to its approval as to any decision reached. The only independent authority which the employees have is in the appointment of distributors to whom the corporation is to sell the merchandise. However, even here, the corporation retains the right to approve or disapprove these buyers on receipt of information as to their standing.

The factual situation here is analogous to that considered in Revenue Ruling 54-588, C.B. 1954-2, 657, in which the *M* Company, Limited, maintains a showroom in New York City where its salesmen solicit orders from samples for merchandise produced by the *N* Company, Limited. Both corporations are foreign corporations managed and controlled in the United Kingdom. Orders are transmitted by mail direct to the *N* Company which ships the merchandise to the customer who remits directly to the *N* Company. The *N* Company pays a commission on sales of its merchandise made through the sales organization of the *M* Company. Neither corporation maintains any stock of goods in the United States from which sales are made. The Revenue Ruling holds that the activities in the United States of the *M* Company, on behalf of the *N* Company, do not constitute a trade or business through a permanent establishment situated in the United States for purposes of the United States-United Kingdom income tax convention and that, accordingly, by reason of Article III(1) of the United States-United Kingdom income tax convention, the commissions received by the *M* Company are not subject to United States income tax.

The Internal Revenue Service has reconsidered Revenue Ruling 54-588 upon a reexamination of the factual situations and the applicable law and regulations. Article III of the United States-United Kingdom income tax convention provides, in part, that a United Kingdom enterprise shall not be subject to United States tax in respect of its industrial or commercial profits unless it is engaged in trade or business in the United States through a permanent establishment situated therein.

Article II(1)(7) of the convention states, among other things, that the term "permanent establishment" when used with respect to an enterprise of one of the contracting parties means a branch, management, factory or other fixed place of business. It also states that the fact that such an enterprise maintains in the territory of the other contracting party a fixed place of business exclusively for the purchase of goods or merchandise shall not of itself constitute such fixed place of business a permanent establishment of such enterprise.

The maintenance of an office or showroom used by a group of salesmen for sales promotion is a fixed place of business. The exception to an office or fixed place of business constituting a permanent establishment is an office or fixed place of business exclusively for the purchase of goods or merchandise. An office or showroom used for sales promotion does not fall within such exception.

Accordingly, it is held that the maintenance in the United States, by a foreign corporation managed and controlled in the United Kingdom, of an office or showroom used by a group of salesmen for sales promotion, under the facts set forth above, constitutes engaging in trade or business in the United States through a permanent establishment situated therein within the meaning of the provisions of the United States-United Kingdom income tax convention.

Revenue Ruling 54-588, in holding that *M* Company does not engage in a trade or business in the United States through a permanent establishment situated therein, relied upon another part of the definition of the term "permanent establishment" to the effect that the term does

not include an agency unless the agent has and habitually exercises a general authority to negotiate and conclude contracts on behalf of the enterprise or has a stock of merchandise from which he regularly fills orders on its behalf. While that part of the definition would have been relevant had the question been whether *N* Company, for which *M* Company solicits orders, maintains a permanent establishment in the United States, the question instead was whether *M* Company maintains a permanent establishment in the United States so as to become subject to United States income tax upon the commissions which it received from *N* Company on the orders obtained. Since *M* Company maintains a showroom in the United States for the solicitation of such orders, that company clearly has a fixed place of business in the United States, constituting a permanent establishment within the meaning of the convention, for the carrying on of its commission business. The conclusion reached was therefore erroneous, and Revenue Ruling 54-588 is hereby revoked.

Whether the enterprise derives any income from sources within the United States that will be subject to United States income tax is to be determined with regard to sections 861 to 864 of the Internal Revenue Code of 1954 and the regulations issued thereunder.

Pursuant to the authority contained in section 7805(b) of the Code, the provisions of this Revenue Ruling will not be applied with respect to income derived prior to March 12, 1962.

SUBPART B.—LEGISLATION

PUBLIC LAW 87-403
EIGHTY-SEVENTH CONGRESS, FEBRUARY 2, 1962
H.R. 8847¹

An Act to amend the Internal Revenue Code of 1954 so as to provide that a distribution of stock made to an individual (or certain corporations) pursuant to an order enforcing the antitrust laws shall not be treated as a dividend distribution but shall be treated as a return of capital; and to provide that the amount of such a distribution made to a corporation shall be the fair market value of the distribution.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) subchapter O of chapter 1 of the Internal Revenue Code of 1954 (relating to gain or loss on disposition of property) is amended by adding at the end thereof the following new part:

PART IX—DISTRIBUTIONS PURSUANT TO ORDERS ENFORCING THE ANTITRUST LAWS

Sec. 1111. Distribution of stock pursuant to order enforcing the antitrust laws.

SEC. 1111. DISTRIBUTION OF STOCK PURSUANT TO ORDER ENFORCING THE ANTITRUST LAWS.

(a) **GENERAL RULE.**—Notwithstanding sections 301, 312, and 316, a distribution of divested stock (as defined in subsection (e)), to a qualifying shareholder (as defined in subsection (b)), to which section 301(c)(1) would, but for this section, apply, shall be a distribution which is not out of the earnings and profits of the distributing corporation for purposes of this subtitle.

(b) **QUALIFYING SHAREHOLDER.**—For purposes of this section, the term “qualifying shareholder” means any shareholder other than a corporation which may be allowed a deduction under section 243, 244, or 245 with respect to dividends received.

(c) **SPECIAL RULES.**—

(1) **DISTRIBUTIONS TO AVOID FEDERAL INCOME TAX.**—Subsection (a) shall not apply to any transaction one of the principal purposes of which is the distribution of the earnings and profits of the distributing corporation or of the corporation whose stock is distributed, or both.

(2) **STOCK.**—For purposes of this section, the term “stock” includes rights to fractional shares.

(d) **DEFINITION OF ANTITRUST ORDER.**—For purposes of this section, the term “antitrust order” means, in the case of any corporation, a final judgment rendered after January 1, 1961, by a court with respect to such corporation in a court proceeding under the Sherman Act (26 Stat. 209; 15 U.S.C. 1-7) or the Clayton Act (38 Stat. 730; 15 U.S.C. 12-27), or both, to which the United States is a party, if such proceeding was commenced on or before January 1, 1959.

(e) **DEFINITION OF DIVESTED STOCK.**—For purposes of this section, the term “divested stock” means stock meeting the following requirements:

(1) the stock is the subject of an antitrust order entered after January 1, 1961, which—

(A) directs the distributing corporation to divest itself of such stock by distributing it to its shareholders (or requires such distribution as an alternative to other action by any person);

(B) specifies and itemizes the stock to be divested; and

¹ House Report No. 1157, page 375, this Bulletin; Senate Report No. 1100, page 385, this Bulletin.

(C) fixes the period of time within which the distributing corporation must divest itself of all stock to be disposed of by it by reason of the suit, and such period expires not later than 3 years from the date on which such order becomes final (appeal time having run or appeal having been completed); and

(2) the court finds—

(A) that the divestiture of such stock, in the manner described in paragraph (1) (A), is necessary or appropriate to effectuate the policies of the Sherman Act, or the Clayton Act, or both;

(B) that the application of subsection (a) is required to reach an equitable antitrust order in such suit or proceeding; and

(C) that the period of time for the complete divestiture fixed in the order is the shortest period within which such divestiture can be executed with due regard to the circumstances of the particular case; but no stock shall be divested stock if the court finds that its divestiture is required because of an intentional violation of the Sherman Act, or the Clayton Act, or both.

(b) The table of parts for subchapter O of chapter 1 of the Internal Revenue Code of 1954 is amended by adding at the end thereof the following:

Part IX. Distributions pursuant to orders enforcing the antitrust laws.

(c) The amendments made by this section shall apply only with respect to distributions made after the date of the enactment of this Act.

SEC. 2. (a) Section 301 of the Internal Revenue Code of 1954 (relating to distributions of property) is amended by redesignating subsection (f) as subsection (g) and inserting after subsection (e) the following new subsection:

(f) SPECIAL RULES FOR DISTRIBUTIONS OF ANTITRUST STOCK TO CORPORATIONS.—

(1) DEFINITION OF ANTITRUST STOCK.—For purposes of this subsection, the term “antitrust stock” means stock received, by a corporation which is a party to a suit described in section 1111(d) (relating to definition of antitrust order), in a distribution made after September 6, 1961, either pursuant to the terms of, or in anticipation of, an antitrust order (as defined in subsection (d) of section 1111).

(2) AMOUNT DISTRIBUTED.—Notwithstanding subsection (b)(1) (but subject to subsection (b)(2)), for purposes of this section the amount of a distribution of antitrust stock received by a corporation shall be the fair market value of such stock.

(3) BASIS.—Notwithstanding subsection (d), the basis of antitrust stock received by a corporation in a distribution to which subsection (a) applies shall be the fair market value of such stock decreased by so much of the deduction for dividends received under the provisions of section 243, 244, or 245 as is, under regulations prescribed by the Secretary or his delegate, attributable to the excess, if any, of—

(A) the fair market value of the stock, over

(B) the adjusted basis (in the hands of the distributing corporation immediately before the distribution) of the stock, increased by the amount of gain which is recognized to the distributing corporation by reason of the distribution.

(b) The amendments made by this section shall apply only with respect to distributions made after the date of the enactment of this Act.

SEC. 3. (a) Section 312 of the Internal Revenue Code of 1954 (relating to the effect on earnings and profits) is amended by adding at the end thereof the following new subsection:

(k) SPECIAL ADJUSTMENT ON DISPOSITION OF ANTITRUST STOCK RECEIVED AS A DIVIDEND.—If a corporation received antitrust stock (as defined in section

301(f)) in a distribution to which section 301 applied, and the amount of the distribution determined under section 301(f)(2) exceeded the basis of the stock determined under section 301(f)(3), then proper adjustment shall be made, under regulations prescribed by the Secretary or his delegate, to the earnings and profits of such corporation at the time such stock (or other property the basis of which is determined by reference to the basis of such stock) is disposed of by such corporation.

(b) Subsection (b) of section 535 of the Internal Revenue Code of 1954 (relating to accumulated taxable income) is amended by adding at the end thereof the following new paragraphs:

(9) DISTRIBUTIONS OF DIVESTED STOCK.—There shall be allowed as a deduction the amount of any dividend distribution received of divested stock (as defined in subsection (e) of section 1111), minus the taxes imposed by this subtitle attributable to such receipt, but only if the stock with respect to which the distribution is made was owned by the distributee on September 6, 1961, or was owned by the distributee for at least 2 years prior to the date on which the antitrust order (as defined in subsection (d) of section 1111) was entered.

(10) SPECIAL ADJUSTMENT ON DISPOSITION OF ANTITRUST STOCK RECEIVED AS A DIVIDEND.—If—

(A) a corporation received antitrust stock (as defined in section 301(f)) in a distribution to which section 301 applied,

(B) the amount of the distribution determined under section 301(f)(2) exceeded the basis of the stock determined under section 301(f)(3), and

(C) paragraph (9) did not apply in respect of such distribution, then proper adjustment shall be made, under regulations prescribed by the Secretary or his delegate, if such stock (or other property the basis of which is determined by reference to the basis of such stock) is sold or exchanged.

(c) Section 543 of the Internal Revenue Code of 1954 (relating to personal holding company income) is amended (1) by adding at the end of paragraph (1) of subsection (a) the following new sentence:

This paragraph shall not apply to a dividend distribution of divested stock (as defined in subsection (e) of section 1111) but only if the stock with respect to which the distribution is made was owned by the distributee on September 6, 1961, or was owned by the distributee for at least 2 years prior to the date on which the antitrust order (as defined in subsection (d) of section 1111) was entered.”; and (2) by adding at the end thereof the following new subsection:

(d) SPECIAL ADJUSTMENT ON DISPOSITION OF ANTITRUST STOCK RECEIVED AS A DIVIDEND.—If—

(1) a corporation received antitrust stock (as defined in section 301(f)) in a distribution to which section 301 applied,

(2) the amount of the distribution determined under section 301(f)(2) exceeded the basis of the stock determined under section 301(f)(3), and

(3) such distribution was includible in personal holding company income under subsection (a)(1),

then proper adjustment shall be made, under regulations prescribed by the Secretary or his delegate, to amounts includible in personal holding company income under subsection (a)(2) with respect to such stock (or other property the basis of which is determined by reference to the basis of such stock).

(d) Subsection (b) of section 545 of the Internal Revenue Code of 1954 (relating to undistributed personal holding company income) is amended by adding at the end thereof the following new paragraphs:

(10) DISTRIBUTIONS OF DIVESTED STOCK.—There shall be allowed as a deduction the amount of any income attributable to the receipt of a distribution of divested stock (as defined in subsection (e) of section 1111),

minus the taxes imposed by this subtitle attributable to such receipt, but only if the stock with respect to which the distribution is made was owned by the distributee on September 6, 1961, or was owned by the distributee for at least 2 years prior to the date on which the antitrust order (as defined in subsection (d) of section 1111) was entered.

(11) SPECIAL ADJUSTMENT ON DISPOSITION OF ANTITRUST STOCK RECEIVED AS A DIVIDEND.—If—

(A) a corporation received antitrust stock (as defined in section 301(f)) in a distribution to which section 301 applied,

(B) the amount of the distribution determined under section 301(f) (2) exceeded the basis of the stock determined under section 301(f) (3), and

(C) Paragraph (10) did not apply in respect of such distribution, then proper adjustment shall be made, under regulations prescribed by the Secretary or his delegate, if such stock (or other property the basis of which is determined by reference to the basis of such stock) is sold or exchanged.

(e) Subsection (b) of section 556 of the Internal Revenue Code of 1954 (relating to undistributed foreign personal holding company income) is amended by adding at the end thereof the following new paragraphs:

(7) DISTRIBUTIONS OF DIVESTED STOCK.—There shall be allowed as a deduction the amount of any income attributable to the receipt of a distribution of divested stock (as defined in subsection (e) of section 1111), minus the taxes imposed by this subtitle attributable to such receipt, but only if the stock with respect to which the distribution is made was owned by the distributee on September 6, 1961, or was owned by the distributee for at least 2 years prior to the date on which the antitrust order (as defined in subsection (d) of section 1111) was entered.

(8) SPECIAL ADJUSTMENT ON DISPOSITION OF ANTITRUST STOCK RECEIVED AS A DIVIDEND.—If—

(A) a corporation received antitrust stock (as defined in section 301(f)) in a distribution to which section 301 applied.

(B) the amount of the distribution determined under section 301(f) (2) exceeded the basis of the stock determined under section 301(f) (3), and

(C) paragraph (7) did not apply in respect of such distribution, then proper adjustment shall be made, under regulations prescribed by the Secretary or his delegate, if such stock (or other property the basis of which is determined by reference to the basis of such stock) is sold or exchanged.

(f) Subsection (b) of section 561 of the Internal Revenue Code of 1954 (relating to deduction for dividends paid) is amended to read as follows:

(b) SPECIAL RULES APPLICABLE.—

(1) In determining the deduction for dividends paid, the rules provided in section 562 (relating to rules applicable in determining dividends eligible for dividends paid deduction) and section 563 (relating to dividends paid after the close of the taxable year) shall be applicable.

(2) If a corporation received antitrust stock (as defined in section 301(f)) in a distribution to which section 301 applied and such corporation distributes such stock (or other property the basis of which is determined by reference to the basis of such stock) to its shareholders, proper adjustment shall be made, under regulations prescribed by the Secretary or his delegates to the amount of the deduction provided for in subsection (a).

(g) The amendments made by this section shall apply only with respect to distributions made after the date of the enactment of this Act.

Approved February 2, 1962.

PUBLIC LAW 87-426
EIGHTY-SEVENTH CONGRESS, MARCH 31, 1962
H.R. 641 ²

An Act to provide for the free entry of an intermediate lens beta-ray spectrometer for the use of Tulane University, New Orleans, Louisiana, and to amend section 165 of the Internal Revenue Code of 1954 with respect to treatment of casualty losses in areas designated by the President as disaster areas.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the Secretary of the Treasury is authorized and directed to admit free of duty one intermediate lens beta-ray spectrometer imported for the use of Tulane University, New Orleans, Louisiana.

SEC. 2. (a) Section 165 of the Internal Revenue Code of 1954 (relating to losses) is amended—

- (1) By redesignating subsection (h) as subsection (i), and
- (2) By inserting after subsection (g) a new subsection (h) as follows—

(h) DISASTER LOSSES.—Notwithstanding the provisions of subsection (a), any loss

(1) attributable to a disaster which occurs during the period following the close of the taxable year and on or before the time prescribed by law for filing the income tax return for the taxable year (determined without regard to any extension of time), and

(2) occurring in an area subsequently determined by the President of the United States to warrant assistance by the Federal Government under sections 1855-1855g of title 42,

at the election of the taxpayer, may be deducted for the taxable year immediately preceding the taxable year in which the disaster occurred. Such deduction shall not be in excess of so much of the loss as would have been deductible in the taxable year in which the casualty occurred. If an election is made under this subsection, the casualty resulting in the loss will be deemed to have occurred in the taxable year for which the deduction is claimed.

(b) The amendments made by this section shall be effective with respect to any disaster occurring after December 31, 1961.

Approved March 31, 1962.

² House Report No. 725 and Senate Report No. 1218 are not published herein.

SUBPART C.—COMMITTEE REPORTS

[H.R. 8847] ¹DISTRIBUTIONS OF STOCK PURSUANT TO ORDERS
ENFORCING THE ANTITRUST LAWS

[House of Representatives Report No. 1157, Eighty-Seventh Congress, First Session]

[September 9, 1961]

Mr. Boggs, from the Committee on Ways and Means, submitted the following report to accompany H.R. 8847.

The Committee on Ways and Means, to whom was referred the bill (H.R. 8847) to amend the Internal Revenue Code of 1954 so as to provide that certain distributions of stock made pursuant to orders enforcing the antitrust laws shall not be treated as dividend distributions but shall be treated as a return of basis and result in gain only to the extent basis of the underlying stock is exceeded, having considered the same, report favorably thereon with amendments and recommend that the bill as amended do pass.

The amendments are as follows:

Strike out all after the enacting clause and insert in lieu thereof the following:

That (a) subchapter O of chapter 1 of the Internal Revenue Code of 1954 (relating to gain or loss on disposition of property) is amended by adding at the end thereof the following new part:

"Part IX—Distributions Pursuant to Orders Enforcing the Antitrust Laws

"Sec. 1111. Distribution of stock pursuant to order enforcing the antitrust laws.

"SEC. 1111. DISTRIBUTION OF STOCK PURSUANT TO ORDER ENFORCING THE ANTITRUST LAWS.

"(a) GENERAL RULE.—Notwithstanding sections 301, 312, and 316, a distribution of divested stock (as defined in subsection (f)), to a qualifying shareholder (as defined in subsection (b)), to which section 301(c)(1) would, but for this section, apply, shall be a distribution which is not out of the earnings and profits of the distributing corporation for purposes of this subtitle.

"(b) QUALIFYING SHAREHOLDER.—For purposes of this section, the term 'qualifying shareholder' means any shareholder other than a corporation, which may be allowed a deduction under section 243, 244, or 245 with respect to dividends received.

"(c) SPECIAL RULES.—

"(1) DISTRIBUTIONS TO AVOID FEDERAL INCOME TAX.—Subsection (a) shall not apply to any transaction one of the principal purposes of which is the distribution of the earnings and profits of the distributing corporation or of the corporation whose stock is distributed, or both.

"(2) STOCK.—For purposes of this section, the term 'stock' includes rights to fractional shares.

"(d) DEFINITION OF ANTITRUST ORDER.—For purposes of this section, the term 'antitrust order' means a judgment, decree, or other order of a court or of a commission or board in a suit or proceeding under the Sherman Act (26 Stat. 209; 15 U.S.C. 1-7) or the Clayton Act (38 Stat. 730; 15 U.S.C. 12-27), or both, to which the United States or such a commission or board is a party.

"(e) DEFINITION OF COURT.—For purposes of this section, the term 'court' means a court or a commission or board issuing an antitrust order.

"(f) DEFINITION OF DIVESTED STOCK.—For purposes of this section, the term 'divested stock' means stock meeting the following requirements:

"(1) the stock is the subject of an antitrust order entered after January 1, 1961, which—

"(A) directs the distributing corporation to divest itself of such stock by distributing it to its shareholders (or requires such distribution as an alternative to other action by any person); and

¹ Public Law 87-403, page 370, this Bulletin.

"(B) specifies and itemizes the stock to be divested; and
 "(2) the court finds—

"(A) that the divestiture of such stock, in the manner described in paragraph (1) (A), is necessary or appropriate to effectuate the policies of the Sherman Act, or the Clayton Act, or both;

"(B) that the application of subsection (a) is required to reach an equitable antitrust order in such suit or proceeding; and

"(C) that the period of time for the complete divestiture fixed in the order (or orders) is the shortest period within which such divestiture can be executed with due regard to the circumstances of the particular case;

but no stock shall be divested stock if the court finds that its divestiture is required because of an intentional violation of the Sherman Act, or the Clayton Act, or both."

(b) The table of parts for subchapter O of chapter 1 of the Internal Revenue Code of 1954 is amended by adding at the end thereof the following:

"Part IX. Distributors pursuant to orders enforcing the antitrust laws."

(c) The amendments made by this section shall apply only with respect to distributions made after the date of the enactment of this Act.

SEC. 2. (a) Section 301 of the Internal Revenue Code of 1954 (relating to distributions of property) is amended by redesignating subsection (f) as subsection (g) and inserting after subsection (e) the following new subsection:

"(f) SPECIAL RULES FOR DISTRIBUTIONS OF ANTITRUST STOCK TO CORPORATIONS.—

"(1) DEFINITION OF ANTITRUST STOCK.—For purposes of this subsection, the term 'antitrust stock' means stock received in a distribution made after September 6, 1961, either pursuant to the terms of, or in anticipation of, an antitrust order (as defined in subsection (d) of section 1111).

"(2) AMOUNT DISTRIBUTED.—Notwithstanding subsection (b) (1) (but subject to subsection (b) (2)), for purposes of this section the amount of a distribution of antitrust stock received by a corporation shall be the fair market value of such stock.

"(3) BASIS.—Notwithstanding subsection (d), the basis of antitrust stock received by a corporation in a distribution to which subsection (a) applies shall be the fair market value of such stock decreased by so much of the deduction for dividends received under the provisions of section 243, 244, or 245 as is, under regulations prescribed by the Secretary or his delegate, attributable to the excess, if any, of—

"(A) the fair market value of the stock, over

"(B) the adjusted basis (in the hands of the distributing corporation immediately before the distribution) of the stock, increased by the amount of gain which is recognized to the distributing corporation by reason of the distribution."

(b) The amendments made by this section shall apply only with respect to distributions made after the date of the enactment of this Act.

SEC. 3. (a) Section 312 of the Internal Revenue Code of 1954 (relating to the effect on earnings and profits) is amended by adding at the end thereof the following new subsection:

"(k) SPECIAL ADJUSTMENT ON DISPOSITION OF ANTITRUST STOCK RECEIVED AS A DIVIDEND.—If a corporation received antitrust stock (as defined in section 301(f)) in a distribution to which section 301 applied, and the amount of the distribution determined under section 301(f) (2) exceeded the basis of the stock determined under section 301(f) (3), then proper adjustment shall be made, under regulations prescribed by the Secretary or his delegate, to the earnings and profits of such corporation at the time such stock (or other property the basis of which is determined by reference to the basis of such stock) is disposed of by such corporation."

(b) Subsection (b) of section 535 of the Internal Revenue Code of 1954 (relating to accumulated taxable income) is amended by adding at the end thereof the following new paragraphs:

"(9) DISTRIBUTIONS OF DIVESTED STOCK.—There shall be allowed as a deduction the amount of any dividend distribution received of divested stock (as defined in subsection (f) of section 1111), minus the taxes imposed by this subtitle attributable to such receipt, but only if the stock with respect to which the distribution is made was owned by the distributee on September 6,

1961, or was owned by the distributee for at least 2 years prior to the date on which the antitrust order (as defined in subsection (d) of section 1111) was entered.

"(10) SPECIAL ADJUSTMENT ON DISPOSITION OF ANTITRUST STOCK RECEIVED AS A DIVIDEND.—If—

"(A) a corporation received antitrust stock (as defined in section 301(f)) in a distribution to which section 301 applied.

"(B) the amount of the distribution determined under section 301(f)(2) exceeded the basis of the stock determined under section 301(f)(3), and

"(C) paragraph (9) did not apply in respect of such distribution, then proper adjustment shall be made, under regulations prescribed by the Secretary or his delegate, if such stock (or other property the basis of which is determined by reference to the basis of such stock) is sold or exchanged."

(c) Section 543 of the Internal Revenue Code of 1954 (relating to personal holding company income) is amended (1) by adding at the end of paragraph (1) of subsection (a) the following new sentence: "This paragraph shall not apply to a dividend distribution of divested stock (as defined in subsection (f) of section 1111) but only if the stock with respect to which the distribution is made was owned by the distributee on September 6, 1961, or was owned by the distributee for at least 2 years prior to the date on which the antitrust order (as defined in subsection (d) of section 1111) was entered."; and (2) by adding at the end thereof the following new subsection:

"(d) SPECIAL ADJUSTMENT ON DISPOSITION OF ANTITRUST STOCK RECEIVED AS A DIVIDEND.—If—

"(1) a corporation received antitrust stock (as defined in section 301(f)) in a distribution to which section 301 applied,

"(2) the amount of the distribution determined under section 301(f)(2) exceeded the basis of the stock determined under section 301(f)(3), and

"(3) such distribution was includible in personal holding company income under subsection (a)(1),

then proper adjustment shall be made, under regulations prescribed by the Secretary or his delegate, to amounts includible in personal holding company income under subsection (a)(2) with respect to such stock (or other property the basis of which is determined by reference to the basis of such stock)."

(d) Subsection (b) of section 545 of the Internal Revenue Code of 1954 (relating to undistributed personal holding company income) is amended by adding at the end thereof the following new paragraphs:

"(10) DISTRIBUTIONS OF DIVESTED STOCK.—There shall be allowed as a deduction the amount of any income attributable to the receipt of a distribution of divested stock (as defined in subsection (f) of section 1111), minus the taxes imposed by this subtitle attributable to such receipt, but only if the stock with respect to which the distribution is made was owned by the distributee on September 6, 1961, or was owned by the distributee for at least 2 years prior to the date on which the antitrust order (as defined in subsection (d) of section 1111) was entered.

"(11) SPECIAL ADJUSTMENT ON DISPOSITION OF ANTITRUST STOCK RECEIVED AS A DIVIDEND.—If—

"(A) a corporation received antitrust stock (as defined in section 301(f)) in a distribution to which section 301 applied.

"(B) the amount of the distribution determined under section 301(f)(2) exceeded the basis of the stock determined under section 301(f)(3), and

"(C) paragraph (10) did not apply in respect of such distribution, then proper adjustment shall be made, under regulations prescribed by the Secretary or his delegate, if such stock (or other property the basis of which is determined by reference to the basis of such stock) is sold or exchanged."

(e) Subsection (b) of section 556 of the Internal Revenue Code of 1954 (relating to undistributed foreign personal holding company income) is amended by adding at the end thereof the following new paragraphs:

"(7) DISTRIBUTIONS OF DIVESTED STOCK.—There shall be allowed as a deduction the amount of any income attributable to the receipt of a distribution of divested stock (as defined in subsection (f) of section 1111), minus the taxes imposed by this subtitle attributable to such receipt, but only if the stock with respect to which the distribution is made was owned by

the distributee on September 6, 1961, or was owned by the distributee for at least 2 years prior to the date on which the antitrust order (as defined in subsection (d) of section 1111) was entered.

"(8) SPECIAL ADJUSTMENT ON DISPOSITION OF ANTITRUST STOCK RECEIVED AS A DIVIDEND.—If—

"(A) a corporation received antitrust stock (as defined in section 301(f)) in a distribution to which section 301 applied,

"(B) the amount of the distribution determined under section 301 (f) (2) exceeded the basis of the stock determined under section 301(f) (3), and

"(C) paragraph (7) did not apply in respect of such distribution, then proper adjustment shall be made, under regulations prescribed by the Secretary or his delegate, if such stock (or other property the basis of which is determined by reference to the basis of such stock) is sold or exchanged."

(f) Subsection (b) of section 561 of the Internal Revenue Code of 1954 (relating to deduction for dividends paid) is amended to read as follows:

"(b) SPECIAL RULES APPLICABLE.—

"(1) In determining the deduction for dividends paid, the rules provided in section 562 (relating to rules applicable in determining dividends eligible for dividends paid deduction) and section 563 (relating to dividends paid after the close of the taxable year) shall be applicable.

"(2) If a corporation received antitrust stock (as defined in section 301 (f)) in a distribution to which section 301 applied and such corporation distributes such stock (or other property the basis of which is determined by reference to the basis of such stock) to its shareholders, proper adjustment shall be made, under regulations prescribed by the Secretary or his delegate, to the amount of the deduction provided for in subsection (a)."

(g) The amendments made by this section shall apply only with respect to distributions made after the date of the enactment of this Act.

Amend the title so as to read:

A bill to amend the Internal Revenue Code of 1954 so as to provide that a distribution of stock made to an individual (or certain corporations) pursuant to an order enforcing the antitrust laws shall not be treated as a dividend distribution but shall be treated as a return of capital; and to provide that the amount of such a distribution made to a corporation shall be the fair market value of the distribution.

I. GENERAL STATEMENT

H.R. 8847, as amended by your committee, would add several new provisions to the Internal Revenue Code of 1954 relating to the income tax treatment of the recipients of stock distributed in an antitrust distribution. (An antitrust distribution is a distribution made in pursuance of an order enforcing the antitrust laws.)

Section 1 of the bill would add to the code a new section 111 which provides, in general, that where stock is received in an antitrust distribution by an individual shareholder (or any shareholder which is not entitled to the corporate dividends received deduction), the distribution will be treated as a return of capital, and its full fair market value will reduce the basis of the stock with respect to which it is made. If, however, the fair market value of the stock distributed exceeds the basis of the stock with respect to which the distribution is made, then gain is recognized to the extent of the excess and is taxable as any other gain would be. (This is the same as the income tax treatment of distributions made by corporations which have no earnings and profits.)

The return of capital treatment provided for by new section 111 may be illustrated by an example. An individual owns a single share of the stock of B corporation which has a basis to him of \$100. In a distribution pursuant to the terms of an antitrust order he receives from that corporation $1\frac{1}{3}$ shares of the X stock worth \$60. Because of the distribution his basis for the B stock (\$100) is reduced by the fair market value of the $1\frac{1}{3}$ shares of X stock received (\$60), so that after the distribution his basis for the B stock is \$40 (\$100 minus \$60). Thus, no income or gain is recognized to this shareholder because of the distribution. However, if his basis for the B stock were \$40, then on the receipt of \$60 worth of X stock a gain of \$20 (\$60 minus \$40) would be recognized. (Under existing law, in both cases the shareholder would have \$60 of dividend income taxed at ordinary income rates.) Of course the basis of the stock received to the recipient is always its fair market value.

Section 2 of the bill would add to the code new section 301(f) which provides special treatment for a corporation entitled to the dividends received deduction which receives stock in an antitrust distribution. In such a case the amount of dividend income and the amount of the dividends received deduction will both be determined by the fair market value of the stock distributed (without regard to the basis of such stock in the hands of the distributing corporation). However, the basis of the stock to the receiving corporation will be the fair market value of such stock diminished by that portion of the dividends received deduction attributable to the unrealized appreciation (if any) in the hands of the distributing corporation.

Under existing law a dividend in kind paid by one corporation to another is measured by the basis of the property distributed in the hands of the distributing corporation if this basis is less than fair market value. Accordingly, if under present law B corporation were to distribute one share of X stock (having a fair market value of \$45) as a dividend to a corporate shareholder, and this stock had a basis to B corporation of \$2, this would be a \$2 dividend to the receiving corporation. The 85-percent dividends received deduction would be \$1.70, so that only 30 cents would be subject to tax at the full corporate rate because of the receipt of the X stock. Thus, the tax would generally be 16 cents (52 percent of 30 cents) to the receiving corporation, although the X stock had a fair market value of \$45.

Under section 301(f), which would be added by the bill, in the case of an antitrust distribution, the tax to the receiving corporation would be computed on the \$45 fair market value of the stock received. This entire amount (\$45) would go into dividend income and there would be a dividends received deduction of 85 percent of \$45 (\$38.25), so that the tax at the full corporate rate would be paid on \$6.75 (\$45 minus \$38.25). The tax would, therefore, be 52 percent of \$6.75 or \$3.51.

Section 3 of the bill would add to the code technical amendments required by new section 301(f). One of the amendments provides for the special adjustment to earnings and profits which may be required when a corporation disposes of stock received in an antitrust distribution.

The other amendments made by section 3 all involve various sections in subchapter G of the 1954 code (relating to corporations used to avoid income tax on shareholders). That subchapter imposes special taxes on corporations improperly accumulating surplus and on personal holding companies and also imposes a special tax on the shareholders of foreign personal holding companies. Each of these taxes is measured by a specially defined type of corporate income. The amendments made to subchapter G provide that these special types of income will not, in general, be increased by reason of a receipt of stock in an antitrust distribution. The amendments also provide for proper adjustment to these special types of income when stock received in an antitrust distribution is sold, exchanged, or distributed as a dividend.

The amendments made by the bill apply with respect to distributions made after the date of enactment.

II. REASONS FOR THE BILL

The amendments made by the bill apply to all antitrust distributions which occur after the date of its enactment. However, the problems arising out of such distributions were called to the attention of Congress by the two decisions of the Supreme Court in the case of *United States v. E. I. du Pont de Nemours and Company, et al.* (353 U.S. 586 (1957), and 365 U.S. 806 (1961)).

Du Pont is a large chemical company engaged (among other things) in the manufacture of automotive paints and fabrics. It owns about 23 percent of the common stock of General Motors, nearly all of which it acquired about 40 years ago. General Motors is one of the largest users of automotive paints and fabrics in the country.

In 1949 the Department of Justice filed a complaint in an antitrust action against Du Pont. In 1957, after protracted litigation, the Supreme Court found that Du Pont's ownership of 23 percent of the stock of General Motors was a violation of section 7 of the Clayton Act, since this ownership might enable Du Pont to prevent other suppliers of automotive paints and fabrics from selling to General Motors. The court reached this conclusion although it believed that " * * * all concerned in high executive posts in both companies acted honorably and fairly * * *." The decision accordingly returned the case to the district court for proper equitable relief.

In the district court the Department of Justice proposed that Du Pont distribute its General Motors stock to its shareholders over a 10-year period. However, impressed by the harsh income tax consequences that would result from such distributions, the district court declined to order a divestiture and instead entered a decree under the terms of which Du Pont would refrain from voting the stock of General Motors but such stock would be voted instead directly by the Du Pont shareholders.

The United States again appealed and on May 22, 1961, the Supreme Court ruled that no less a remedy than complete divestiture is required and that such divestiture must be completed within 10 years. Thus, at the present time Du Pont will be required to rid itself of 63 million shares of General Motors stock within the period mentioned.

The problem of getting rid of such a huge amount of stock without upsetting the market is by no means an easy one. It seems that under any plan Du Pont will have to distribute some or all of the General Motors stock to its shareholders. It should be observed that an individual Du Pont shareholder receiving General Motors stock will (under existing law) be taxed on dividend income to the extent of fair market value of the stock received. Thus, he will owe a large tax but may have no cash in hand with which to pay it. In these circumstances it will frequently happen that he will be obliged to sell some or all of the stock received. Your committee believes that this result is harsh, insofar as the Du Pont shareholders are concerned, since these shareholders were not violators of the antitrust laws and were not parties to the proceedings. In addition, serious harm would result to the General Motors shareholders. It is clear that if a large number of persons are at the same time compelled to sell General Motors stock, the increase in the supply of this stock will appreciably depress its price to the detriment of the many General Motors shareholders who are not guilty of any wrongdoing. It is the purpose of this bill to prevent both the application of an unreasonably high tax rate to the individual shareholders of Du Pont and to save the General Motors shareholders from having the value of their investment seriously diminished by reason of events beyond their control.

Under the amendment made by the bill, the only individual shareholders who will owe any tax will be those whose basis for their Du Pont stock is less than the value of the General Motors stock to be distributed to them. Since in recent years the market price of the Du Pont stock has been high, in general, only shareholders who acquired the Du Pont stock before 1950 will pay any tax. As a result, a very large fraction of the recipients of the General Motors stock will not be under any pressure to sell this stock, so that the depressing effect on the market will be minimized.

Further market stability is expected to result from the enactment of the bill due to the fact that a major part of the stock held at a very low price is held by a relatively small group of shareholders. It is believed likely that this group will be able to sell some General Motors stock in an organized and orderly manner through underwriters.

For the reasons given, your committee believes that the enactment of the bill will make it possible to distribute the General Motors stock to the individual shareholders without unfair consequences to these shareholders and without damage to investors in General Motors stock. Your committee also believes that enactment of the bill will make it possible to accomplish this within a reasonable period of time.

However, if the return of capital approach which the bill applies to individuals were to be applied to domestic corporations as well as to individuals, this would result in a tax to some of the corporate shareholders which would be greatly in excess of the tax they would owe under present law. The largest corporate shareholder of Du Pont stock owns the Du Pont stock at a basis far below the present fair market value of the General Motors stock, so that under the return of capital approach a very substantial capital gain would be recognized on a distribution of the General Motors stock to it. For this reason, your committee believes it preferable to provide for the taxation of corporate shareholders under the modification of existing law above described, although under this method the tax on the corporate shareholders will be somewhat more tax than it would be under existing law.

Your committee believes that the special taxes imposed by subchapter G (which are, in effect, penalty taxes) should not be increased by antitrust distributions. For this reason section 3 was included in the bill.

The Treasury Department does not object to enactment of the bill as amended.

III. TECHNICAL EXPLANATION OF THE BILL

First section. Distributions of stock pursuant to orders enforcing the antitrust laws

The first section of H.R. 8847, as reported by your committee, amends subchapter O of chapter 1 of the Internal Revenue Code of 1954 by adding a new part IX. This part IX adds a new section 1111 providing that a distribution of stock made to an individual (or certain corporations) pursuant to an order enforcing the antitrust laws shall not be treated as a dividend distribution but shall be treated as a return of capital.

Section 1111. Distribution of stock pursuant to order enforcing the antitrust laws

Section 1111(a) provides that, notwithstanding sections 301, 312, and 316 of the Internal Revenue Code of 1954, the distribution of divested stock to a qualifying shareholder which would otherwise be treated as a dividend will be a distribution not out of earnings and profits. This rule will apply for all purposes of subtitle A. Thus, such a distribution will not diminish the earnings and profits of the distributing corporation.

To illustrate the application of section 1111(a), assume that Q, a qualifying shareholder, owns stock in corporation A with a basis of \$100 and that corporation A distributes the stock of corporation X, which is divested stock with a fair market value of \$40, to Q. Since the distribution is not out of earnings and profits because of the applicability of section 1111(a), the distribution is applied against and reduces the adjusted basis of Q's stock in corporation A under the provisions of section 301(c)(2). After the distribution the basis of the stock of corporation A held by Q is \$60 (\$100 minus \$40) and the basis of the stock of corporation X held by Q is fair market value, or \$40. On the other hand, assume that the facts are the same as stated above except that, prior to the distribution, the basis of the stock of corporation A in the hands of Q is \$15 instead of \$100. Since the fair market value of the distribution exceeds the basis of the stock of corporation A held by Q by \$25 (\$40 minus \$15), that amount is treated as gain from the sale or exchange of property under section 301(c)(3). After the distribution, Q's basis for the stock of corporation A is zero and his basis for the stock of corporation X is \$40.

Section 1111(b) defines a qualifying shareholder as any shareholder other than a corporation which may be allowed a deduction under section 243, 244, or 245 with respect to dividends received. Thus, a foreign corporation not doing business in the United States, or an electing small business corporation under subchapter S, would be a qualifying shareholder. On the other hand, a domestic corporation is not considered a qualifying shareholder even though it did not obtain the dividends received deduction because of the rules contained in section 246(b) or 246(c).

Section 1111(c)(1) provides that subsection (a) will not be applicable if one of the principal purposes of the transaction is the distribution of earnings and profits of the distributing corporation or of the corporation whose stock is distributed.

Section 1111(c)(2) provides that the term "stock" includes rights to fractional shares.

Section 1111(d) defines the term "antitrust order" as a judgment, decree, or other order of a court or of a commission or board in a suit or proceeding under the Sherman Act or the Clayton Act or both, to which the United States or such commission or board is a party.

Section 1111(e) defines the term "court" as a court or commission or board issuing an antitrust order.

Section 1111(f) defines the term "divested stock" as stock which meets certain requirements. Under paragraph (1) of subsection (f) the stock must be subject to an antitrust order entered after January 1, 1961, and the order must require the distributing corporation to divest itself of such stock by distributing it to its shareholders (or must require such distribution as an alternative to other action by any person) and it must specify and itemize the stock to be divested. Paragraph (2) of subsection (f) contains the additional requirement that the court must make certain findings. First, the court must find that the divestiture by means of distribution is necessary or appropriate to effectuate the policies of the Sherman Act or the Clayton Act or both. Secondly, the court must find that the application of subsection (a) is required to reach an equitable antitrust order in

such suit or proceeding. Finally, the court must find that the period of time for the complete divestiture fixed in the order (or orders) is the shortest period within which such divestiture can be executed with due regard to the circumstances of the particular case. Subsection (f) further provides that stock will not be considered divested stock if the court finds that divestiture is required because of an intentional violation of the Sherman Act or Clayton Act, or both.

Subsection (b) of the first section of the bill amends the table of parts for subchapter O of chapter 1 of the Internal Revenue Code of 1954.

Subsection (c) of the first section of the bill provides that the amendments made by the first section shall apply only with respect to distributions made after the date of enactment of the act.

Section 2. Amendment to section 301 of the Internal Revenue Code

Section 2(a) of the bill amends section 301 of the Internal Revenue Code of 1954 by redesignating subsection (f) as subsection (g) and inserting after subsection (e) a new subsection (f). In general, the new subsection (f) provides that the amount of a distribution of antitrust stock received by a corporation in a distribution to which section 301 applies shall be its fair market value. Subsection (f) also provides rules for determining the basis of such stock in the distributee corporation's hands.

Section 301(f) (1) defines "antitrust stock" as stock received in a distribution made after September 6, 1961, either pursuant to the terms of, or in anticipation of, an antitrust order (as defined in subsec. (d) of sec. 1111). Thus, the definition of antitrust stock for purposes of section 301 is broader than the definition of divested stock in section 1111, and stock may be antitrust stock even though it fails to meet the requirements of the definition of divested stock.

Section 301(f) (2) states that notwithstanding section 301(b) (1), but subject to section 301(b) (2), for purposes of section 301 the amount of a distribution of divested stock received by a corporation shall be its fair market value. This rule applies without regard to the adjusted basis of the stock in the hands of the distributing corporation. However, the amount of the distribution as determined under subsection (f) will be reduced in accordance with the rules contained in section 301(b) (2), where a liability of the corporation is assumed by the shareholder in connection with the distribution or where the stock is distributed subject to a liability.

Section 301(f) (3) provides the rule for determining the basis of antitrust stock received by a corporation in a distribution to which subsection (a) of section 301 applies. Such basis shall be the fair market value of the stock (determined as of the date of the distribution in accordance with section 301(b) (3)) decreased by so much of the deduction for dividends received under the provisions of section 243, 244, or 245 as is, under regulations prescribed by the Secretary or his delegate, attributable to the excess, if any, of (1) the fair market value of the stock, over (2) the adjusted basis (in the hands of the distributing corporation immediately before the distribution) of the stock, increased by the amount of gain which is recognized to the distributing corporation by reason of the distribution.

For example, corporation A distributes antitrust stock to corporation B. The stock has a basis to corporation A of \$1,500 and the fair market value of the stock is \$2,500. Under section 301(f) (2) the amount distributed is \$2,500 (the fair market value) notwithstanding section 301(b) (1) (B) which would otherwise have provided that the amount distributed was \$1,500 (the adjusted basis of the stock in the hands of the distributing corporation). Assume corporation B is allowed a dividends received deduction of 85 percent of the fair market value of the stock under section 243. After the distribution the basis of the stock in the hands of corporation B as determined under section 301(f) (3) is the fair market value of the stock (\$2,500) decreased by the amount of the dividends received deduction attributable to the excess of the fair market value of the stock (\$2,500) over the adjusted basis of the stock in the hands of the distributing corporation (\$1,500). Since this excess is \$1,000, and since the amount of the dividends received deduction attributable to such excess is 85 percent of \$1,000 or \$850, the basis of the stock in the hands of corporation B is \$2,500 minus \$850, or \$1,650.

Section 2(b) of the bill provides that the amendments made by section 2 shall apply only with respect to distributions made after the date of enactment of the act.

Section 3. Amendments to sections 312, 535, 543, 545, 556, and 561 of the Internal Revenue Code

Section 3(a) of the bill amends section 312 of the Internal Revenue Code of 1954 (relating to the effect on earnings and profits) by adding a new subsection (k) which provides a special adjustment to earnings and profits in the event of certain dispositions of antitrust stock received as a dividend. The new subsection (k) provides that if a corporation received antitrust stock in a distribution to which section 301 applied, and the amount of the distribution determined under section 301(f)(2) exceeded the basis of the stock determined under section 301(f)(3), then proper adjustment shall be made, under regulations prescribed by the Secretary of the Treasury or his delegate, to the earnings and profits of such corporation at the time such stock (or other property the basis of which is determined by reference to the basis of such stock) is disposed of by such corporation. Ordinarily, the adjustment will be the excess of the amount which was included in the earnings and profits of the corporation at the time it received the distribution of antitrust stock, over the adjusted basis of the stock in the distributee corporation's hands immediately after the distribution. However, the adjustment will not reduce the earnings and profits below zero. Assume, for example, that a corporation receives antitrust stock in a transaction to which section 301 applied. The amount of the distribution, determined under section 301(f)(2), is \$1,000 and the basis of the property in the corporation's hands, determined under section 301(f)(3), is \$400. The property is later sold by the corporation for \$450. The amount of the adjustment will be \$600. If, in the above case the stock is distributed to the shareholders of the corporation rather than sold, the adjustment also will be \$600. However, generally no adjustment would be made where the antitrust stock is exchanged for other property the basis of which is determined by reference to the basis of such antitrust stock, since the adjustment would be postponed until the corporation disposes of the property received in the exchange.

Section 3(b) of the bill amends subsection (b) of section 535 of the Internal Revenue Code of 1954 (relating to accumulated taxable income) by adding new paragraphs (9) and (10).

Paragraph (9) sets forth a new adjustment to taxable income which shall be made for purposes of computing accumulated taxable income. Under this provision there shall be allowed as a deduction the amount of any dividend distribution of divested stock (as defined in subsec. (f) of sec. 1111), minus the taxes imposed by subtitle A attributable to such receipt. This adjustment prevents the receipt of divested stock from increasing accumulated taxable income. However, the adjustment is made only if the stock with respect to which the distribution is made was owned by the distributee on September 6, 1961, or was owned by the distributee for at least 2 years prior to the date on which the antitrust order (as defined in subsec. (d) of sec. 1111) was entered. This limitation will deny the benefit of the adjustment, for example, where an individual shareholder transfers stock as a contribution to capital to a corporation shortly before a distribution of divested stock. In determining whether stock was owned by a distributee corporation on September 6, 1961, or for at least 2 years prior to the date on which the antitrust order was entered, stock which is received tax free as a stock dividend under section 305 will be treated as owned for the same period of time as the stock with respect to which the stock dividend was distributed. However, a corporation which acquires stock as a contribution to capital or in a transfer qualifying under section 351 will be treated as owning the stock only during the period of actual ownership, notwithstanding that the holding period for such stock under section 1223 includes the period for which such stock was held by the transferor.

Paragraph (10) provides that, in computing accumulated taxable income, if a corporation received antitrust stock (as defined in sec. 301(f)) in a distribution to which section 301 applied, and the amount of the distribution determined under section 301(f)(2) exceeded the basis of the stock determined under section 301(f)(3), then proper adjustment shall be made, under regulations prescribed by the Secretary or his delegate, if such stock (or other property the basis of which is determined by reference to the basis of such stock) is sold or exchanged. Ordinarily, the adjustment will be the excess of the amount which was included in the accumulated taxable income of the corporation at the time it received the distribution of antitrust stock, over the adjusted basis of the stock in the distributee corporation's hands immediately after the distribution. The adjustment does not apply where the antitrust stock qualified as divested

stock at the time of receipt and paragraph (9) applied to prevent the receipt of such stock from increasing accumulated taxable income.

Section 3(c) of the bill amends section 543 of the Internal Revenue Code of 1954 (relating to personal holding company income) by adding a new sentence at the end of paragraph (1) of subsection (a) and by adding a new subsection (d).

The new sentence in paragraph (1) of section 543(a) provides, in effect, that a dividend distribution of divested stock (as defined in subsec. (f) of sec. 1111) will not be treated as personal holding company income. However, this rule applies only if the stock with respect to which the distribution is made was owned by the distributee on September 6, 1961, or was owned by the distributee for at least 2 years prior to the date on which the antitrust order (as defined in subsec. (d) of sec. 1111) was entered.

The new subsection (d) of section 543 provides a special adjustment on disposition of antitrust stock received as a dividend. Under new subsection (d), if a corporation received antitrust stock (as defined in sec. 301(f)) in a distribution to which section 301 applied, and the amount of the distribution determined under section 301(f)(2) exceeded the basis of the stock determined under section 301(f)(3), then proper adjustment shall be made, under regulations prescribed by the Secretary of the Treasury or his delegate, to amounts includible in personal holding company income under paragraph (2) of section 543(a) with respect to such stock (or other property the basis of which is determined by reference to the basis of such stock). Thus, if the fair market value of antitrust stock received as a dividend was treated as personal holding company income at the time of receipt, gain from a subsequent sale of such stock will not again be treated as personal holding company income under section 543(a)(2) except to the extent that such gain represents appreciation in value occurring after the stock was received. This adjustment is not to be made if the antitrust stock, when received as a dividend, was excluded from personal holding company income under the new sentence of section 543(a)(1).

Since foreign personal holding company income is determined under section 553 by reference to section 543, the amendments made by section 3(c) of the bill will also apply in determining foreign personal holding company income under section 553.

Section 3(d) of the bill amends section 545(b) of the Internal Revenue Code of 1954 (relating to undistributed personal holding company income) by adding new paragraphs (10) and (11).

Paragraph (10) allows as a deduction, for purposes of computing undistributed personal holding company income, the amount of any income attributable to the receipt of a distribution of divested stocks (as defined in subsec. (f) of sec. 1111), minus the taxes imposed by subtitle A attributable to such receipt. Thus, the receipt of divested stock will not increase undistributed personal holding company income. However, this rule applies only if the stock with respect to which the distribution is made was owned by the distributee on September 6, 1961, or was owned by the distributee for at least 2 years prior to the date on which the antitrust order (as defined in subsec. (d) of sec. 1111) was entered. This limitation will deny the benefit of the deduction, for example, where an individual owning stock with respect to which a distribution of divested stock is to be made transfers such stock to a personal holding company shortly before the distribution.

Paragraph (11) provides that, in computing undistributed personal holding company income, if a corporation received antitrust stock in a distribution to which section 301 applied, and the amount of the distribution determined under section 301(f)(2) exceeded the basis of the stock determined under section 301(f)(3), then proper adjustment shall be made, under regulations prescribed by the Secretary of the Treasury or his delegate, if such stock (or other property the basis of which is determined by reference to the basis of such stock) is sold or exchanged. Ordinarily, the amount of the adjustment will be equal to the excess of the amount included in undistributed personal holding company income on the receipt of such stock over the basis of the stock in the hands of the recipient corporation immediately after such receipt. This adjustment is not made where new paragraph (10) of section 545(b) applied in respect of such distribution to prevent the receipt of the distribution from increasing undistributed personal holding company income.

Section 3(e) of the bill amends section 556(b) of the Internal Revenue Code of 1954 (relating to undistributed foreign personal holding company income) by adding two new paragraphs, designated as (7) and (8). The effect of these

amendments is to provide for the treatment of undistributed foreign personal holding company income in a manner parallel to the manner in which undistributed personal holding company income is treated under the amendments made to section 545(b) of the Internal Revenue Code by section 3(d) of the bill with respect to distributions of divested stock and dispositions of antitrust stock.

Section 3(f) of the bill amends section 561(b) of the Internal Revenue Code of 1954 (relating to deduction for dividends paid) by inserting a new subsection (b) in place of subsection (b) of existing law. The rules contained in subsection (b) of existing law are retained in paragraph (1) of the new subsection. Paragraph (2) of subsection (b) provides that, in computing the deduction for dividends paid, if a corporation received antitrust stock (as defined in section 301(f)) in a distribution to which section 301 applied, then proper adjustment shall be made, under regulations prescribed by the Secretary of the Treasury or his delegate, if such stock (or other property the basis for which is determined by reference to such stock) is distributed by the corporation to its shareholders. For example, if a personal holding company receives divested stock and because of paragraph (10) (as added by this bill) of section 545(b) a deduction is allowed for the amount of income (minus taxes paid) attributable to the receipt of such distribution, then upon distribution of such stock as a dividend by the corporation to its shareholders, the amount of the dividends paid deduction with respect to such dividend distribution under section 561 shall be reduced to zero in computing the undistributed personal holding company income.

Section 3(g) of the bill provides that the amendments made by section 3 of the bill shall apply only with respect to distributions made after the date of enactment of the bill.

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[H.R. 8847] ²

DISTRIBUTIONS OF STOCK PURSUANT TO ORDERS ENFORCING THE ANTITRUST LAWS

[Senate Report No. 1100, Eighty-Seventh Congress, First Session, Calendar No. 1080]

[September 21, 1961]

Mr. BYRD of Virginia, from the Committee on Finance, submitted the following report together with Minority Views to accompany H. R. 8847.

The Committee on Finance, to whom was referred the bill (H.R. 8847) to amend the Internal Revenue Code of 1954 so as to provide that a distribution of stock made to an individual (or certain corporations) pursuant to an order enforcing the antitrust laws shall not be treated as a dividend distribution but shall be treated as a return of capital; and to provide that the amount of such a distribution made to a corporation shall be the fair market value of the distribution, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

I. GENERAL STATEMENT

H.R. 8847, as passed by the House, would add several new provisions to the Internal Revenue Code of 1954 relating to the income tax treatment of the recipients of stock distributed in an antitrust distribution. (An antitrust distribution is a distribution made in pursuance of a court order enforcing the antitrust laws.) At the request of the administration, the bill has been limited to distributions in the *Du Pont* antitrust case (*United States v. E. I. du Pont de Nemours and Company, et al.*, 353 U.S. 586 (1957) and 365 U.S. 806 (1961)). The bill only applies if the order, pursuant to which the distribution is made, requires the divestiture of stock to be completed within 3 years or less from the date the order becomes final.

Section 1 of the bill would add to the code a new section 1111 which provides, in general, that where stock is received in an antitrust distribution by an individual shareholder (or any shareholder which is not entitled to the corporate

² Public Law 87-403, page 370, this Bulletin.

dividends received deduction), the distribution will be treated as a return of capital, and its full fair market value will reduce the basis of the stock with respect to which it is made. If, however, the fair market value of the stock distributed exceeds the basis of the stock with respect to which the distribution is made, then gain is recognized to the extent of the excess and is taxable as any other gain would be. (This is the same as the income tax treatment of distributions made by corporations which have no earnings and profits.)

This treatment may affect the taxation of individuals who do not hold title to the stock. For example, if under the terms of a trust instrument, and all the other circumstances of the case, all capital gains of the trust are taxable to the beneficiary (whether or not distributed), then a distribution of antitrust stock to the trustee would result in capital gains income to the beneficiary and not to the trustee if the requirements of the statute are otherwise satisfied.

The return of capital treatment provided for by new section 1111 may be illustrated by an example. An individual owns a single share of the stock of Du Pont which has a basis to him of \$100. In a distribution pursuant to the terms of an antitrust order he receives from that corporation $1\frac{1}{2}$ shares of the General Motors stock. Because of the distribution his basis for the Du Pont stock (\$100) is reduced by the fair market value of the $1\frac{1}{2}$ shares of General Motors stock received (\$60), so that after the distribution his basis for the Du Pont stock is \$40 (\$100 minus \$60). Thus, no income or gain is recognized to this shareholder because of the distribution. However, if his basis for the Du Pont stock were \$40, then on the receipt of \$60 worth of General Motors stock a gain of \$20 (\$60 minus \$40) would be recognized. (Under existing law, in both cases the shareholder would have \$60 of dividend income taxed at ordinary income rates.) Of course the basis of the stock received to the recipient is always its fair market value. Without regard to the shareholder's basis for his Du Pont stock, his holding period, for income tax purposes for the General Motors stock received, begins when he receives it.

The special tax treatment of individuals will not apply to a distribution of General Motors stock which is made in lieu of an ordinary cash dividend distribution which would have been made if the bill had not been enacted. This is provided for by subsection 1111(c) (1) which would be added to the code by the bill.

Section 2 of the bill would add to the code new section 301(f) which provides special treatment for a corporation entitled to the dividends received deduction which is a party to an antitrust court proceeding and which receives stock in an antitrust distribution. In such case the amount of dividend income and the amount of the dividends received deduction will both be determined by the fair market value of the stock distributed (without regard to the basis of such stock in the hands of the distributing corporation). However, the basis of the stock to the receiving corporation will be the fair market value of such stock diminished by that portion of the dividends received deduction attributable to the unrealized appreciation (if any) in the hands of the distributing corporation.

Under existing law a dividend in kind paid by one corporation to another is measured by the basis of the property distributed in the hands of the distributing corporation if this basis is less than fair market value. Accordingly, under present law if Du Pont Co. were to distribute one share of General Motors stock (having a fair market value of \$45) as a dividend to Christiana Securities Corp., and this stock had a basis to Du Pont Co. of \$2, this would be a \$2 dividend to Christiana. The 85-percent dividends received deduction would be \$1.70, so that only 30 cents would be subject to tax at the full corporate rate because of the receipt of the General Motors stock. Thus, the tax would be 16 cents (52 percent of 30 cents) to Christiana, although the General Motors stock had a fair market value of \$45.

Under section 301(f), which would be added by the bill, in the case of an antitrust distribution ordered in a suit to which Christiana is a party, the tax to Christiana would be computed on the \$45 fair market value of the stock received. This entire amount (\$45) would go into dividend income and there would be a dividends received deduction of 85 percent of \$45 (\$38.25), so that tax at the full corporate rate would be paid on \$6.75 (\$45 minus \$38.25). The tax would, therefore, be 52 percent of \$6.75 or \$3.51. Because of section 1223(2) of the Internal Revenue Code, Christiana's holding period for the General Motors stock received would include the period during which the General Motors stock was held by Du Pont.

Section 3 of the bill would add to the code technical amendments relating to the new section 301(f).

The amendments made by the bill apply with respect to distributions made after the date of enactment.

II. REASONS FOR THE BILL

The problems arising out of antitrust distributions were called to the attention of Congress by the two decisions of the Supreme Court in the case of *United States v. E. I. du Pont de Nemours and Company, et al.* (353 U.S. 586 (1957) and 365 U.S. 806 (1961)).

Du Pont is a large chemical company engaged (among other things) in the manufacture of automotive paints and fabrics. It owns about 23 percent of the common stock of General Motors, nearly all of which it acquired about 40 years ago. General Motors is one of the largest users of automotive paints and fabrics in the country.

In 1949 the Department of Justice filed a complaint in an antitrust action against Du Pont. In 1957, after protracted litigation, the Supreme Court found that Du Pont's ownership of 23 percent of the stock of General Motors was a violation of section 7 of the Clayton Act, since this ownership might enable Du Pont to prevent other suppliers of automotive paints and fabrics from selling to General Motors. The court reached this conclusion although it believed that " * * all concerned in high executive posts in both companies acted honorably and fairly * * * " The decision accordingly returned the case to the district court for proper equitable relief.

In the district court the Department of Justice proposed that Du Pont distribute its General Motors stock to its shareholders over a 10-year period. However, impressed by the harsh income tax consequences that would result from such distributions, the district court declined to order a divestiture and instead entered a decree under the terms of which Du Pont would refrain from voting the stock of General Motors but such stock would be voted instead directly by the Du Pont shareholders.

The United States again appealed and on May 22, 1961, the Supreme Court ruled that no less a remedy than complete divestiture is required and that such divestiture must be completed within 10 years. Thus, at the present time Du Pont will be required to rid itself of 63 million shares of General Motors stock within the period mentioned.

The problem of getting rid of such a huge amount of stock without upsetting the market is by no means an easy one. It seems that under any plan Du Pont will have to distribute at least some of the General Motors stock to its shareholders. It should be observed that an individual Du Pont shareholder receiving General Motors stock will (under existing law) be taxed on dividend income to the extent of fair market value of the stock received. Thus, he will owe a large tax but may have no cash in hand with which to pay it. In these circumstances it will frequently happen that he will be obliged to sell some or all of the stock received. Your committee believes that this result is harsh, insofar as the Du Pont shareholders are concerned, since these shareholders were not violators of the antitrust laws and were not parties to the proceedings. In addition, serious harm would result to the General Motors shareholders. It is clear that if a large number of persons are at the same time compelled to sell General Motors stock, the increase in the supply of this stock will appreciably depress its price to the detriment of the many General Motors shareholders who are not guilty of any wrongdoing. It is the purpose of this bill to prevent both the application of an unreasonably high tax rate to the individual shareholders of Du Pont and to save the General Motors shareholders from having the value of their investment seriously diminished by reason of events beyond their control.

Under the amendment made by the bill, the only individual shareholders who will owe any tax on the receipt of the General Motors stock will be those whose basis for their Du Pont stock is less than the value of the General Motors stock to be distributed to them. Since in recent years the market price of the Du Pont stock has been high, in general, only shareholders who acquired the Du Pont stock before 1950 will pay any tax. As a result, a very large portion of the recipients of the General Motors stock will not be under any pressure to sell this stock, so that the depressing effect on the market will be minimized.

Further market stability is expected to result from the enactment of the bill due to the fact that a major part of the Du Pont stock held at a very low basis is held by a relatively small group of shareholders. It is believed likely that this group will be able to sell some General Motors stock in an organized and orderly manner through underwriters.

For the reasons given, your committee believes that the enactment of the bill will make it possible to distribute the General Motors stock to the individual shareholders without unfair consequences to these shareholders and without damage to investors in General Motors stock. Your committee also believes that enactment of the bill will make it possible to accomplish this within the 3-year period fixed in the bill.

Christiana Corp. is the largest corporate shareholder of Du Pont, owning about one-third of the outstanding stock. For this reason, if Du Pont distributes all of the General Motors stock owned by it, Christiana will receive about 20 million shares of General Motors. The Department of Justice is expected to seek a court order requiring Christiana to divest itself of the General Motors stock by selling such stock. However, the court may direct Christiana to distribute some or all of the General Motors stock received in the distribution. If this were to occur, under terms of the amendments made by the bill the individual shareholders of Christiana would be treated in the same manner as individual shareholders of Du Pont were treated in the antitrust distribution made by it. Your committee wishes to make it very clear that it expresses no opinion as to what particular method of divestiture of General Motors stock by Du Pont or by Christiana is appropriate. It is contemplated by your committee that all issues dealing with the manner of divestiture are to be determined judicially, solely with reference to the antitrust principles announced by the Supreme Court in the *Du Pont* case.

It should be observed that under the amendments made by the bill, Christiana will pay somewhat more tax on the receipt of the General Motors stock than it would pay if such amendments had not been made. Your committee believes that this is justified by the fact that Christiana's individual shareholders will receive the special "return of capital" treatment provided for in the bill, if Christiana should be ordered to distribute to them the stock received by it. However, Christiana will pay the additional tax whether or not a distribution by it is ordered.

The amendments made by the bill provide only for distributions in court proceedings which were begun on or before January 1, 1959. Your committee has not yet reached a definite opinion as to what relief, if any, should be given to other taxpayers who may be required to distribute stock pursuant to the antitrust laws. However, it should be observed that in many antitrust situations the corporation which would be required to distribute stock of another corporation would own more than 80 percent of such stock. Thus, in many cases the distribution of the stock would be tax free to the shareholders because of section 355 of the Internal Revenue Code. (That section permits the tax free distribution of the stock of an 80-percent owned subsidiary when parent and subsidiary have each been engaged in the active conduct of a trade or business for more than 5 years.)

The Treasury Department and the Department of Justice do not object to enactment of the substitute for the committee amendment to H.R. 8847.

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MINORITY VIEWS

INTRODUCTION

We are opposed to the Du Pont bill in its present form for a variety of reasons. These include the fact that—

(1) In the absence of a final court order, we are legislating in a partial vacuum. The tax and other consequences of the Du Pont divestiture of General Motors stock will not be known until there is a final court order, presumably late this fall or early next year.

(2) The priority for tax relief for the shareholders of General Motors and Du Pont, in view of the numerous tax loopholes and gross inequities in the present tax law, is about as low as for any group in the country. Although it has been impossible to move in both the House and the Senate on the tax reform proposals of the President, we find that a bill for the relief of those who are among the highest income groups in the country is treated with loving care and tender mercy by the committees of the Congress.

(3) The bill selects the most favored tax treatment for individual shareholders by treating the divestiture of General Motors stock to them as a "capital gain," and it also gives the most favored tax treatment to cor-

porations by treating the divestiture of General Motors stock to them as an "intercorporate dividend." There is a serious inconsistency here and the result could be a loss of from \$110 to \$140 million of revenue which the Government should properly receive.

TIMING

The haste with which the Congress is acting on this matter is not only unseemly and likely to be conducive of poor legislation, but also ill advised and unnecessary.

This bill, as it is now presented to the Senate, is, in form and in substance, a private relief bill. Ordinarily when a taxpayer comes before the Congress for relief the first information required of him is that he spell out the condition or hardship from which relief is sought. In this case the conditions have not yet been determined.

On September 1 of this year, Du Pont filed its proposed judgment of divestiture with the Chicago court. The Department of Justice has until October 2 to propose amendments. The court will then take the matter under advisement and decide what its final order is to be. Assuming the Chicago court acts with all possible speed and dispatch, an assumption not warranted by previous events. It is not likely that the final order would be entered before the first of November, perhaps much later.

The Supreme Court has decreed that divestiture must commence within 90 days of final judgment, which means that divestiture need not begin prior to February 1, 1962, or later. This will give the Congress ample time in which to act on a relief measure in January, provided a relief measure seems appropriate to mitigate whatever harshness there may be in the court order. The Congress will then know definitely whether the relief it is granting is for the benefit of the Du Pont Co., Christiana, the Du Pont family, General Motors, or the individual stockholders of Du Pont and General Motors. It will, indeed, then know whether any relief at all is indicated, and, if so, what type of relief.

As matters now stand, this bill is for the relief of the Du Pont Co., as we shall later show.

It is, perhaps, even improper for the Congress to act at this time on any bill, since such action might well influence the final decree of the Chicago court. In our opinion the courts should be allowed to proceed on a case, once litigation has begun, without congressional interference. This litigation has now been before the courts for about 12 years and should be brought to an orderly conclusion. We cannot see that direct congressional interference at this time would be in keeping with the role which should properly be played, under the Constitution, by our branch of government. Indeed, congressional interference of this type would be no more appropriate than interference by the Executive.

PRIORITY

The Finance Committee ordinarily takes the position that tax measures must originate in the House. Time and again we have failed to hold hearings on important legislation or tax reform amendments to legislation on the grounds that the House has not acted or has not initiated the proposal.

This year when we urged Senate hearings on the President's tax reform proposals before the House had finished action, the committee refused to do so on this very ground.

In the case of the Du Pont bill, however, the Finance Committee held hearings before the House had finished its consideration of the bill. We wish to make it clear that we do not disapprove of this procedure. In fact, we applaud it. We are constrained to note, however, that it is not followed consistently, as pointed out above.

In the years we have served on the Finance Committee, we have never known the committee to hold an evening meeting. This year, however, members were notified at 3 minutes of 7 p.m. on September 20 that an executive session to consider this bill would be held at 8 p.m. We doubt very much that such swift action would be taken on a proposal to close a tax loophole or to give tax relief to the millions of people in this country who pay ordinary income tax and who are not in a position to take advantage of the numerous loopholes in the tax laws.

The Congress is therefore giving priority, both for tax relief and in the speed of its procedures, to a group whose need is not yet known and who, in any case, would have a very low priority for such relief compared with the ordinary taxpayer, in the light of the burdens which he must bear.

DEFECTS IN THE BILL

1. Is the divestiture of General Motors stock a capital transaction or is it a dividend?

There are some very serious defects in the bill. The Du Pont Co. will be required to divest its General Motors stock to both individual stockholders and corporate stockholders.

In the case of individual stockholders, if the divestiture is treated as an ordinary dividend the tax is relatively high, but if the divestiture is treated as a return of capital the tax is relatively low. Thus, with respect to individual stockholders, this bill treats the divestiture as a return of capital and thus requires that the lower tax be paid.

In the case of divestiture to corporations, if the divestiture is treated as an intercorporate dividend the tax is very low (i.e., 52 percent of 15 percent, or 7.8 percent), but if the divestiture is treated as a return of capital the tax is relatively high. Thus, in the case of divestiture to corporations, this bill chooses the method by which a lower tax is paid and treats the divestiture as a dividend.

In other words, with respect to the two classes who will receive General Motors stock from Du Pont, namely, individual stockholders and corporate stockholders, in each case the bill gives the most favored tax treatment to the recipient.

Our position is that this divestiture is either a capital transaction or it is a dividend. It cannot be both. It should not be a return of capital to the individual and a dividend to the corporation, nor should it be a dividend to the individual and a return of capital to the corporation. It should be one or the other, and the bill is highly inconsistent in this respect.

Needless to say, inconsistency in the bill gives the most favored tax treatment in each case. This inconsistency in treatment of individual stockholders on the one hand, and the corporate stockholders on the other, can have very serious consequences with respect to the public interest.

The Christiana Securities Co., which is in effect a family holding company, owns about 29 percent of the Du Pont stock. Hence, a proportionate share of the General Motors stock which is to be divested will go to Christiana. Under the bill this will be taxed as an intercorporate dividend, which, in this case, would be at the rate of 52 percent of 15 percent of the market value of the stock. Since the market value of the stock is about \$45 this means that Christiana will pay a tax of approximately \$3.50 per share because of this treatment. If, on the other hand, the divestitures of General Motors stock to Christiana and other corporations were treated as a capital gain—as the company and the bill argue is correct for the divestiture to individuals—the tax would be approximately \$10.75 per share. In other words, there is a tax savings of about \$7.25 per share for that portion of General Motors stock which is divested to corporations.

Unless a capital gains tax is paid, this will mean a loss in revenue to the Government, which we think rightly should be paid, and a gain to Christiana, of somewhere between \$110 and \$140 million.

This effect could be ameliorated if Christiana were required to divest itself of General Motors stock to its individual shareholders. But at this time Christiana is not before the court, there is no assurance that the court will order Christiana to divest itself of General Motors stock, and the receipt by the public and the Treasury of some \$110 to \$140 million remains a very "iffy" question.

If this bill were amended to require that the divestiture of General Motors stock to Christiana be treated as a capital gain, the problem would be greatly lessened and justice would be served.

Then the tax effects essentially would be the same whether Christiana divested or did not divest itself of its General Motors stock, and the court would be free to pass a judgment and to enter a final order without even having to consider these tax consequences. It is for this reason that we believe that the bill, as a minimum, should be amended in either one of two ways, namely: (1) to require that the divestiture of General Motors stock by Du Pont to corporations be treated as a capital gain, or (2) to require that the provisions of the bill be inapplicable unless Christiana is directed to divest to its stockholders or to sell the General Motors stock which it will receive from Du Pont.

Christiana owns 29 percent of the Du Pont stock. The Du Pont family, very broadly defined, comprises some 250 individuals, who own about 69 percent of Christiana common stock, or 9,180,000 shares of the 13,248,640 shares of Christiana which are outstanding. While only a small number of these people have any direct business connection with either Du Pont or with Christiana Securities Co., it is true that if Christiana is not required to divest itself of the General Motors stock it will receive from Du Pont, the favorable tax consequences we have mentioned would accrue to these individuals in proportion to their holdings in Christiana.

2. *Divestiture in lieu of dividends*

Another possible consequence of the bill as written is that the Du Pont Co. might, in divesting itself of its General Motors stock, do so in lieu of paying its ordinary dividend. That is to say that instead of paying its ordinary dividend it would give its stockholders General Motors stock. The stockholder would then be in a position of paying a capital gains tax instead of the ordinary dividend tax on what really is ordinary dividend from the company.

The bill has a general provision to guard against this danger but it lacks any specific test. We therefore believe that an amendment is in order to provide that only those amounts which are in excess of the average dividend paid over the past 3 years should be allowed the capital gains treatment.

3. *Partial liquidation*

This bill is based on the theory that the General Motors stock to be distributed is a return, or partial return, of capital to Du Pont stockholders—at least this is true as to individual stockholders. In our view this is not the best approach, even among possible approaches in the capital transactions area.

The return of capital theory has a place in the tax laws, and indeed is firmly ensconced there. It often happens in the oil industry that, with highly artificial and artificially high depletion allowances, an oil company has no bookkeeping profits. It generates extremely large cash flows, but shows no earnings on its books. It will be in a position to return to investors most, or all, of their original investment, and still be a healthy and going concern. This money returned to stockholders is not classified as a dividend, however, because it is technically not out of earnings. In such a case, under existing law, the stockholder's basis is reduced, but he pays no income tax on a dividend. This gives a free ride to the stockholder, to the extent that his basis can be reduced to zero.

The Du Pont case does not fit this type of transaction. The distribution of General Motors stock to Du Pont stockholders is not a return of capital, but is, in reality, a distribution of a greatly appreciated capital asset in the form of a dividend. And, of course, under this bill it is still called a dividend as far as corporate stockholders are concerned, because such a classification will make their taxes lighter.

The facts of this situation more nearly fit the partial liquidation theory. The distribution of General Motors stock is a partial liquidation of the assets of Du Pont. Existing law recognizes this sort of transaction, and provides a capital gains tax treatment for it. The reason this type of tax cannot be applied under existing law in this case, however, is that existing law provides that, in order to get capital gains the distributing corporation must own at least 80 percent of the total assets of the corporation with respect to which distribution is made. The Du Pont case does not fit the 80 percent criterion since Du Pont does not own 80 percent of General Motors, but it fits, logically, this type of transaction.

It would seem to us that it would be much more logical to follow the partial liquidation theory in this transaction. Indeed, this was the recommendation of the Treasury in 1959. Under this theory, a capital gains tax would be paid by individual stockholders, just as in the current bill, but the basis for General Motors and Du Pont stock would be computed differently. Also, all stockholders, individual and corporate, would be treated alike.

One of the peculiarities of this bill, and one which is glossed over by its proponents, is the very artificial way in which the basis is computed for both the General Motors stock and the Du Pont stock in the hands of Du Pont stockholders following distribution of the General Motors stock. Under this bill, a great deal of the tax which ought to be paid under the capital gains theory is delayed by an artificial reduction of the basis of the Du Pont stock, and this basis may be reduced as low as zero.

Proponents of this measure will say that this portion of the tax is merely postponed. This is not so, particularly in the case of wealthy stockholders

who regularly make use of foundations and other devices to reduce their tax.

We think it is also in order to point out the position in which this bill puts General Motors. By the artificial method used in allocating basis between Du Pont and General Motors stock, there will be a great deal of Du Pont stock which will have a zero, or close to zero, basis. This stock will be held off the market. It will not be sold, because to sell it would subject the seller to a high capital gains tax. The Du Pont stockholder who wants to sell anything will sell the General Motors stock which he will receive as a result of this divestiture because that stock will have a relatively high basis and, therefore, such a sale will subject him to a low capital gains tax.

Now, what does this mean for General Motors? It means that General Motors stock may very well have an uncertain market for years to come. The management of General Motors will be at a decided disadvantage if they try to issue any new stock to raise equity capital. This bill, in our opinion, does no favors for General Motors; indeed, if this bill were as helpful to General Motors as has been claimed, it seems to us that the president of General Motors would have been before the Finance Committee to urge its passage. That company was content with filing a routine statement.

SHIFTING THE TAX BURDEN

Actually this bill has been, and is being, widely misinterpreted as a relief measure for the benefit of Du Pont stockholders. It is no such thing. It is a relief measure for the benefit of the Du Pont Co. and will result in shifting a tax from the company to the stockholders directly.

The president of Du Pont has testified before the Finance Committee to the effect that, under existing law, his company would follow a three-part plan of divestiture which would subject the stockholders of Du Pont to no taxes in excess of the normal tax on their dividends. Instead, this plan would subject the Du Pont Co. to a tax of somewhere between \$123 and \$350 million. This tax, of course, spread over a 10-year period, would hardly be confiscatory for a company which earned \$787 million in 1960.

Under the terms of this bill, however, the tax burden would be shifted directly to, and squarely upon the shoulders of, the individual and corporate stockholders of the Du Pont Co. This bill is, therefore, not for the benefit of the stockholders, as such, but for the benefit of the company.

We will be ready in January to consider a bill to cover whatever situation develops as a result of the Court order, after such order has become final. At this time, we feel any bill is premature, and the bill now before the Senate, regardless of its possible merits or obvious defects, should not be enacted into law.

PAUL H. DOUGLAS.
ALBERT GORE.

PART V
ADMINISTRATIVE AND MISCELLANEOUS
MATTERS

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PART V

ADMINISTRATIVE AND MISCELLANEOUS MATTERS

OFFICE OF THE SECRETARY

TREASURY DEPARTMENT ORDER NO. 107 (Rev. 8)

Certain officials—Authority to affix seal of the Treasury Department.

By virtue of the authority vested in me as Secretary of the Treasury, including the authority conferred by section 161 of the Revised Statutes, it is hereby ordered that:

1. Except as provided for in paragraph 2, the following officers are authorized to affix the Seal of the Treasury Department in the authentication of originals and copies of books, records, papers, writings, and documents of the Department, for all purposes, including the purposes authorized by 28 U.S.C. 1733(b):

- (a) In the Office of Administrative Services:
 - (1) Director of Administrative Services;
 - (2) Chief, General Services Division;
 - (3) Chief, Printing and Procurement Division;
 - (4) Chief, Directives Control and Distribution Branch.
- (b) In the Internal Revenue Service:
 - (1) Commissioner of Internal Revenue;
 - (2) Director, and Assistant Director, Collection Division;
 - (3) Chief, and Assistant Chief, Operations Branch, Collection Division;
 - (4) Chief, and Assistant Chief, Miscellaneous Services Section, Operations Branch, Collection Division.
- (c) In the Bureau of Customs:
 - (1) Commissioner of Customs;
 - (2) Assistant Commissioner of Customs;
 - (3) Deputy Commissioner, Division of Management and Controls;
 - (4) Deputy Commissioner, Division of Investigations and Enforcement;
 - (5) Deputy Commissioner, Division of Appraisement Administration.
- (d) In the Bureau of the Public Debt:
 - (1) Commissioner of the Public Debt;
 - (2) Deputy Commissioner in Charge of the Chicago Office;
 - (3) Assistant Deputy Commissioner in Charge of the Chicago Office.

(e) In the U.S. Coast Guard:

- (1) Commandant;
- (2) Assistant Commandant;
- (3) Administrative Aide to the Commandant.

2. Copies of documents which are to be published in the FEDERAL REGISTER may be certified only by the officers named in paragraph 1(a) of this Order.

3. The Director of Administrative Services, the Commissioner of Internal Revenue Service, the Commissioner of the Public Debt, and the Commandant of the U.S. Coast Guard are authorized to procure and maintain custody of the dies of the Treasury Seal.

The officers authorized in paragraph 1(c) may make use of such dies.

Dated April 16, 1962.

[SEAL]

HENRY H. FOWLER,
Acting Secretary.

(Filed by the Division of the Federal Register on April 25, 1962, 8:45 a.m., and published in the issue of the Federal Register for April 26, 1962, 27 F.R. 4000)

DELEGATION ORDER NO. 11 (REV. 2)

(Effective January 1, 1962)

Delegation of authority to accept certain offers in compromise.

Pursuant to the authority vested in me by Treasury Department Order No. 150-25, dated June 1, 1953 [18 F.R. 3238], it is hereby ordered:

1. Subject to the limitations contained in applicable regulations and procedures, District Directors are delegated authority, under section 7122 of the Internal Revenue Code, to accept offers in compromise in cases in which the liability sought to be compromised (including any interest, additional amount, addition to the tax, or assessable penalty) is less than \$50,000, and in cases involving specific penalties.

2. This authority may not be redelegated.

3. This Order supersedes Delegation Order No. 11 (Revised), issued April 13, 1960 [C.B. 1960-2, 919].

MORTIMER M. CAPLIN,
Commissioner.

(Filed by the Division of the Federal Register on January 11, 1962, 8:46 a.m., and published in the issue of the Federal Register for January 12, 1962, 27 F.R. 357)

DELEGATION ORDER NO. 75 (REV. 1)

(Effective January 1, 1962)

Authority of Regional Appellate Division in offers in compromise.

Pursuant to authority vested in me as Commissioner of Internal Revenue, it is ordered that:

1. Each Assistant Regional Commissioner (Appellate) as Chief of the Appellate Division of the Region, is authorized and each Asso-

ciate Chief of the Appellate Division is authorized to determine the disposition to be made of any offer in compromise submitted under the provisions of section 3761 of the Internal Revenue Code of 1939, or section 7122 of the Internal Revenue Code of 1954, in which (a) the proponent has made a written request for Appellate Division consideration or (b) the liability was previously determined by the Appellate Division and the offer is based in whole or in part on doubt as to liability. Each Assistant Chief and each Special Assistant to the Chief is authorized to determine the disposition to be made of any such offer in compromise in which the unpaid amount of tax (including any interest, penalty, additional amount or addition to the tax) is less than \$50,000.

2. A determination by the Appellate Division to accept an offer under the provision of paragraph (1) hereof will be subject to my approval if the unpaid amount of tax (including any interest, penalty, additional amount or addition to the tax) is \$50,000 or more.

3. The authorities delegated in paragraph (1) hereof may not be redelegated and are not applicable to cases arising under laws relating to narcotics, smoking opium, marihuana, alcohol, tobacco tax or firearms or to offers in compromise coming within the jurisdiction of the Chief Counsel under existing procedures, rules or delegations.

4. This Order supersedes Delegation Order No. 75, issued February 18, 1960 [C.B. 1960-1, 861], and Amendment No. 1 thereto, issued June 1, 1960 [C.B. 1960-2, 921].

MORTIMER M. CAPLIN,
Commissioner.

(Filed by the Division of the Federal Register on January 11, 1962, 8:46 a.m., and published in the issue of the Federal Register for January 12, 1962, 27 F.R. 357)

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUB- CHAPTER H, PART 601.—STATEMENT OF PROCEDURAL RULES¹

Miscellaneous amendments

This part as filed with the Federal Register on June 29, 1955 [C.B. 1955-2, 921], and as last amended on July 29, 1961 [C.B. 1961-2, 546], is further amended as follows:

PARAGRAPH 1. Paragraph (b) of § 601.101 is amended to read as follows:

§ 601.101 INTRODUCTION.

* * * * *

(b) *Scope.*—This part sets forth the procedural rules of the Internal Revenue Service respecting all taxes administered by the Service, and supersedes the previously published statement (26 CFR (1949 ed., Part 300-End) Parts 600 and 601) with respect to such procedural rules. Subpart A provides a descriptive statement of the general course and method by which the Service's functions are channeled and determined, insofar as such functions relate generally to the assessment and collection of internal revenue taxes. Certain provisions special to particular taxes are separately described in Subpart D. Conference and practice requirements of the Internal Revenue Service are contained in Subpart E. Specific matters not generally involved in the assessment and collection functions are separately described in Subpart B. A description of the rule-making functions of the Treasury Department with respect to in-

¹ 26 F.R. 12688.

ternal revenue tax matters is contained in Subpart F. The procedural rules of the Service with respect to distilled spirits, wines, beer, tobacco products (manufactured tobacco, cigars, and cigarettes), tobacco materials, cigarette papers and tubes, and certain firearms are described in Subpart C of this part. Subpart G relates to matters of official record in the Internal Revenue Service and the extent to which records and documents are subject to publication or open to public inspection. This part does not contain a detailed discussion of the substantive provisions pertaining to any particular tax or the procedures relating thereto, and for such information it is necessary that reference be made to the applicable provisions of law and the regulations promulgated thereunder. The regulations relating to the taxes administered by the Service are contained in Titles 26 and 27 of the Code of Federal Regulations.

PAR. 2. Paragraph (c) (1) of § 601.103 is amended to read as follows:

§ 601.103 SUMMARY OF GENERAL TAX PROCEDURE.

* * * * *

(c) *Disputed liability.*—(1) *General.*—If the informal conference does not result in agreement on the adjustments proposed to be made, the taxpayer is given an opportunity to submit a protest in writing, stating under penalties of perjury the facts on which he relies and the grounds for his contention that the adjustments are not proper. Following review of the protest, the case will be referred to the Appellate Division of the region (if that Division has jurisdiction, see § 601.106(a)(3)), and the taxpayer may also be accorded a conference in the Appellate Division. The determination of tax liability by the Appellate Division is final insofar as the taxpayer's appellate rights within the Service are concerned.

PAR. 3. Section 601.105 is amended by revising subparagraph (5) of paragraph (b), by revising subparagraph (1) of paragraph (d), and by adding a new paragraph (i) at the end. These amended provisions read as follows:

§ 601.105 EXAMINATION OF RETURNS AND CLAIMS FOR REFUND, CREDIT OR ABATEMENT; DETERMINATION OF CORRECT TAX LIABILITY.

* * * * *

(b) *Examination of returns.* * * *

(5) *Technical advice from the National Office.*—Where the district director decides that an issue requires technical advice from the National Office, the taxpayer will be advised of the proposed referral. If he so desires, the taxpayer may submit a brief of the facts, law, and argument to be transmitted with the case to the National Office. Similarly, a taxpayer may request that an issue be referred to the National Office for technical advice on the grounds of lack of uniformity or that the issue is so unusual or complex as to warrant National Office consideration. If the examining officer (or informal conference, in case of an informal conference) is of the opinion that the circumstances do not warrant such referral, the matter will be submitted to the Chief, Audit Division, for decision. If the Chief, Audit Division, determines that advice from the National Office will not be requested, he will inform the taxpayer, in writing, of his decision.

* * * * *

(d) *Thirty-day letters and protests.*—(1) *General.*—The report of the examining agent, as approved after review, recommends one of four determinations:

- (i) Acceptance of the return as filed and closing of the case;
- (ii) Assertion of a given deficiency or additional tax;
- (iii) Allowance of a given overassessment, with or without a claim for refund, credit, or abatement;
- (iv) If a claim for refund, credit, or abatement has been filed and has been found wholly lacking in merit, denial of the claim.

If any one of the last three determinations is made (except a full allowance of a claim in respect of any tax), unless the taxpayer has previously agreed with the finding by signing an agreement form as described in this section, the district director sends to the taxpayer a preliminary or "30-day letter". This is a form letter which states the determination proposed to be made. It is accompanied by a copy of the examining agent's report explaining the basis of the proposed

determination. It suggests to the taxpayer that if he concurs in the recommendation, he indicate his agreement by executing and returning the enclosed form of waiver or acceptance. The preliminary letter also advises the taxpayer that if he disagrees with the proposed determination he may file a written protest under penalties of perjury within 30 days from the date of the letter stating the grounds for his disagreement and he may have a hearing in the Appellate Division of the region if requested and if that Division has jurisdiction (see § 601.106(a)(3)). Failure by the taxpayer to make any response within 30 days will result in the issuance of a statutory notice of deficiency or other appropriate action, such as the issuance of a notice of adjustment or the denial of a claim in income, profits, estate, and gift tax cases, and appropriate adjustment of the tax liability or denial of a claim in excise and employment tax cases.

* * * * *

(i) *Regional post review of examined cases.*—Regional commissioners review samples of the examined cases closed in their district offices to assure uniformity throughout their districts in the application of the provisions of the Code, regulations, and rulings, as well as the general policies of the Service. In certain circumstances, such as where substantial errors are found or where there is evidence of fraud or collusion, the regional commissioner has authority to reopen the case. When a re-examination of books and records is necessary, Form 2756, Notice of Re-examination, will be delivered to the taxpayer at the time the re-examination is begun.

PAR. 4. Section 601.106 is amended by revising subparagraph (2) (iii) of paragraph (a), revising paragraph (b), revising subparagraph (1) of paragraph (d), revising subparagraph (1) of paragraph (e), revising subparagraphs (1), (4), and (5) of paragraph (f), and revising subparagraph (1) of paragraph (g). These amended provisions read as follows:

§ 601.106 APPELLATE FUNCTIONS.—(a) *General.* (1) * * *

(2) * * *

(iii) Eliminate the ad valorem fraud penalty in any income, profits, estate, or gift tax case not docketed in the Tax Court, except with the concurrence of regional counsel;

* * * * *

(b) *Initiation of proceedings before the Appellate Division.*—In any case in which the district director has issued a preliminary or “30-day letter” and the taxpayer files a written protest under penalties of perjury against the proposed determination of tax liability, except as to those taxes described in paragraph (a)(3) of this section, the taxpayer has the right (and will be so advised by the district director) of administrative appeal to the Appellate Division of the region. Organizations such as labor unions and trade associations which have been examined by the district director to determine the amounts expended by the organization for purposes of lobbying, promotion or defeat of legislation, political campaigns, or propaganda related to those purposes are treated as “taxpayers” for the purpose of this right of administrative appeal. Thus, upon filing a protest to the district director’s findings that a portion of member dues is to be disallowed as a deduction to each member because expended for such purposes, the organization will be afforded full rights of administrative appeal to the Appellate Division of the region similar to those rights afforded to taxpayers generally. After review of any protest by the district director, the case and its administrative record are referred to the Appellate Division. No taxpayer is required to submit his case to the Appellate Division for consideration. Appeal is at the option of the taxpayer. A request for administrative appeal to the Appellate Division will not be denied because no informal conference was held in the district director’s office. After the issuance by the district director of a statutory notice of deficiency, upon the taxpayer’s request, the Appellate Division may take up the case for settlement and may grant the taxpayer a hearing thereon. Except in unusual circumstances, however, no hearing in such a case will be granted prior to the filing of a petition in the Tax Court for a redetermination of the deficiency proposed in the statutory notice.

* * * * *

(d) *Disposition and settlement of cases before the Appellate Division.*—(1) *Cases not docketed in the Tax Court.*—(i) If after consideration of the case by the Appellate Division of the region a satisfactory settlement of the issues is reached with the taxpayer, he will be requested to sign Form 870-AD or other appropriate agreement form waiving restrictions on the assessment and collection of any deficiency and accepting any overassessment resulting under the agreed settlement.

(ii) If after consideration of the case by the Appellate Division of the region it is determined that there is a deficiency in income, profits, estate, or gift tax, to which the taxpayer does not agree, a statutory notice of deficiency will be prepared and issued by the Appellate Division after consideration by the regional counsel of the memorandum recommending the issuance of such statutory notice. Officers of the Appellate Division having authority for the administrative determination of tax liabilities referred to in paragraph (a) of this section are also authorized to prepare, sign on behalf of the Commissioner, and send to the taxpayer by registered or certified mail any statutory notice of deficiency prescribed in sections 6212 and 6861 of the Code, and in corresponding provisions of the Internal Revenue Code of 1939. Within 90 days, or 150 days if the notice is addressed to a person outside the States of the Union and the District of Columbia, after such a statutory notice of deficiency is mailed (not counting Saturday, Sunday, or a legal holiday in the District of Columbia as the last day), the taxpayer may file a petition with the Tax Court of the United States for a redetermination of the deficiency. In any other unagreed case, the case and its administrative record will be returned to the district director with directions to take such action with respect to the tax liability determined in the Appellate Division as may be appropriate, such as the issuance of a statutory notice of disallowance of a claim for refund or credit in whole or in part, the preparation of a notice of adjustment or other appropriate action, or the collection of any additional tax (excise and employment tax cases).

(e) *Transfer and centralization of cases.*—(1) If a case is docketed in the Tax Court of the United States and the place designated by the Court for trial is within one region, and such case originated in the office of a district director situated within another region, the Commissioner has the authority to confer all or any part of the jurisdiction, authority, and duties vested in the Appellate Division of the region in which the case originated upon the Appellate Division of the region within which the place designated for trial is located. Except in unusual cases, jurisdiction will not be transferred to the Appellate Division of the region which includes Washington, D.C., in any docketed case designated for trial at Washington, D.C., which did not originate within such region, unless the taxpayer currently resides within that region and can produce all required books and records there. Likewise, the Chief Counsel has corresponding authority to transfer the jurisdiction, authority, and duties of the regional counsel for any region to the regional counsel of another region within which the case has been designated for trial before the Tax Court.

(f) *Conference and practice requirements.* * * *

(1) *Rule I.*—The Appellate Division conferee shall bear in mind that an exaction by the United States Government which is not based upon law, statutory or otherwise, is a taking of property without due process of law, in violation of the Fifth Amendment to the United States Constitution. The conferee, in his conclusions of fact or application of the law, shall hew to the law and the recognized standards of legal construction. It shall be the duty of the conferee to determine the correct amount of the tax, with strict impartiality as between the taxpayer and the Government, and without favoritism or discrimination as between taxpayers.

(4) *Rule IV.*—Where the Appellate Division official having settlement authority and the district director deem it advisable, the district director may be represented at any Appellate Division conferences on a non-docketed case. This rule is also applicable to the Director of International Operations in the event his office issued the preliminary or "30-day letter".

(5) *Rule V.*—In order to bring an income, profits, estate, or gift tax case in prestatutory notice status or an unagreed employment or excise tax case before

the Appellate Division, the taxpayer must first file with the district director a written protest under the penalties of perjury, setting forth specifically the reasons for his refusal to accept the district director's findings. The protest and any new facts, law, or argument presented therewith will be reviewed by the district director for the purpose of deciding whether further development and action is required prior to referring the case to the Appellate Division.

* * * * *

(g) *Limitations on the jurisdiction and functions of the Appellate Division.*—(1) *Overpayments of more than \$100,000.*—If the Appellate Division of a region determines in any case that there is an overpayment of income, war profits, excess profits, estate, or gift tax, including penalties and interest, in excess of \$100,000, such determination is subject to review by the Office of the Chief Counsel. See § 601.108.

* * * * *

PAR. 5. Section 601.108 is amended by revising the heading, revising paragraph (a) and revising paragraph (b) to read as follows:

§ 601.108 REVIEW OF OVERPAYMENTS EXCEEDING \$100,000.—(a) *By Office of Chief Counsel.*—Determinations of overpayments (other than overassessments of alcohol, tobacco, and certain firearms taxes) with respect to any internal revenue tax exceeding \$100,000 are subject to review by the Office of the Chief Counsel. If upon review of such a determination by the Office of the Chief Counsel that office questions the proposed refund or credit, the taxpayer or his representative will ordinarily, if a legal question is involved, be advised by letter regarding such issue. Such letter will also advise the taxpayer or his representative that upon request a conference will be granted by the Office of the Chief Counsel at which time the taxpayer or his representative may appear and present his views regarding the issue.

(b) *Other applicable procedures.*—If there are issues involved and agreement is reached with the taxpayer on such issues (including agreement with the Office of the Chief Counsel on any issue raised by that office), the taxpayer will be requested to file a letter stating his agreement with any proposed revision of the amount determined for refund or credit and the basis thereof, and also to agree in such letter to execute Form 870-AD or other appropriate agreement form accepting such revised amount and, where appropriate, agreeing not to file any further claims for refund, credit, or abatement with respect to any tax, penalty, or interest to which such refund or credit relates.

PAR. 6. Paragraph (b)(1) of § 601.109 is amended to read as follows:

§ 601.109 BANKRUPTCY AND RECEIVERSHIP CASES.

* * * * *

(b) *Procedure in office of district director.*—(1) While the district director is required by section 6871 of the Code to make immediate assessment of any deficiency in income, estate, or gift taxes, such assessment is not made as a jeopardy assessment (see § 601.105(h)), and the provisions of section 6861 do not apply to any assessment made under section 6871. Therefore, the notice of deficiency provided for in section 6861(b) will not be mailed to the taxpayer. Nevertheless, a letter (Form 7900) will be prepared and addressed in the name of the taxpayer, immediately followed by the name of the trustee, receiver, debtor in possession or other person designated by the court in which the bankruptcy or receivership proceeding is pending as in control of the assets or affairs of the debtor. Such letter will state how the deficiency was computed and advise that within 30 days a written protest under penalties of perjury may be filed with the district director showing wherein the deficiency is claimed to be incorrect, and that upon request an informal conference will be granted with respect to such deficiency. If, after protest is filed and any informal conference is held, adjustment appears necessary in the deficiency, appropriate action will be taken. Except where the interests of the Government require otherwise, Form 7900 letters are issued by the office of the district director. If at the time of the adjudication of bankruptcy in a liquidating proceeding or the approval of a petition in any other proceeding under the Bankruptcy Act or appointment of a receiver a case was pending before the Tax Court of the United States, the prescribed Form 7900 letter will not advise the addressee of any right to file a

protest or to request a conference in the office of the district director. Protests must be filed in triplicate. In general, the procedure concerning informal conferences described in § 601.105(c) is also applicable to an informal conference held after the issuance of a Form 7900 letter, except that the examining agent's report may be prepared prior to such conference.

PAR. 7. Section 601.203 is amended by revising paragraph (b), revising subparagraph (3) of paragraph (c), and revising paragraph (d). These amended provisions read as follows:

§ 601.203 OFFERS IN COMPROMISE.

(b) *Use of prescribed form.*—Offers in compromise are required to be submitted on Form 656 (Rev. 7-57), properly executed, and accompanied by a financial statement on Form 433 (if based on inability to pay). Form 656 is used in all cases regardless of whether the amount of the offer is tendered in full at the time the offer is filed or the amount of the offer is to be paid by deferred payment or payments. Copies of Form 656 may be obtained from district directors. An offer in compromise should be filed with the district director charged with the duty of collecting the tax sought to be compromised.

(c) *Consideration of offer.* * * *

(3) The district directors are authorized to reject any offer in compromise referred for their consideration. Offers considered in the Office of the Chief Counsel in Washington which are not acceptable are rejected by the Commissioner. Offers considered by Regional Counsel which are not acceptable are rejected by district directors. If an offer is not acceptable, the taxpayer is promptly notified of the rejection of the offer. If an offer is rejected, the sum submitted with the offer is returned by the district director to the proponent. A selective post review of offers rejected by a district director involving liabilities totaling \$5,000 or more is made by each regional commissioner.

(d) *Conferences.*—Before filing a formal offer in compromise, a taxpayer may request a conference in the office which would have jurisdiction of the offer filed by him for the purpose of exploring the possibilities of compromising the unpaid tax liability. A conference may also be requested by the taxpayer in the office which has jurisdiction of the offer filed by him after all investigations have been made for the purpose of determining the amount which may be accepted as a compromise. If the offer is one with respect to which the district director has processing jurisdiction and the proponent does not agree with the rejection or proposed rejection, and neither the internal revenue agent nor the conferee of the district director's office has been able to convince the proponent of the correctness of the conclusion reached, the proponent will be apprised of his privilege of submitting a request in writing for a hearing before the Appellate Division of the region. The procedure outlined in the preceding sentence will not be followed if the offer relates to a tax as to which the Appellate Division does not have authority to function. See § 601.106(a)(3). Taxpayers and their representatives are required to fulfill and comply with the conference and practice requirements of the Internal Revenue Service. See §§ 601.501 to 601.511.

PAR. 8. Paragraph (b) of § 601.204 is amended to read as follows:

§ 601.204 CHANGES IN ACCOUNTING PERIODS AND IN METHODS OF ACCOUNTING.

(b) *Methods of accounting.*—A taxpayer who changes the method of accounting employed in keeping his books shall, before computing his income upon such method for purposes of income taxation, comply with the provisions of the income tax regulations relating to changes in accounting methods. The regulations require that, in the ordinary case, the taxpayer secure the consent of the Commissioner to the change. See section 446 of the Code and the regulations thereunder. Application for permission to change the method of accounting employed shall be made on Form 3115 and shall be submitted to the Commissioner of Internal Revenue, Washington 25, D.C., within 90 days after the beginning of the taxable year in which it is desired to make the change. Permission to change the method of accounting will not be granted unless the

taxpayer and the Commissioner agree to the terms and conditions under which the change will be effected. The request will be considered by the Tax Rulings Division except that if the proposed change relates to depletion, depreciation, or obsolescence the request will be considered by the Special Technical Services Division.

PAR. 9. Paragraph (c) of § 601.301 is amended by revising subdivisions (i), (vi), (vii) and adding a new subdivision (viii) to subparagraph (2), revising subparagraph (10), revising subparagraph (17), and revising subparagraph (18). These amended provisions read as follows:

§ 601.301 IMPOSITION OF TAXES, QUALIFICATION REQUIREMENTS, AND REGULATIONS.

* * * * *

(c) *Regulations.* * * *

(2) *Miscellaneous liquor transactions.* * * *

(i) Restamping of packages of distilled spirits by persons other than proprietors of distilled spirits plants;

* * * * *

(vi) Redemption of unused distilled spirits excise tax stamps and unused rectification tax stamps;

(vii) Manufacture and sale of certain compounds, preparations, and products containing alcohol; and

(viii) Redemption, in Puerto Rico, of unused rectification tax sheet stamps and unused special Puerto Rican rectification stamps.

* * * * *

(10) *Labeling and advertising of distilled spirits.*—Regulations No. 5 (27 CFR Part 5), issued under the Federal Alcohol Administration Act, as amended, contain the requirements relative to the labeling and advertising of distilled spirits under the Federal Alcohol Administration Act, including standards of identity for distilled spirits, standards of fill for bottles of distilled spirits, withdrawal of bottled imported distilled spirits from customs custody, and the issuance of certificates of label approval and certificates of exemption from label approval.

* * * * *

(17) *Labeling and advertising of malt beverages.*—Regulations No. 7 (27 CFR Part 7), issued under the Federal Alcohol Administration Act, as amended, contain the requirements relative to the labeling and advertising of malt beverages (beer) under the Federal Alcohol Administration Act, including withdrawal of imported malt beverages from customs custody, and the issuance of certificates of label approval.

(18) *Liquor dealers.*—Part 194 of this chapter contains the regulations relative to the special (occupational) taxes imposed on wholesale and retail dealers in liquors, wholesale and retail dealers in beer, and limited retail dealers; restrictions on purchases of distilled spirits; reuse or refilling of liquor bottles (see also Part 175 of this chapter); sale or possession of refilled or used liquor bottles; and repackaging of alcohol for industrial use.

PAR. 10. Paragraph (a) of § 601.302 is amended to read as follows:

§ 601.302 TAXES.—(a) *Collection.*—Taxes on distilled spirits, wines, beer, and rectified products are paid by returns. If the person responsible for paying the tax has filed a proper bond with the assistant regional commissioner (alcohol and tobacco tax), he may file semimonthly returns, with proper remittances, to cover the taxes incurred on distilled spirits, wines, beer, and rectified products during such semimonthly period. If the taxpayer is not qualified to defer taxpayment, or has been placed on a prepayment basis by the assistant regional commissioner, he must prepay the tax on the distilled spirits, wines, beer, or rectified products. Distilled spirits and rectification tax returns are filed with an officer designated by the assistant regional commissioner (alcohol and tobacco tax), or with the district director when so directed by the assistant regional commissioner, except that where a remittance is in cash the return must be filed with the district director. Returns of tax on beer and wine are filed with the district director in all cases. The forms for filing these tax re-

turns are furnished to industry members by the assistant regional commissioner (alcohol and tobacco tax). Special tax stamps are issued to denote the payment of special (occupational) taxes by liquor dealers, brewers, rectifiers, still manufacturers, and manufacturers of nonbeverage products; such stamps are required to be posted in the taxpayer's place of business as evidence of taxpayment. Special tax stamps are also issued to denote payment of the commodity tax on stills and condensers, and are required to be cancelled and secured to the article or furnished to the user of the apparatus for retention at the premises where such apparatus is set up, available for inspection by internal revenue officers. Detailed information respecting the payment of tax on liquors and the payment of occupational and commodity taxes, including the forms to be used and the procedure to be followed, is contained in the respective regulations described in § 601.301(c).

PAR. 11. Section 601.303 is amended by revising subparagraph (2) of paragraph (c), and revising paragraph (d), to read as follows:

§ 601.303 CLAIMS.

* * * * *

(c) *Claims for refund.* * * *

(2) *Taxes on liquors lost, destroyed, returned to bond, or taken as samples by the United States.*—A taxpayer may, subject to the conditions in the appropriate regulations, file claim on Form 843 with the assistant regional commissioner (alcohol and tobacco tax) for refund of tax paid on (i) spirits returned to bonded premises, lost in rectification or bottling operations, lost by accident or disaster, or taken as samples by the United States, or (ii) wine returned to bond as unmerchandise, or lost by disaster, or (iii) beer removed from the market, or lost by disaster. If the claim is allowed, a notice of allowance with a check for the amount of the refund is forwarded to the claimant; except, that where there are any unpaid taxes outstanding against the claimant, the refund may be applied to the outstanding taxes and a check for the balance, if any, forwarded to the claimant. If the claim is rejected, a notice giving the reasons for rejection is forwarded to the claimant.

(d) *Claims for allowance, credit, or relief.* A qualified permittee, manufacturer, or proprietor may, subject to the conditions in the appropriate regulations, file claim on Form 2635 with the assistant regional commissioner (alcohol and tobacco tax) for allowance of loss, credit of tax, or relief from tax liability, as applicable, on (1) spirits returned to bonded premises, lost or destroyed on bonded premises or in transit thereto, or lost in rectification or bottling operations; (2) wine lost or destroyed on bonded premises or in transit thereto, and unmerchandise domestic wine returned to bond; (3) beer removed from the market, lost (other than by theft), or destroyed by fire, casualty, or act of God; (4) denatured spirits lost or destroyed in bond, or lost on the premises of a qualified dealer or user or in transit to such premises; and (5) tax-free spirits lost on the premises of a qualified user or in transit to such premises.

PAR. 12. Section 601.304 is amended by revising subparagraphs (5) and (6) and adding a new subparagraph (7) to paragraph (g), and revising paragraph (k). These amended provisions read as follows:

§ 601.304 PREPARATION AND FILING OF CLAIMS.

* * * * *

(g) *Miscellaneous.* * * *

(5) Payment of an amount equal to the internal revenue tax paid or determined and customs duties paid on distilled spirits, wines, rectified products, and beer previously withdrawn, which were lost, rendered unmarketable, or condemned by a duly authorized official by reason of a major disaster occurring in the United States after December 31, 1954.

(6) Redemption of unused distilled spirits excise tax stamps or unused rectification tax sheet stamps, and

(7) Redemption, in Puerto Rico, of unused rectification tax sheet stamps and unused special Puerto Rican rectification stamps.

* * * * *

(k) *Distilled spirits used in nonbeverage products.*—Procedural instructions in respect of claims (1) for drawback of tax on distilled spirits used in the

manufacture of medicines, medicinal preparations, food products, flavors, or flavoring extracts which are unfit for beverage purposes, and (2) for refund or adjustment of special (occupational) tax are contained in Part 197 of this chapter.

PAR. 13. Paragraph (d) of § 601.315 is amended to read as follows:

§ 601.315 CLAIMS.

* * * * *

(d) *Refund of tax.*—Taxes paid by return, or otherwise, on tobacco products and cigarette papers and tubes lost (otherwise than by theft) or destroyed, by fire, casualty, or act of God, while in the possession or ownership of the manufacturer, importer, or export warehouse proprietor, or withdrawn by him from the market, may be refunded. A claim for refund of tax is filed on Form 843 with the assistant regional commissioner (alcohol and tobacco tax) for the region in which the tax was paid. If tax was paid in more than one region, a claim may be filed with the assistant regional commissioner for any one of the regions in which tax was paid.

PAR. 14. Section 601.320 is amended to read as follows:

§ 601.320 TAXES RELATING TO MACHINE GUNS AND CERTAIN OTHER FIREARMS.—Part 179 of this chapter contains the regulations relative to the (a) payment of special (occupational) taxes by manufacturers and importers of, and dealers (including pawnbrokers) in, certain types of firearms, including machine guns and silencers or mufflers, (b) payment of the tax on the making or transfer of such firearms, (c) registration, identification, importation and exportation of such firearms, (d) keeping of books and records and rendering of returns, and (e) the forfeiture and disposition of seized firearms under the provisions of the National Firearms Act.

PAR. 15. Section 601.402 is amended by adding at the end of paragraph (d) the following new subparagraph:

§ 601.402 SALES TAXES COLLECTED BY RETURN.

* * * * *

(d) *Registration and bonding requirements.* * * *

(3) Every importer of foreign cars, trucks, buses, etc., taxable under chapter 32 of the Code must make application to the district director for the district in which he will file returns of the tax for a determination whether he is required to give bond securing the payment of the tax on his sales of such commodities. Detailed instructions as to the information required to be included in the application and the procedure to be followed by the importer are set forth in the applicable regulations. Form 3006 has been prescribed for the convenience of importers and may be obtained from the district director.

PAR. 16. Section 601.403 is amended by revising subparagraph (2) of paragraph (c) to read as follows:

§ 601.403 MISCELLANEOUS EXCISE TAXES COLLECTED BY RETURN.

* * * * *

(c) *Collection of tax.* * * *

(2) *Collected taxes.*—The other miscellaneous excise taxes referred to in this section are imposed on the person making the payment for the admission, telephone, transportation or other service involved. These taxes are required to be collected by the theatre, telephone company, railroad, or other person receiving the payment. All taxes collected in this manner are held by the collecting agent in trust for the United States until deposited in accordance with the Depositary Receipt procedure or paid over to the district director. The collecting agencies are required to file returns and the tax is payable, without notice from the district director, at the time fixed for filing returns. If the person from whom the tax is required to be collected refuses to pay it or, if for any reason it is impossible for the collecting agency to collect the tax from such person, the collecting agency is required to report to the district director for the district in which its returns are required to be filed the name and address

of such person, the nature of the service or facility rendered, and amount paid therefor, and the date on which paid. Upon receipt of this information the district director will proceed against the person to whom the facilities were provided or the services rendered to assert the amount of tax due, affording such person the same informal conference, protest and appellate rights as are available to other excise taxpayers. In addition, when a field or office audit of a collecting agency's records, or of a taxpayer's records, discloses that the collecting agency failed during prior reporting periods to collect taxes due, the district director may assert such taxes directly against the persons to whom the facilities were provided or the services rendered, whether or not the collecting agency had attempted collection or the persons liable for the tax had refused payment thereof.

PAR. 17. Section 601.404 is amended by revising subparagraph (1) of paragraph (j) to read as follows:

§ 601.404 MISCELLANEOUS EXCISE TAXES COLLECTED BY SALE OF REVENUE STAMPS.

* * * * *

(j) *Provisions special to commodity stamp taxes.*—(1) Provision is made for the withdrawal of filled cheese and playing cards from factories, free of tax, for the use of the United States. The procedure to be followed and the form of exemption certificate to be used in the case of such withdrawals are prescribed in the applicable regulations. Provision is also made for the exportation without payment of tax on adulterated butter and playing cards. The procedure to be followed in the case of such exportation is prescribed in the applicable regulations.

PAR. 18. Section 601.702 is amended by revising subparagraph (1) of paragraph (a) and revising subparagraph (1)(i) of paragraph (b), to read as follows:

§ 601.702 PUBLICATION AND PUBLIC INSPECTION. (a) *General.* * * *

(1) *Inspection of tax returns.*—The inspection of returns is governed by the provisions of the internal revenue laws and rules promulgated by the President or by the Secretary of the Treasury pursuant to such provisions. See the regulations under section 6103 of the Code.

* * * * *

(b) *Final opinions and orders.* * * *

(1) *Accepted offers in compromise.*—(i) *Income, profits, estate, or gift tax.*—For a period of one year, a copy of the Abstract and Statement for each accepted offer in compromise in respect of income, profits, estate, or gift tax liability is made available for examination (a) in the Public Information Division of the National Office when the offer covers a liability of \$5,000 and over; and (b) in the office of the appropriate district director when the offer covers a liability of less than \$5,000. See the regulations under section 6103 of the Code and section 9 of Revenue Procedure 60-22 (C.B. 1960-2, 992).

(R.S. 161; 5 U.S.C. 22)

MORTIMER M. CAPLIN,
Commissioner of Internal Revenue.

(Filed by the Division of the Federal Register on December 28, 1961, 8:49 a.m., and published in the issue of the Federal Register for December 29, 1961, 26 F.R. 12688)

(Also Part I, Section 819; 26 CFR 1.819-2.)

T.D. 6594¹

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

Percentage to be used by foreign life insurance companies in computing income tax for the taxable year 1961 and estimated tax for the taxable year 1962.

¹ 27 F.R. 2315.

DEPARTMENT OF THE TREASURY,
Washington 25, D.C.

*To Officers and Employees of the Treasury Department and Others
Concerned:*

Section 819(b) of the Internal Revenue Code of 1954, as added by the Life Insurance Company Income Tax Act of 1959 (73 Stat. 136) [P.L. 86-69, C.B. 1959-2, 654], provides for the determination of a percentage to be used in determining a "minimum figure" for each foreign life insurance company described in section 819(a). Where this minimum figure exceeds the foreign life insurance company's surplus held in the United States, the amount of the "policy and other contract liability requirements" (determined under section 805 without regard to section 819(b)), and the amount of the "required interest" (determined under section 809(a) without regard to section 819(b)), must each be reduced by an amount determined by multiplying such excess by the "current earnings rate" (as defined in section 805(b)(2)). Accordingly, it is hereby determined that for purposes of computing the 1961 income tax by foreign life insurance companies a percentage of 13.4 shall be used in determining the "minimum figure" under section 819(b).

It is presently anticipated that the data with respect to domestic life insurance companies for 1961 required for the computation of the percentage to be used by foreign life insurance companies in computing their estimated tax for the taxable year 1962 will not be available in time for the filing of the declaration of estimated tax for such taxable year. Accordingly, it is hereby determined that for purposes of computing the estimated tax for the taxable year 1962 and payments of installments thereof by foreign life insurance companies, a percentage of 13.4 (the percentage applicable for 1961) shall be used in determining the minimum figure under section 819(b). No additions to tax shall be made because of any underpayment of estimated tax for the taxable year 1962 which results solely from the use of this percentage.

Because the percentage announced in this Treasury Decision is computed from information contained in the income tax returns of domestic life insurance companies for the year 1960, which are not open to public inspection, the public accordingly cannot effectively participate in the determination of such figure. Therefore, it is found that it is unnecessary to issue this Treasury Decision with notice and public procedure thereon under section 4(a) of the Administrative Procedure Act, approved June 11, 1946, or subject to the effective date limitation of section 4(c) of said Act.

STANLEY S. SURREY,
Assistant Secretary of the Treasury.

March 9, 1962.

(Filed by the Division of the Federal Register on March 9, 1962, 10:24 a.m., and published in the issue of the Federal Register for March 10, 1962, 27 F.R. 2315)

(Also Part I, Section 456.)

T.D. 6596¹

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 17.—TEMPORARY REGULATIONS UNDER SECTION 456 OF THE INTERNAL REVENUE CODE OF 1954

Temporary regulations relating to elections permitted by section 456 of the Internal Revenue Code of 1954 and operation of the special transitional rule contained in such section.

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

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

The following regulations, prescribed under section 456 of the Internal Revenue Code of 1954, as added by the Act of July 26, 1961 (Public Law 87-109, 75 Stat. 222 [C.B. 1961-2, 318]), relate to certain elections and other matters under such section.

The regulations set forth herein are temporary and are designed to inform taxpayers as to how to make the elections permitted by section 456, the scope of the elections, and the operation of the special transitional rule contained in the section. More comprehensive rules with respect to these and other provisions of the section will be issued subsequently.

In order to prescribe temporary regulations relating to certain provisions of section 456 of the Internal Revenue Code of 1954, the following regulations are hereby adopted:

AUTHORITY: §§ 17.1 and 17.1-1 issued under the authority contained in sec. 7805, I.R.C. 1954; 68A Stat. 917; 26 U.S.C. 7805.

§ 17.1 STATUTORY PROVISIONS; PREPAID DUES INCOME OF CERTAIN MEMBERSHIP ORGANIZATIONS.

SEC. 456. PREPAID DUES INCOME OF CERTAIN MEMBERSHIP ORGANIZATIONS.

(a) YEAR IN WHICH INCLUDED.—Prepaid dues income to which this section applies shall be included in gross income for the taxable years during which the liability described in subsection (e) (2) exists.

(b) WHERE TAXPAYER'S LIABILITY CEASES.—In the case of any prepaid dues income to which this section applies—

(1) If the liability described in subsection (e) (2) ends, then so much of such income as was not includible in gross income under subsection (a) for preceding taxable years shall be included in gross income for the taxable year in which the liability ends.

(2) If the taxpayer ceases to exist, then so much of such income as was not includible in gross income under subsection (a) for preceding taxable years shall be included in gross income for the taxable year in which such cessation of existence occurs.

(c) PREPAID DUES INCOME TO WHICH THIS SECTION APPLIES.—

(1) ELECTION OF BENEFITS.—This section shall apply to prepaid dues income if and only if the taxpayer makes an election under this section with respect to the trade or business in connection with which such income is received. The election shall be made in such manner as the Secretary or his delegate may by regulations prescribe. No election may be made with respect to a trade or business if in computing taxable income the cash receipts and disbursements method of accounting is used with respect to such trade or business.

(2) SCOPE OF ELECTION.—An election made under this section shall apply to all prepaid dues income received in connection with the

¹ 27 F.R. 3626.

trade or business with respect to which the taxpayer has made the election; except that the taxpayer may, to the extent permitted under regulations prescribed by the Secretary or his delegate, include in gross income for the taxable year of receipt the entire amount of any prepaid dues income if the liability from which it arose is to end within 12 months after the date of receipt. Except as provided in subsection (d), an election made under this section shall not apply to any prepaid dues income received before the first taxable year for which the election is made.

(3) WHEN ELECTION MAY BE MADE.—

(A) WITH CONSENT.—A taxpayer may, with the consent of the Secretary or his delegate, make an election under this section at any time.

(B) WITHOUT CONSENT.—A taxpayer may, without the consent of the Secretary or his delegate, make an election under this section for its first taxable year (i) which begins after December 31, 1960, and (ii) in which it receives prepaid dues income in the trade or business. Such election shall be made not later than the time prescribed by law for filing the return for the taxable year (including extensions thereof) with respect to which such election is made.

(4) PERIOD TO WHICH ELECTION APPLIES.—An election under this section shall be effective for the taxable year with respect to which it is first made and for all subsequent taxable years, unless the taxpayer secures the consent of the Secretary or his delegate to the revocation of such election. For purposes of this title, the computation of taxable income under an election made under this section shall be treated as a method of accounting.

(d) TRANSITIONAL RULE.—

(1) AMOUNT INCLUDIBLE IN GROSS INCOME FOR ELECTION YEARS.—If a taxpayer makes an election under this section with respect to prepaid dues income, such taxpayer shall include in gross income, for each taxable year to which such election applies, not only that portion of prepaid dues income received in such year otherwise includible in gross income for such year under this section, but shall also include in gross income for such year an additional amount equal to the amount of prepaid dues income received in the 3 taxable years preceding the first taxable year to which such election applies which would have been included in gross income in the taxable year had the election been effective 3 years earlier.

(2) DEDUCTIONS OF AMOUNTS INCLUDED IN INCOME MORE THAN ONCE.—A taxpayer who makes an election with respect to prepaid dues income, and who includes in gross income for any taxable year to which the election applies an additional amount computed under paragraph (1), shall be permitted to deduct, for such taxable year and for each of the 4 succeeding taxable years, an amount equal to one-fifth of such additional amount, but only to the extent that such additional amount was also included in the taxpayer's gross income during any of the 3 taxable years preceding the first taxable year to which such election applies.

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

(1) PREPAID DUES INCOME.—The term "prepaid dues income" means any amount (includible in gross income) which is received by a membership organization in connection with, and is directly attributable to, a liability to render services or make available membership privileges over a period of time which extends beyond the close of the taxable year in which such amount is received.

(2) LIABILITY.—The term "liability" means a liability to render services or make available membership privileges over a period of time which does not exceed 36 months, which liability shall be deemed to exist ratably over the period of time that such services are required to be rendered, or that such membership privileges are required to be made available.

(3) MEMBERSHIP ORGANIZATION.—The term "membership organization" means a corporation, association, federation, or other organization—

(A) Organized without capital stock of any kind, and

(B) No part of the net earnings of which is distributable to any member.

(4) RECEIPT OF PREPAID DUES INCOME.—Prepaid dues income shall be treated as received during the taxable year for which it is includible in gross income under section 451 (without regard to this section).

[Sec. 456 as added by the Act of July 26, 1961 (Public Law 87-109, 75 Stat. 222)]

§ 17.1-1 PREPAID DUES INCOME OF CERTAIN MEMBERSHIP ORGANIZATIONS.—(a) *In general.*—Section 456 permits certain membership organizations to elect, in such manner as the Secretary or his delegate may by regulations prescribe, to include prepaid dues income in gross income for the taxable years during which the liability of the taxpayer exists to render services or to make available membership privileges. The election applies only to prepaid dues income relating to a liability existing over a period of time which extends beyond the close of the taxable year of receipt, and which does not exceed 36 months. The liability shall be deemed to exist ratably over the period the services are to be rendered or the membership privileges made available. No election may be made under section 456 with respect to a trade or business if in computing taxable income the cash receipts and disbursements method of accounting is used with respect to such trade or business. However, if the taxpayer is on a “combination” method of accounting under section 446(c) (4) and the regulations thereunder, it may elect the benefits of section 456 if it uses an accrual method of accounting for prepaid dues income. Except to the extent provided in paragraph (f) of this section, relating to the transitional rule, an election shall not apply to any prepaid dues income received before the first taxable year to which the election is applicable. If the membership organization is engaged in two or more trades or businesses in which it receives prepaid dues income, it may make a separate election under section 456 with respect to each trade or business. An election shall apply to all prepaid dues income received in connection with the trade or business with respect to which the election is made, except that the taxpayer may elect (in accordance with the provisions of paragraph (c) of this section) to include in gross income for the taxable year of receipt the entire amount of any prepaid dues income if the liability from which it arose is to end within 12 months after the date of receipt (hereinafter sometimes referred to as the “within 12 months” election). A membership organization, within the meaning of section 456, is a corporation, association, federation or other organization (1) which is organized without capital stock of any kind, and (2) no part of the net earnings of which is under its charter, by-laws, or other document of organization or association distributable, directly or indirectly, to any member.

(b) *Manner of making election not requiring consent.*—A taxpayer may make an election under section 456 without the consent of the Commissioner for the first taxable year beginning after December 31, 1960, in which it receives prepaid dues income in the trade or business for which such election is made. The election must be made not later than the time prescribed by law for filing the income tax return for such year (including extensions thereof). The election shall be made

by means of a statement attached to such return. In addition, a taxpayer should attach a copy of a typical membership contract used by the organization and a copy of its charter, by-laws or other document of organization or association. The statement shall indicate that the taxpayer is electing to apply the provisions of section 456 to the trade or business, and shall contain the following information:

(1) The name and a description of the taxpayer's trade or business to which the election is to apply.

(2) The method of accounting used for prepaid dues income in the trade or business during the first taxable year for which the election is to be effective and during each of the three preceding taxable years, and if there was a change in the method of accounting for prepaid dues income during such three-year period, a detailed explanation of such change including the adjustments necessary to prevent duplications or omissions of income.

(3) Indicate if any type of deferral method for prepaid dues income has been used during any of the three taxable years preceding the first taxable year for which the election is effective. Where any type of such deferral method has been used during this period, set forth an explanation of the method and a schedule showing the amounts received in each such year and the amounts deferred to each succeeding year.

(4) A schedule with appropriate explanations showing:

(i) The total amount of prepaid dues income received in the trade or business in the first taxable year for which the election is effective and the amount of such income to be included in each taxable year in accordance with the election,

(ii) The total amount, if any, of prepaid dues income received in the first taxable year for which the election is effective which is directly attributable to a liability of the taxpayer to render services or make available membership privileges over a period of time in excess of 36 months, and

(iii) The total amount, if any, of prepaid dues income received in the trade or business in—

(a) The taxable year preceding the first taxable year for which the election is effective if all memberships sold by the taxpayer are for periods of one year or less,

(b) Each of the two taxable years preceding the first taxable year for which the election is effective if any memberships are sold for periods in excess of one year but none are sold for periods in excess of two years, or

(c) Each of the three taxable years preceding the first taxable year for which the election is effective if any memberships are sold for periods in excess of two years.

In each respective case set forth the amount of such income which would have been includible in each taxable year had the election been effective for the years for which the information is required.

In any case in which prepaid dues income is received from more than one trade or business, the statement shall set forth separately

the required information with respect to each trade or business for which the election is made. See paragraph (c) of this section for additional information required to be submitted with the statement if the taxpayer also elects to include in gross income for the taxable year of receipt the entire amount of prepaid dues income attributable to a liability which is to end within 12 months after the date of receipt.

(c) *Liability ending within 12 months.*—A taxpayer who makes an election under paragraph (b) of this section with respect to a trade or business may also elect to include in gross income for the taxable year of receipt (as distinguished from the period over which the liability exists) the entire amount of any prepaid dues income from such trade or business if the liability from which it arose is to end within 12 months after the date of receipt. The taxable year of receipt is the taxable year for which the prepaid dues income is includible in gross income under section 451 (without regard to section 456). The “within 12 months” election shall be made by including in the statement required by paragraph (b) of this section, a declaration that the taxpayer elects to include such income in gross income for the taxable year of receipt, and the amount of such income for the first year to which the election is to apply. If the taxpayer is engaged in more than one trade or business for which the election under section 456 is made, it must include in such statement a declaration for each trade or business for which it makes the “within 12 months” election. If the taxpayer does not make the “within 12 months” election at the time it makes the election under paragraph (b) of this section, but later wishes to make such election, it must apply for permission from the Commissioner.

(d) *Effect of election.*—An election made under either paragraph (b) or (c) of this section shall be binding for the taxable year for which such election is made and for all subsequent taxable years, unless consent to revoke the election is obtained from the Commissioner. An application for consent to revoke an election under section 456 will not be accepted before the date of publication in the Federal Register of the Income Tax Regulations (Part 1 of this chapter) under section 456. Such regulations, however, will provide a reasonable period of time within which taxpayers will be permitted to make an application for consent to revoke an election in the case of taxable years which begin after December 31, 1960, and end before the date of such publication.

(e) *Consent to make an election at any time.*—The computation of taxable income under an election provided by section 456 constitutes a method of accounting and, except as provided in paragraph (b) or (c) of this section, a taxpayer may make an election provided in section 456 only with the consent of the Commissioner. An application for consent to make an election under section 456(c)(3)(A) will not be accepted before the date of publication in the Federal Register of the Income Tax Regulations (Part 1 of this chapter) under section 456. Such regulations, however, will provide a reasonable period of time within which taxpayers will be permitted to make such an application in the case of taxable years which begin after December 31, 1960, and end before the date of such publication.

(f) *Transitional rule.*—(1) Under section 456(d)(1), a taxpayer making an election under section 456 shall include in its gross income for the first taxable year to which the election applies and for each of the two succeeding taxable years not only that portion of prepaid dues income which is includible in gross income for each taxable year under section 456(a), but also an additional amount equal to that portion of the total prepaid dues income received in each of the three taxable years preceding the first taxable year to which the election applies which would have been includible in gross income for such first taxable year and such two succeeding taxable years had the election under section 456 been effective during such three preceding taxable years. In computing such additional amounts,

(i) Prepaid dues income shall be treated as received during the taxable year for which it is includible in gross income under section 451 (without regard to section 456),

(ii) In the case of taxpayers who did not include in gross income for the taxable year preceding the first taxable year for which the election is effective, that portion of the prepaid dues income received in such year attributable to a liability which is to end within 12 months after the date of receipt, no effect shall be given to a "within 12 months" election made under paragraph (c) of this section, and

(iii) There shall be taken into account only prepaid dues income arising from a trade or business with respect to which an election is made under paragraph (b) of this section.

Section 481 and the regulations thereunder shall have no application to the additional amounts includible in gross income under this paragraph.

(2) A taxpayer who makes an election with respect to prepaid dues income, and who includes in gross income for any taxable year to which the election applies an additional amount computed under section 456(d)(1) and subparagraph (1) of this paragraph, shall be permitted under section 456(d)(2) to deduct for such taxable year and for each of the four succeeding taxable years, an amount equal to one-fifth of such additional amount, but only to the extent such additional amount was also included in the taxpayer's gross income for any of the three taxable years preceding the first taxable year to which such election applies. The taxpayer shall maintain books and records in sufficient detail to enable the district director to determine upon audit that the additional amounts were included in the taxpayer's gross income for any of the three taxable years preceding such first taxable year.

(3) The application of subparagraphs (1) and (2) of this paragraph may be illustrated by the following example:

Example. (i) Assume that X Corporation, a membership organization qualified to make the election under section 456, elects to report its prepaid dues income in accordance with the provisions of section 456 for its taxable year ending December 31, 1961. Assume further that X Corporation receives in the middle of each taxable year \$3,000 of prepaid dues income in connection with a liability to render services over a three-year period beginning with the date of receipt. Un-

der section 456(a), X Corporation will report income received in 1961 and subsequent years as follows:

Year of receipt	Total receipts	1961	1962	1963	1964	1965	1966	1967	1968
1961.....	\$3,000	\$500	\$1,000	\$1,000	\$500				
1962.....	3,000		500	1,000	1,000	\$500			
1963.....	3,000			500	1,000	1,000	\$500		
1964.....	3,000				500	1,000	1,000	\$500	
1965.....	3,000					500	1,000	1,000	\$500
1966.....	3,000						500	1,000	1,000
1967.....	3,000							500	1,000
1968.....	3,000								500
Total reportable under section 456(a).....		500	1,500	2,500	3,000	3,000	3,000	3,000	3,000

(ii) Under section 456(d)(1), X Corporation must include in its gross income for the first taxable year to which the election applies and for each of the two succeeding taxable years, the amounts which would have been included in those years had the election been effective three years earlier. If the election had been effective in 1958, the following amounts received in 1958, 1959, and 1960 would have been reported in 1961 and subsequent years:

Year of receipt	Amount received	Years of including additional amounts		
		1961	1962	1963
1958.....	\$3,000	\$500		
1959.....	3,000	1,000	\$500	
1960.....	3,000	1,000	1,000	\$500
Total additional amounts to be included under section 456(d)(1).....		\$2,500	\$1,500	\$500

(iii) Having included the additional amounts as required by section 456(d)(1), and assuming such amounts were actually included in gross income in the three taxable years preceding the first taxable year for which the election is effective, X Corporation is entitled to deduct under section 456(d)(2) in the year of inclusion and in each of the succeeding four years an amount equal to one-fifth of the amounts included, as follows:

Year of inclusion	Amount	Years of deduction						
		1961	1962	1963	1964	1965	1966	1967
1961.....	\$2,500	\$500	\$500	\$500	\$500	\$500		
1962.....	1,500		300	300	300	300	\$300	
1963.....	500			100	100	100	100	\$100
Total amount deductible under section 456(d)(2).....		500	800	900	900	900	400	100

(iv) The net result of the inclusions under section 456(d)(1) and the deductions under section 456(d)(2) may be summarized as follows:

	Year							
	1961	1962	1963	1964	1965	1966	1967	1968
Amount includible under section 456(a).....	\$500	\$1,500	\$2,500	\$3,000	\$3,000	\$3,000	\$3,000	\$3,000
Amount includible under section 456(d)(1).....	2,500	1,500	500	-----	-----	-----	-----	-----
Total.....	\$3,000	\$3,000	\$3,000	\$3,000	\$3,000	\$3,000	\$3,000	\$3,000
Amount deductible under section 456(d)(2).....	500	800	900	900	900	400	100	-----
Net amount reportable under section 456.....	\$2,500	\$2,200	\$2,100	\$2,100	\$2,100	\$2,600	\$2,900	\$3,000

Because this Treasury Decision merely provides temporary regulations designed to inform those taxpayers who intend to make the election under section 456 as to how, when, and where to perform certain acts required under that section, it is found unnecessary to issue this Treasury Decision with notice and public procedure thereon under section 4(a) of the Administrative Procedure Act, approved June 11, 1946, or subject to the effective date limitation of section 4(c) of that Act.

MORTIMER M. CAPLIN,
Commissioner of Internal Revenue.

Approved April 12, 1962.

STANLEY S. SURREY,
Assistant Secretary of the Treasury.

(Filed by the Division of the Federal Register on April 16, 1962, 8:49 a.m., and published in the issue of the Federal Register for April 17, 1962, 27 F.R. 3626)

(Also Part I, Section 167; 26 CFR 1.167(a)-1.) Rev. Proc. 62-1¹

Revision of average useful lives of selected major items of textile machinery and equipment and the effect of the revision on the remaining useful lives of machinery and equipment now in use.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is (1) to set forth a schedule of revised average useful lives which may be used as a guide in the computation of depreciation for selected major items of textile machinery and equipment, and (2) to explain the effect of the issuance of the schedule on the remaining useful lives of such items of textile machinery and equipment now in use.

SEC. 2. BACKGROUND.

.01 In January 1942, the Internal Revenue Service published a revised edition of Bulletin "F" setting forth suggested average useful lives for many items of property, including textile machinery and equipment.

¹ Also released as Technical Information Release 350, dated December 18, 1961; amplified by Rev. Proc. 62-7, page 428.

.02 On May 2, 1961, the President of the United States announced a program of assistance to the textile industry, designed to meet a wide range of problems the industry faces as a result of rapid technological change, shifts in consumer preference, and increasing international competition. Included in the President's over-all program to be carried out by a number of agencies of the Government was a request to the Treasury Department to review existing depreciation allowances on textile machinery.

.03 Accordingly, an intensive review was made by Treasury and Service officials of the average useful lives of machinery and equipment used in the domestic textile industry. This review included independent studies by Service engineers, inspection trips to several textile mills and to the facilities of textile machinery manufacturers, and a careful evaluation of the facts relating to recent technological innovations in the industry. In addition, meetings were held with representatives of the industry.

SEC. 3. REVISED AVERAGE USEFUL LIVES.

As a consequence of these studies and based upon existing law and regulations, the previously-suggested estimated average useful lives which will be considered the reasonably normal period of usefulness in the usual experience of users of several types of textile machinery and equipment have been revised as follows:

Average useful life (years)			
Cards.....	15	Looms.....	15
Combers.....	15	Opening, blending, feeding equip-	
Drawing frames.....	15	ment.....	15
Finishing equipment:		Roving frames.....	15
Bleaching.....	12	Slashers.....	15
Dry finishing.....	12	Spinning frames.....	15
Drying.....	12	Twisters.....	15
Dyeing.....	12	Winders.....	15
Washing.....	12		

SEC. 4. SCOPE AND OBJECTIVE.

.01 The revised average useful lives, shown in section 3, will be applicable only for those taxable years for which returns are due to be filed (not including any extensions of time) on or after October 11, 1961, the date the President announced the results of the above study.

.02 The revised average useful lives generally will be applicable to new machinery and equipment acquired by a taxpayer during taxable years described in paragraph .01 above.

.03 Some revision of the remaining useful lives of machinery and equipment acquired new and placed in use by a taxpayer during a taxable year prior to the first taxable year to which the revised average useful lives are applicable, as explained in paragraph .01 above, may also be necessary to reflect the results of this study; but in the case of property having a remaining useful life of five years or less, an adjustment will be made only where the taxpayer can support the use of a shorter life.

.04 No departure is intended from the rule expressed in section 1.167(a)-1 of the Income Tax Regulations, that the useful life of an asset for depreciation purposes is the period over which it may reasonably be expected to be useful to the taxpayer in his trade or business or in the production of his income. The revised suggested average useful lives reflect the obsolescence which this study has recognized. Such lives may be used by any taxpayer who shows the firm intention to follow replacement practices which justify his use of these lives. However, under section 1.167(a)-1(b) of the regulations the estimated useful life of property is subject to modification after lapse of a reasonable period of time by reason of conditions known to exist at the end of the taxable year of modification, such as where it is found that the taxpayer's experience, including his replacement practice, does not justify the useful lives used by the taxpayer. For purposes of applying the preceding sentence, *Revenue Rulings* 90 and 91, C.B. 1953-1, pages 43 and 44, respectively, remain in full force and effect. In any case where a taxpayer can support the use of lives shorter than those shown in the schedule in Section 3, use of the shorter lives will, of course, be permitted.

.05 Salvage will not be redetermined solely on the basis of revisions to useful life made under these new guides. The adoption of the revised average useful lives for textile machinery and equipment will not result in treating the salvage on such items on a basis different from that provided by existing regulations. Any consideration for a redetermination of salvage will depend upon the actual facts in each case.

SEC. 5. PROCEDURE FOR REVISION OF USEFUL LIVES OF EXISTING MACHINERY AND EQUIPMENT.

.01 In order to minimize controversies which could arise from the application of the changed average useful lives to machinery and equipment described in section 4.03 and to promote uniformity in the handling of the determination of allowable depreciation under the various computation methods, the procedure set out below is to be followed.

.02 *Straight line.*—In cases where a taxpayer is depreciating existing machinery under the straight line method, allowable depreciation will be determined by applying depreciation rates based upon the revised useful lives to the original cost basis, reduced by salvage where appropriate. To illustrate, assume that a machine costing \$100,000 and being depreciated over a useful life of 25 years, had been in use for five years. Assume also, for purposes of simplification, that salvage is zero. (However, salvage must be recognized as a factor in the computations, whenever it exists, as provided in the regulations.) For the first five years the machine was depreciated at a four percent rate (25 year life) so that the depreciation reserve totaled \$20,000 at the end of that time. The remaining cost to be recovered through the depreciation deduction is, therefore, \$80,000. Under the schedule in section 3 the revised useful life for new equipment of this type is found to be 15 years. Under this revised useful life the annual depreciation rate will be 6.667 percent and the revised annual depre-

ciation allowable would be $\$100,000 \times .06667$ or $\$6,667$. The revised remaining useful life of the machine is thus computed to be $\frac{80,000}{6,667}$ or 12 years. The annual depreciation allowance after the change in the useful life is computed as follows:

Year	Computation	Annual depreciation allowance	Total depreciation
6.....	$\$100,000 \times .06667$	\$6,667	\$26,667
7.....		6,667	33,334
8.....		6,667	40,001
9.....		6,667	46,668
10.....		6,667	53,335
11.....		6,667	60,002
12.....		6,667	66,669
13.....		6,667	73,336
14.....		6,667	80,003
15.....		6,667	86,670
16.....		6,667	93,337
17.....		6,663	100,000

.03 *Sum of the years digits.*—On existing machinery presently being depreciated under the sum of the years digits method, the remaining useful life is the same as that determined under the straight line method as described in section 5.02. Depreciation allowable after the date of change will then be computed, as provided in section 1.167 (b)–3(a) of the regulations, using this remaining useful life. For example, assume the cost of a machine being depreciated over a useful life of 25 years was \$100,000 and that the machine had been in use for five years. To simplify the example, assume further that salvage is zero. (However, as provided in the regulations, salvage is to be recognized as a factor in the computation whenever it exists.) The depreciation allowable for the first five years would have been computed as follows:

Year	Computation	Annual depreciation	Total depreciation	Remaining balance
1.....	$\$100,000 \times 25/325$	\$7,692	\$7,692	
2.....	$\$100,000 \times 24/325$	7,385	15,077	
3.....	Etc.....	7,077	22,154	
4.....	Etc.....	6,769	28,923	
5.....	Etc.....	6,462	35,385	\$64,615

The revised useful life for new equipment of this type, as scheduled in section 3, is found to be 15 years. The revised remaining life at the end of five years, as computed under the straight line method in paragraph .02 above, is 12 years. The annual depreciation allowance after the change in the useful life will then be computed as follows:

Year	Computation	Annual depreciation	Total depreciation
6.....	$\$64,615 \times 12/78$	\$9,944	\$45,326
7.....	$\$64,615 \times 11/78$	9,113	54,439
8.....	$\$64,615 \times 10/78$	8,284	62,723
9.....	Etc.....	7,456	70,179
10.....	Etc.....	6,627	76,806
11-17.....	Etc.....		

.04 *Declining balance method.*—Where existing machinery presently is being depreciated under the declining balance method, the remaining useful life is the same as that determined under the straight line method as described in section 5.02. Depreciation allowable after the date of the change will be computed following the procedure set forth in section 1.167(b)-2(c) of the regulations. Assuming the same facts as in the example in paragraph .03 above, the depreciation allowable for the first five years would have been computed as follows:

Year	Computation	Annual depreciation	Total depreciation	Remaining balance
1.....	$\$100,000 \times (.04 \times 2)$	\$8,000	\$8,000	
2.....	$\$92,000 \times .08$	7,360	15,360	
3.....	$\$84,640 \times .08$	6,771	22,131	
4.....	Etc.....	6,229	28,360	
5.....	Etc.....	5,731	34,091	\$65,909

The revised useful life for new equipment of this type, as found in section 3, is 15 years. The revised remaining life at the end of five years, as computed under the straight line method in paragraph

.02 above, is..... 12 years
Expired life..... 5 years

Revised useful life for declining balance computation..... 17 years

The revised rate for declining balance computation is $\frac{1 \times 2}{17} = .1176$

The annual depreciation allowance after the change in the useful life will then be computed as follows:

Year	Computation	Annual depreciation	Total depreciation	Remaining balance
6.....	$\$65,909 \times .1176$	\$7,751	\$41,842	\$58,158
7.....	$\$58,158 \times .1176$	6,840	48,682	51,318
8.....	$\$51,318 \times .1176$	6,035	54,717	
9-17.....	Etc.....			

.05 *Remaining useful life of five years or less.*—Where, by reason of revisions to remaining useful lives as described above, the remaining useful life of an item of machinery or equipment would be five years or less, a remaining useful life of five years will be assigned, except where the taxpayer can substantiate the use of a shorter life. To illustrate, assume that a machine costing \$100,000, was originally estimated to have a useful life of 25 years, and had been depreciated under the straight line method for 18 years as of the date of the change. The revised useful life for new assets of this type, under section 3, is 15 years.

Cost..... \$100,000
Depreciation reserve at date of change ($18 \times .04 \times \$100,000$).... 72,000
Unrecovered cost..... 28,000
Revised annual depreciation allowable (15 year life basis)
 $\$100,000 \times .06667$ equals \$6,667.
Revised remaining life $\frac{28,000}{6,667}$ equals 4.2 years.

Since the remaining life on the old basis was more than five years (25 minus 18) and the remaining life on the new basis would be less than five years (4.2 years), five years will be the period over which the remaining cost may be recovered.

Revised depreciation rate—straight line method—is \$28,000 divided by 5 which gives an annual allowable depreciation deduction of \$5,600.

The annual rate on the original cost is $\frac{5,600}{100,000}$ which is 5.6 percent.

The annual depreciation allowable for the remaining five years, under the straight line method is as follows:

Year	Computation	Annual depreciation	Total depreciation
19.....	\$100,000×.056.....	\$5,600	\$77,600
20.....		5,600	83,200
21.....		5,600	88,800
22.....		5,600	94,400
23.....		5,600	100,000

Salvage has been assumed to be zero; however, as provided in the regulations, salvage is to be recognized as a factor in the computations whenever it exists.

This rule shall not apply in any case where the remaining term of the useful life as originally determined and used by the taxpayer is less than five years.

SEC. 6. ITEMS OF TEXTILE MACHINERY AND EQUIPMENT NOT LISTED IN SECTION 3.

A study is being made of the average useful lives of other items of textile machinery and equipment not listed in section 3. When this study is completed, the results thereof will be published in the Internal Revenue Bulletin.

SEC. 7. EFFECT ON OTHER DOCUMENTS.

The average useful lives of the items of textile machinery and equipment shown in section 3 above, supersede the lives assigned such items in the 1942 revision of Bulletin "F".

SEC. 8. INQUIRIES.

Inquiries regarding this Revenue Procedure should be addressed to the Commissioner of Internal Revenue, Washington 25, D.C., Attention: CP:A:UA.

(Also Part I, Section 167; 26 CFR 1.167(a)-1.) Rev. Proc. 62-2¹

Revision of average useful lives of additional items of textile machinery and equipment and the effect of the revision on the remaining useful lives of machinery and equipment now in use.

Revenue Procedure 62-1, page 415, amplified.

SECTION 1. BACKGROUND AND PURPOSE.

.01 Revenue Procedure 62-1, page 415, set forth a schedule of revised average useful lives of selected major items of textile ma-

¹ Also released as Technical Information Release 358, dated January 15, 1962; amplified by Rev. Proc. 62-7, page 428.

chinery and equipment and explained the effect of the revision on the remaining useful lives of such items of machinery and equipment then in use. Section 6 of that Revenue Procedure stated that a study was being made of the average useful lives of other items of textile machinery and equipment not listed therein, and that when the study was completed the results thereof would be published in the Internal Revenue Bulletin.

.02 A study has now been completed of the average useful lives of certain items of machinery and equipment used largely in the apparel segment of the textile industry. The purpose of this Revenue Procedure, therefore, is to amplify Revenue Procedure 62-1 by (1) setting forth a schedule of revised average useful lives which may be used as a guide in the computation of depreciation for such additional items of textile machinery and equipment, and (2) explaining the effect of the issuance of the schedule on the remaining useful lives of such items of textile machinery and equipment now in use.

SEC. 2. REVISED AVERAGE USEFUL LIVES.

As a consequence of the additional studies and based upon existing law and regulations, the previously suggested estimated average useful lives which will be considered the reasonably normal period of usefulness in the usual experience of users of several types of textile machinery and equipment have been revised as follows:

MACHINERY AND EQUIPMENT USED IN APPAREL INDUSTRY (CUTTING-UP AND NEEDLE TRADES)

	<i>Average useful life (years)</i>
I. Cutting Department	
Spreading machines.....	10
Inspection equipment.....	12
Power cutting machines.....	8
Power drills and marking equipment.....	8
Cutting tables.....	15
Ticket, tag and label equipment.....	15
Pattern equipment.....	10
Die cutting equipment:	
Dies.....	5
Power presses.....	20
II. Sewing Department	
Sewing machines and allied equipment.....	9
Creasing and forming machines.....	9
Trimming equipment.....	9
Driving equipment feeders and stackers.....	9
Sealing and joining equipment.....	5
III. Pressing and Finishing Department	
Finishing and forming equipment.....	10
Packaging equipment.....	12

SEC. 3. SCOPE AND OBJECTIVE.

.01 The revised average useful lives, shown in section 2, will be applicable only for those taxable years for which returns are due to be filed (not including any extensions of time) on or after January 15, 1962.

.02 Except for the difference in effective dates, as set forth in .01 above, the provisions of section 4 of Revenue Procedure 62-1 will be applicable to items of machinery and equipment shown in section 2 of this Revenue Procedure.

SEC. 4. PROCEDURE FOR REVISION OF USEFUL LIVES OF EXISTING MACHINERY AND EQUIPMENT.

Revisions of useful lives of existing machinery and equipment of the types shown in section 2 will be made following the examples shown in section 5 of Revenue Procedure 62-1.

SEC. 5. ITEMS OF TEXTILE MACHINERY AND EQUIPMENT NOT LISTED IN SECTION 2 OR IN REVENUE PROCEDURE 62-1.

The study of the average useful lives of other items of textile machinery and equipment not listed in Revenue Procedure 62-1, or section 2 above, is continuing. When this study is completed the results thereof will be published in the Internal Revenue Bulletin.

SEC. 6. EFFECT ON OTHER DOCUMENTS.

.01 The average useful lives of the items of textile machinery and equipment shown in section 2 above, supersede the lives assigned such items in the 1942 revision of Bulletin "F."

.02 Revenue Procedure 62-1, page 415, is hereby amplified.

SEC. 7. INQUIRIES

Inquiries regarding this Revenue Procedure should be addressed to the Commissioner of Internal Revenue, Washington 25, D.C., Attention CP:A:UA.

26 CFR 601.301: Imposition of taxes, qualification requirements, and regulations. Rev. Proc. 62-3¹
(Also Part III-A, Section 5201; 201.278.)

Methods to be used for the testing for spirits content of certain chemicals, including chemical by-products, produced and collected in the production facilities of a distilled spirits plant.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to set forth the approved methods for testing for spirits content certain chemicals produced and collected in the production facility of a distilled spirits plant.

SEC. 2. BACKGROUND.

Section 201.278 of the Distilled Spirits Plants Regulations provides that all chemicals produced, including chemical by-products of the spirits production system, shall be substantially free of spirits before being transferred to storage tanks or removed from the production facilities; the spirits content of such chemicals shall not, except as authorized by the Director, Alcohol and Tobacco Tax Division, exceed 10 percent by volume; and the testing of such chemicals for spirits content will be conducted by the proprietor in accordance with methods approved by the Director.

SEC. 3. REQUIRED APPARATUS AND REAGENTS.

The apparatus and reagents required for testing the chemicals for spirits content are as follows:

1. Fusel oil tube—A&TTD type. (The bulb holds three times the volume of the graduated neck portion. The graduations are from the top line marked 0 to the bottom line marked 100.)

¹ Also released as Industry Circular 62-2, dated January 24, 1962.

2. Flask or graduate—300 to 500 ml. capacity.
3. Three graduates—25 ml. capacity.
4. Saturated salt solution (sodium chloride).
5. Sulfuric acid, concentrated, specific gravity 1.84.
6. Two percent sulfuric acid solution (2 ml. concentrated sulfuric acid diluted with distilled water to 100 ml.).
7. Sodium sulfate, anhydrous (Na_2SO_4).
8. Ceric ammonium nitrate reagent. (Triturate 10 g. of ceric ammonium nitrate ($(\text{NH}_4)_2\text{Ce}(\text{NO}_3)_6$) with 3.5 ml. concentrated nitric acid (HNO_3) and dilute with distilled water to 125 ml. Filter if cloudy.)
9. Standard acetone—alcohol solution. (To 90 ml. of acetone (C.P.) add 10 ml. of ethyl alcohol (C.P.).)
10. Standard alcohol solution (2 percent ethyl alcohol (C.P.) 98 percent saturated salt solution).
11. Chloroform (CHCl_3).
12. Nitric acid, concentrated (HNO_3).

SEC. 4. APPROVED METHODS FOR TESTING.

Samples meeting test requirements contain no more than 10 percent ethyl alcohol by volume and, thus, the tests serve as a rapid screening procedure. Failure to meet test requirements is not conclusive proof of the presence of more than 10 percent ethyl alcohol by volume since other chemicals may be present which affect solubilities or oxidation rate as in the case of acetone. Where samples fail to meet the approved method for testing and other laboratory analyses indicate that the sample contains less than 10 percent ethyl alcohol by volume, additional samples should be taken and forwarded to the regional laboratory for analyses by other methods. Approved methods for testing acetone, butyl alcohol, ethyl ether, ethyl oil, and fusel oil are listed below.

1. *Acetone*.—Put 5 ml. of ceric ammonium nitrate reagent in a 25 ml. graduate, add 5 ml. of acetone sample, close the graduate, and shake several times to mix. Immediately compare the color with that produced when 5 ml. of standard acetone-alcohol solution is similarly treated. If the color of the acetone sample being tested is not greater than the color of the standard (made with 5 ml. of standard acetone-alcohol solution), the acetone sample contains no more than 10 percent ethyl alcohol by volume. If desired, both the acetone sample and the standard may be diluted with equal quantities of distilled water. The difference in color is more apparent at 5 percent alcohol since at 10 percent alcohol the color is quite dark.

2. *Butyl alcohol*.—Put 20 ml. of saturated salt solution in the fusel oil tube and add 2 percent sulfuric acid solution until the 100 mark on the fusel oil tube is reached. Add butyl alcohol sample until the 0 mark on the fusel oil tube is reached, close the fusel oil tube, shake for about 5 minutes, and place in an upright position to allow the two layers to separate (30 minutes may be required to get a good separation). A reading of 90 or less at a temperature of 60 degrees to 80 degrees F. indicates more than 10 percent ethyl alcohol by volume.*

3. *Ethyl ether*.—Put saturated salt solution in the fusel oil tube until the 100 mark on the fusel oil tube is reached. Add ethyl ether sample until the 0 mark on the fusel oil tube is reached, close the fusel

oil tube, shake, and place in an upright position to allow the two layers to separate (about 2 or 3 minutes). A reading of 90 or less at a temperature of 60 degrees to 80 degrees F. indicates more than 10 percent ethyl alcohol by volume.*

4. *Ethyl oil*.—Either of the following methods may be used:

(1) Put saturated salt solution in the fusel oil tube until the 100 mark on the fusel oil tube is reached. Add ethyl oil sample until the 0 mark on the fusel oil tube is reached, close the fusel oil tube, shake, and place in an upright position to allow the two layers to separate. A reading below 90 at a temperature of 60 degrees to 80 degrees F. indicates more than 10 percent ethyl alcohol by volume.*

(2) Put 19 ml. of chloroform in a 25 ml. graduate, add 1 ml. of ethyl oil sample, close the graduate, shake several times to mix, and then add 5 ml. of saturated salt solution. Into another 25 ml. graduate put 20 ml. of chloroform, add 5 ml. of standard alcohol solution, close the graduate, shake for 3 minutes, and place in an upright position to allow the two layers to separate. Into each of these two graduates add 5 ml. of ceric ammonium nitrate reagent and stir several times to mix reagent with the upper layer in the graduate. If the color in the graduate containing the ethyl oil sample is not greater than the color in the graduate containing the standard alcohol solution, the ethyl alcohol is not more than 10 percent by volume.

5. *Fusel oil*.—Put saturated salt solution in the fusel oil tube until the 100 mark on the fusel oil tube is reached. Add fusel oil sample until the 0 mark on the fusel oil tube is reached, close the fusel oil tube, shake, and place in an upright position to allow the two layers to separate. A reading below 90 at a temperature of 60 degrees to 80 degrees F. indicates more than 10 percent ethyl alcohol by volume.*

SEC. 5. TEMPERATURE EFFECTS ON SAMPLE.

Oxidation rate of acetone is increased by elevated temperatures and decreased by lower temperatures. An increase in temperature increases the solubility of the solvents in the saturated salt solution.

SEC. 6. MOISTURE EFFECTS ON SAMPLE.

Except for acetone, appreciable quantities of water have a decided effect on the test results. The water is completely dissolved in the saturated salt solution and, thus, would be read in the fusel oil tube as alcohol. When the solvents meet the requirements of the test, there is no need to make a correction for water; but, if the test indicates the presence of more than 10 percent ethyl alcohol by volume, then the following procedure may be used to dry the sample before making the test:

Dehydration of sample—Put 200 ml. of sample in the 300 to 500 ml. flask or graduate and add approximately 80 grams of anhydrous sodium sulfate. Shake, let stand for 1 hour (butyl alcohol requires 36 hours contact), and decant the supernatant

*The ethyl alcohol in the sample is dissolved in the saturated salt solution and remains in the lower layer. The decrease in the upper layer gives a measure of the amount of ethyl alcohol contained in the sample.

liquid which is used as the test sample in the preceding tests. The anhydrous sodium sulfate is a fairly effective drying agent and as such it removes most of the water.

SEC. 7. INQUIRIES.

Inquiries regarding this Revenue Procedure should refer to its number and be addressed to the office of the appropriate Assistant Regional Commissioner, Alcohol and Tobacco Tax.

26 CFR 601.301: Imposition of taxes, qualification requirements, and regulations.
(Also Part III-A, Sections 5201, 5205, 5207;
201.466, 201.624, 201.632, 201.633.)

Rev. Proc. 62-4

Procedure for recording and reporting the use of red strip stamps by proprietors of distilled spirits plants bottling premises in restamping operations on their contiguous or adjacent wholesale liquor dealer or taxpaid storeroom premises.

SECTION 1. PURPOSE.

This Revenue Procedure outlines the method to be followed where the Assistant Regional Commissioner, Alcohol and Tobacco Tax, has authorized a proprietor of bottling premises to use red strip stamps in restamping operations to be conducted on contiguous or adjacent wholesale liquor dealer or taxpaid storeroom premises.

SEC. 2. PROCEDURE.

A proprietor of bottling premises who wishes to remove red strip stamps from such premises to his wholesale liquor dealer or taxpaid storeroom premises for use in restamping operations must secure approval of the Assistant Regional Commissioner for continuing permission to do so. Thereafter, the application required by section 201.466 of the Distilled Spirits Plants Regulations shall be filed with the assigned officer at the distilled spirits plant so that such officer may supervise restamping operations to the extent deemed necessary.

SEC. 3. RECORDS AND REPORTS.

The proprietor must indicate on his daily strip stamp record, as required by section 201.624 of the regulations, and on the daily memorandum report, required by section 201.632(b) of the regulations, the quantity of stamps removed to and used on his wholesale liquor dealer or taxpaid storeroom premises. Form 2260, Monthly Report of Bottle Strip Stamps, required by section 201.633 of the regulations, must reflect the number of stamps removed from the bottling premises and used on wholesale liquor dealer or taxpaid storeroom premises.

SEC. 4. INQUIRIES.

Inquiries regarding this Revenue Procedure should refer to its number and be addressed to the office of the appropriate Assistant Regional Commissioner, Alcohol and Tobacco Tax.

26 CFR 601.311: Imposition of taxes; regulations. Rev. Proc. 62-5¹ (Also Part I, Section 5723; 270.214, 275.73.)

The word "cigars" must appear separately on a package of large cigars from that appearing in the class designation.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to explain the requirement concerning the "notice" to appear on packages of large cigars and to furnish suggestions for compliance with the regulations.

SEC. 2. BACKGROUND.

The Internal Revenue Service has received inquiries whether the appearance of the word "cigars" in the class designation on a package of large cigars would fulfill the requirements of section 270.214 of the Manufacture of Tobacco Products Regulations and section 275.73 of the Regulations on Importation of Tobacco Materials, Tobacco Products, and Cigarette Papers and Tubes, or if the word "cigars" must be separately stated on the package.

SEC. 3. REQUIREMENT OF REGULATIONS.

Under the return system it is necessary that packages of tobacco products have positive expressions of the quantity, kind, and class, if applicable, of the tobacco products contained in the packages. Therefore, for large cigars sections 270.214 and 275.73 of the regulations specifically require that packages of such products shall, before removal subject to tax, have adequately imprinted thereon, or on a label securely affixed thereto, the designation "cigars" and the appropriate class designation.

This means that the appearance on the package of the word "cigars" in the class designation for large cigars does not fulfill the requirement of section 270.214 or section 275.73 of the regulations and that the word "cigars" must be separately and adequately stated. While such descriptive words as "cigarillos," "cheroots," "blunts," "panatelas," etc., may be used on packages of cigars, they will not be considered as a substitute for the word "cigars."

SEC. 4. SUGGESTIONS FOR COMPLIANCE.

.01 The Internal Revenue Service suggests to manufacturers and importers the following ways in which the word "cigars" may appear on the package. The word "cigars" may be imprinted directly on the package or on a label securely affixed to the package. For example, it may appear in connection with (1) a brand name, such as "Perfect Cigars," (2) the quantity statement, such as "25 cigars," or (3) a slogan, such as "finest quality cigars."

.02 Manufacturers and importers are urged to submit packages to their Assistant Regional Commissioner, Alcohol and Tobacco Tax, for advice where there is any doubt about compliance with the requirement of the regulations.

SEC. 5. USE OF EXISTING PACKAGING MATERIAL.

Manufacturers and importers of cigars presently using packages which do not bear the required notice as provided in sections 270.214

¹ Based on Industry Circular No. 61-45, dated November 6, 1961.

and 275.73 of the regulations should advise their Assistant Regional Commissioner as to the quantity of such stock on hand and the approximate time for its use, and request authorization to use such existing supplies.

SEC. 6. INQUIRIES.

Inquiries in regard to this Revenue Procedure should refer to its number and be addressed to the office of the appropriate Assistant Regional Commissioner, Alcohol and Tobacco Tax.

26 CFR 601.311: Imposition of taxes; regulations. Rev. Proc. 62-6¹
(Also Part I, Section 5723; 270.212.)

Where a manufacturer of tobacco products makes transfers in bond between factories of the same ownership, and does not wish to mark the packages with his name and the location of his factory from which the products are to be removed subject to tax or the permit number of his factory from which the tobacco products are to be so removed, he may state his name and identify the factory of production by imprinting an approved symbol on the closure, if any, or on the package at the time it passes through the packaging machine, or by a statement imprinted directly on the package, on the closure, if any, or on a label affixed to the package.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to set forth ways in which manufacturers of tobacco products may identify the factory of production on packages of tobacco products transferred in bond between factories of the same ownership prior to their removal subject to tax.

SEC. 2. BACKGROUND.

Section 270.212 of the Manufacture of Tobacco Products Regulations continues the requirement for marking of packages with either (1) the name of the manufacturer and the location of his factory from which the products are to be removed subject to tax, or (2) the permit number of the factory from which the products are to be removed subject to tax. However, where tobacco products are transferred "in bond" between factories of the same ownership, it is not always possible for the manufacturer to know, at the time of production, from which of his factories the products will be removed subject to tax. Accordingly, section 270.212 includes the proviso that the Director, Alcohol and Tobacco Tax Division, may, on application, authorize a manufacturer to mark his packages of tobacco products (manufactured in and removed subject to tax from any of his factories) with the name of the manufacturer if the factory of production is identified by a statement (e.g., manufactured in Richmond, Va.), by a symbol, or by other means (other than the permit number) approved by the Director.

SEC. 3. MARKS ON PACKAGES.

.01 Where a manufacturer makes transfers "in bond," and does not wish to mark his packages in accordance with the basic requirement involving identification of the factory from which the tobacco

¹ Based on Industry Circular No. 61-46, dated November 16, 1961.

products are to be removed subject to tax, he may comply with the proviso of section 270.212 of the regulations in any one of the following ways: To identify the factory of production, a symbol may be imprinted on the closure, if any, or on the package at the time it passes through the packaging machinery. As another illustration, the factory of production may be identified by a statement, such as "Manufactured in Richmond, Va.," imprinted directly on the package, on the closure, if any, or on a label affixed to the package. Where identification of the factory of production is accomplished during the packaging operation, identical packaging material can be employed at any of the factories under the same ownership. In any event, of course, his name must be stated.

.02 Packages marked in any of the ways specified in section 3.01 above can be removed subject to tax from the factory of production or transferred "in bond" between factories of the same ownership and subsequently removed subject to tax from one of such factories. There must be a specific application under section 270.212 of the regulations approved by the Director prior to the use of any of such means of complying with the proviso of such section.

SEC. 4. INQUIRIES.

Inquiries in regard to this Revenue Procedure should refer to its number and be addressed to the office of the appropriate Assistant Regional Commissioner, Alcohol and Tobacco Tax.

(Also Part I, Section 167; 26 CFR 1.167(a)-1.)

Rev. Proc. 62-7¹

Revision of average useful lives of additional items of textile machinery and equipment and the effect of the revision on the remaining useful lives of machinery and equipment now in use.

Revenue Procedure 61-1, page 415, and Revenue Procedure 62-2, page 420, amplified.

SECTION 1. BACKGROUND AND PURPOSE.

.01 Revenue Procedure 62-1, page 415, sets forth a schedule of revised average useful lives of selected major items of textile machinery and equipment and explained the effect of the revision on the remaining useful lives of such items of machinery and equipment then in use. Section 6 of Revenue Procedure 62-1 stated that a study was being made of the average useful lives of other items of textile machinery and equipment not listed therein, and that when the study was completed the results thereof would be published in the Internal Revenue Bulletin. Revenue Procedure 62-2, page —, was subsequently published setting forth revised average useful lives of additional items of textile machinery and equipment.

.02 A study has now been completed of the average useful lives of the remaining items of machinery and equipment used in the textile industry. The purpose of this Revenue Procedure, therefore, is to further amplify Revenue Procedure 62-1 by (1) setting forth a schedule of revised average useful lives which may be used as a guide

¹ Also released as Technical Information Release 362, dated February 16, 1962; this Revenue Procedure reflects the original document as published in I.R.B. 1962-10, 14, with changes which appear in the Special Announcement in I.R.B. 1962-26, 52.

in the computation of depreciation for such additional items of textile machinery and equipment, and (2) explaining the effect of the issuance of the schedule on the remaining useful lives of such items of textile machinery and equipment now in use.

SEC. 2. REVISED AVERAGE USEFUL LIVES.

As a consequence of the additional studies and based upon existing law and regulations, the previously suggested estimated average useful lives which will be considered the reasonably normal period of usefulness in the usual experience of users of several types of textile machinery and equipment have been revised as follows:

SCHEDULE I

Machinery and Equipment Used in the Manufacture of Knit Wear—Hosiery and Fabrics

	<i>Years</i>
Boarding Machines.....	8
Collection System Equipment—Knit Goods.....	10
Dryers—Hosiery and Knitted Wear.....	10
Knitting Machines.....	9
Loopers.....	9
Seaming Machines.....	9
Twist Setting Machines.....	9

SCHEDULE II

Items of Textile Machinery and Equipment Associated With the Major Items Listed in Revenue Procedure 62-1

The items listed in this Schedule II are used in and are a part of the spinning and weaving segment of the textile industry that was the subject of the engineering study the results of which were announced on October 11, 1961. Although the average useful life findings of only the major items of spinning and weaving equipment were announced at that time, such findings of October 11, 1961, are to be regarded as having included the following detailed listing of items of spinning and weaving equipment.

<i>Years</i>	<i>Years</i>
Ageing Machines.....	12
Atomizing Machines.....	12
Backfilling Machines.....	12
Backwashing Machines—Wool.....	12
Beating Machines.....	12
Bin Pilers.....	12
Blender-Feeders.....	15
Bobbin Cleaning Machines.....	15
Boil-off and Degumming Machines.....	12
Braiding Machines.....	15
Breaker—Bales.....	15
Brushing Machines.....	12
Buffing Machine—Rolls.....	15
Burring Machines.....	12
Button Breakers.....	12
Calenders.....	12
Carbonizing Machines.....	12
Card Coilers.....	15
Card Grinders.....	15
Card Strippers.....	15
Cloth Turning Machines.....	12
Compress, Press Raw Stock.....	12
Conditioning Machines—Cloth.....	12
Conditioning Machines—Yarn.....	15
Crabbing Machines.....	12
Creasing Machines.....	12
Creels.....	15
Curing Machines.....	12
Cutting and Folding Machines.....	12
Decating Machines.....	12
Doffing Machines.....	15
Doubling and Rolling Machines.....	12
Doubling Machines—Yarn.....	15
Drawing-in and Tying-in Machines.....	15
Dye Tanks, Tubs and Vats.....	12
End Collection Systems.....	15
Extractors.....	12
Fish Line Machines.....	15
Fulling Machines.....	12
Garnet Machines.....	15
Gilling Machines.....	15
Grease Recovery Machines—Wool.....	12
Heat Setting Machines.....	12
Inspecting Machines.....	12
J Boxes.....	12
Jacquard Card Cutters.....	15
Jacquard Heads.....	15

	<i>Years</i>		<i>Years</i>
Jacquard Lacing Machines.....	15	Saturators	12
Kettles, Copper or Steam Jacket..	12	Scouring and Cleaning Machines..	12
Kettles, Mixing.....	12	Scouring Trains—Wool.....	12
Kier Loading Machines.....	12	Scrays	12
Kiers	12	Scutchers—Cloth	12
Lap Preparing Machines.....	15	Shearing Machines	12
Lustering Machines.....	12	Singeing Machines.....	12
Mangles	12	Sizeing Machines.....	15
Mercerizing Machines.....	12	Skein Winders.....	15
Moistening Equipment.....	12	Slitting Machines.....	12
Napping Machines.....	12	Slubbers	15
Opening Machines.....	15	Soaping Machines.....	12
Padders	12	Speeder—Roving	15
Picking Machines.....	15	Spoolers	15
Pile-cutting Machines.....	12	Steaming Machines.....	12
Pile-raising Machines.....	12	Sueding Machines.....	12
Pin Drafters.....	15	Tenter Frames.....	12
Plaiters	12	Textile Humidifying, Air Con-	
Polishing Machines.....	12	ditioning, and Clearing Sys-	
Pot Spinning Machines.....	15	tems	15
Pre-Shrinking Machines.....	12	Top Squaring Machines.....	15
Print Machines.....	12	Tow Converter.....	15
Quetschs	12	Tubing Machines.....	12
Quilling Machines.....	15	Velour Machines.....	12
Redrawing Machines.....	15	Warpers	15
Reeling Machines.....	15	Waterproofing Machines.....	12
Rolls—Cards.....	15	Waxing Machines.....	12
Rope Machines.....	15	Winders and Batches—Fabric..	12
Rubbing Machines.....	12		

SCHEDULE III

Miscellaneous Items of Textile Machinery and Equipment Not Otherwise Covered

	<i>Years</i>		<i>Years</i>
Card Clothing, Metallic.....	5	Necktie Machines.....	10
Concrete Settling Basins.....	40	Non-Woven Fabric Machines.....	10
Conveyor Equipment.....	10	Pumps	
Copper Rolls—Printing.....	8	Air	15
Crocheting Machines.....	10	Chemical	15
Embroidery Machines.....	10	Fire	25
Eyelet Machines.....	10	Raw Water.....	20
Facing Machines.....	10	Rayon	10
Filter Beds—Water.....	25	Shears	10
Fringing Machines.....	10	Softener—Water	15
Insert Machines.....	10	Stretch Yarn Machines.....	9
Instruments		Tanks	
Laboratory	10	Steel	25
Measuring	10	Wood	20
Optical	10	Textile Department Accessories	
Recording	10	(Synthetic)	10
Textile Quality Control.....	6	Textile Machinery (Synthetic)..	15
Laminating Machines.....	10	Texturizing and Bulking Equip-	
Loom Winders.....	10	ment	9
Material Handling Equipment.....	15	Throwing Equipment.....	9
Measuring Machines.....	15	Tufting Machines.....	10
Mono-rail Systems, Over head....	15	Vacuum Suction Systems.....	15

SEC. 3. SCOPE AND OBJECTIVE.

.01 The revised average useful lives, shown in section 2, will be applicable only for those taxable years for which returns are due to be filed (not including any extensions of time) on or after the effective dates shown below:

Schedule I—effective date February 15, 1962

Schedule II—effective date October 11, 1961

Schedule III—effective date February 15, 1962

.02 Except for the difference in effective dates, as set forth in .01 above, the provisions of section 4 of Revenue Procedure 62-1 will be applicable to items of machinery and equipment shown in section 2 of this Revenue Procedure.

SEC. 4. PROCEDURE FOR REVISION OF USEFUL LIVES OF EXISTING MACHINERY AND EQUIPMENT

Revisions of useful lives of existing machinery and equipment of the types shown in section 2 will be made following the examples shown in section 5 of Revenue Procedure 62-1.

SEC. 5. EFFECT ON OTHER DOCUMENTS.

.01 The average useful lives of the items of textile machinery and equipment shown in section 2 above, supersede the lives assigned such items in the 1942 revision of Bulletin "F."

.02 Revenue Procedure 62-1, page 415, and Revenue Procedure 62-2, page 420, are hereby amplified.

SEC. 6. INQUIRIES.

Inquiries regarding this Revenue Procedure should be addressed to the Commissioner of Internal Revenue, Washington 25, D.C., Attention T : S : EA.

26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of correct tax liability.

Rev. Proc. 62-8

Additional full-time conferee positions are being established in District Audit Divisions to conduct informal conferences, thus relieving group supervisors of this responsibility and permitting them to devote more time to the supervision of examining officers.

Revenue Procedure 60-24, C.B. 1960-2, 998, modified.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to modify Revenue Procedure 60-24, C.B. 1960-2, 998, by providing that full-time conferees will now be assigned to handle the majority of the informal conferences previously conducted by group supervisors.

SEC. 2. BACKGROUND.

Under the provisions of section 5.02 of Revenue Procedure 60-24, group supervisors of examining officers have been assigned to handle a substantial number of informal conferences. As a result of experience gained in the informal conference activity since the issuance of Revenue Procedure 60-24, additional full-time conferee positions have been provided in District Audit Divisions. This expansion of the Conference Coordinator's Staff will permit group supervisors to devote more time to supervising examining officers and will improve the informal conference activity by providing additional full-time conferee specialists having greater expertise in the informal conference function.

SEC. 3. REVISIONS IN PROCEDURE.

Conference Coordinators will assign full-time conferees to conduct the majority of the informal conferences previously handled by group supervisors.

SEC. 4. EFFECT ON OTHER DOCUMENTS.

This Revenue Procedure modifies section 5.02 of Revenue Procedure 60-24, C.B. 1960-2, 998.

SEC. 5. INQUIRIES.

Inquiries regarding this Revenue Procedure should be addressed to the Assistant Commissioner (Compliance), Washington 25, D.C., Attention: CP:A:P.

26 CFR 601.702: Publication and public inspection. Rev. Proc. 62-9 (Also Part I, Section 6103; 301.6103(a)-1; 301.6103(a)-2.)

Procedures to be followed by District Directors of the Internal Revenue Service in permitting inspection of Federal tax returns filed under the Internal Revenue Code of 1954, and in furnishing copies of such returns and documents.

SECTION 1. PURPOSE.

This revenue procedure sets forth instructions concerning the inspection by certain persons, of tax returns and related documents filed under the Internal Revenue Code of 1954, and the furnishing of copies of such returns and documents, as provided in sections 301.6103(a)-1 and 301.6103(a)-2 of the Regulations on Procedure and Administration.

SEC. 2 AUTHORITY.

District Directors of the Internal Revenue Service are authorized by Delegation Order No. 83, dated October 16, 1961, C.B. 1961-2, 545, to process applications by certain persons to inspect returns and related documents and may permit such inspection of such returns and related documents in their official custody. In response to requests for copies, they may furnish copies of such returns and related documents. For the purposes of this Revenue Procedure the term "District Director" also includes the Director of International Operations.

SEC. 3. RETURNS WHICH MAY BE INSPECTED UNDER THIS REVENUE PROCEDURE.

Returns in respect of the taxes imposed by chapters 1, 2, 3, and 6 (income taxes), chapter 5 (tax on transfers to avoid income tax), chapter 11 (estate tax), chapter 12 (gift tax), chapter 23 (unemployment tax), chapter 32 (manufacturers excise taxes), subchapters B, C, and D of chapter 33 (communications tax, transportation taxes, and tax on safe deposit boxes, respectively), and subchapter B of chapter 37 (tax on coconut and palm oil) of the Code shall be open to inspection as hereinafter provided to certain persons having a material interest which will be affected by information contained in such returns.

SEC. 4. TIME AND PLACE OF INSPECTION.

Returns may be inspected in the office of the District Director where such returns and related documents are on file. Inspection shall be made only in the presence of an internal revenue officer or employee and only during the regular hours of business of the Internal Revenue Service office.

SEC. 5. APPLICATIONS FOR INSPECTION.

.01 Applications for permission to inspect returns, or for copies of returns, shall be made in writing to the District Director with whom the return was filed. The application should set forth the following:

- (1) The name and address of the person for whom the return was made.
- (2) The kind of tax reported on the return.
- (3) The taxable period covered by the return.
- (4) The reason why inspection is desired.
- (5) A statement, or other satisfactory evidence, that the applicant is a person entitled to make the inspection or to be furnished with the copy requested.

.02 Taxpayers and others authorized to inspect returns who come to the office in person will be required to sign a request for the information desired.

.03 No information contained in returns or related documents may be given over the telephone under any circumstances.

SEC. 6. RETURN OF INDIVIDUAL.

A return of an individual shall be open to inspection—

- .01 By the individual for whom the return was made.
- .02 If the individual for whom the return was made is legally incompetent, by the committee, trustee, or guardian of his estate.
- .03 If the individual for whom the return was made has died—
 - (1) By the administrator, executor, or trustee of his estate.
 - (2) In the discretion of the District Director, by any heir at law, next of kin, or beneficiary under the will, of such decedent, upon submission of satisfactory evidence that such heir at law, next of kin, or beneficiary has a material interest which will be affected by information contained in the return.
- .04 If the property of the individual for whom the return was made is in the hands of a receiver or trustee in bankruptcy, by such receiver or trustee.
- .05 By the duly constituted attorney in fact of any of the foregoing persons, subject to the conditions of inspection prescribed herein for such person.

SEC. 7. JOINT RETURN OF INCOME TAX.

A joint income tax return of husband and wife shall be open to inspection—

- .01 By either of the individuals for whom the return was made.
- .02 If either of the individuals for whom the return was made is legally incompetent, by the committee, trustee, or guardian of the estate of such individual.

.03 If either of the individuals for whom the return was made has died—

(1) By the administrator, executor, or trustee of the estate of such decedent.

(2) In the discretion of the District Director, by any heir at law, next of kin, or beneficiary under the will, of such decedent, upon submission of satisfactory evidence that such heir at law, next of kin, or beneficiary has a material interest which will be affected by information contained in the return.

.04 If the property of either of the individuals for whom the return was made is in the hands of a receiver or trustee in bankruptcy, by such receiver or trustee.

.05 By the duly constituted attorney in fact of any of the foregoing persons, subject to the conditions of inspection prescribed herein for such person.

SEC. 8. RETURN OF PARTNERSHIP.

A return of a partnership shall be open to inspection—

.01 By any person who was a member of the partnership during any part of the period covered by the return upon submission of satisfactory evidence of such membership.

.02 If an individual who was a member of the partnership during any part of the period covered by the return is legally incompetent, by the committee, trustee, or guardian of his estate.

.03 If an individual who was a member of the partnership during any part of the period covered by the return has died—

(1) By the administrator, executor, or trustee of his estate.

(2) In the discretion of the District Director, by any heir at law, next of kin, or beneficiary under the will, of such decedent, upon submission of satisfactory evidence that such heir at law, next of kin, or beneficiary has a material interest which will be affected by information contained in the return.

.04 If the property of the partnership is in the hands of a receiver or trustee in bankruptcy, by such receiver or trustee.

.05 By the duly constituted attorney in fact of any of the foregoing persons, subject to the conditions of inspection prescribed herein for such person.

SEC. 9. RETURN OF ESTATE.

A return of an estate shall be open to inspection—

.01 By the administrator, executor, or trustee of the estate.

.02 In the discretion of the District Director, by any heir at law, next of kin, or beneficiary under the will, of the decedent for whose estate the return was made, upon submission of satisfactory evidence that such heir at law, next of kin, or beneficiary has a material interest which will be affected by information contained in the return, or, if any such heir at law, next of kin, or beneficiary has died or is legally incompetent, by the administrator, executor, committee, trustee, or guardian of his estate, upon a like submission of evidence.

.03 By the duly constituted attorney in fact of any of the foregoing persons, subject to the conditions of inspection prescribed herein for such person.

SEC. 10. RETURN OF A TRUST.

A return of a trust shall be open to inspection—

- .01 By the trustee or trustees, jointly or severally.
- .02 By any person who was a beneficiary of the trust during any part of the period covered by the return, upon submission of satisfactory evidence that the person was such a beneficiary.
- .03 If any individual who was a beneficiary of the trust during any part of the period covered by the return is legally incompetent, by the committee, trustee, or guardian of his estate.
- .04 If any individual who was a beneficiary of the trust during any part of the period covered by the return has died—
 - (1) By the administrator, executor, or trustee of his estate.
 - (2) In the discretion of the District Director, by any heir at law, next of kin, or beneficiary under the will, of such decedent, upon submission of satisfactory evidence that such heir at law, next of kin, or beneficiary has a material interest which will be affected by information contained in the return.
- .05 By the duly constituted attorney in fact of any of the foregoing persons, subject to the conditions of inspection prescribed herein for such person.

SEC. 11. RETURN OF A CORPORATION.

A return of a corporation shall be open to inspection:

- .01 By any person designated by action of its board of directors, or other similar governing body, upon submission of satisfactory evidence of such action.
- .02 By any officer or employee of the corporation upon written request signed by any principal officer and attested by the secretary, or other officer, under the corporate seal, if any.
- .03 By the duly constituted attorney in fact of the corporation.
- .04 If the property of the corporation is in the hands of a receiver or trustee in bankruptcy, by such receiver or trustee, or by the duly constituted attorney in fact of such receiver or trustee.
- .05 In the discretion of the District Director, if the corporation has been dissolved, by any person who, under these provisions in section 11, might have inspected the return at the date of dissolution.
- .06 For provisions relating to inspection of corporation income and unemployment tax returns by shareholders see section 301.6103(c)-1 of the Regulations on Procedure and Administration, published in Treasury Decision 6546, C.B. 1961-1, 682, at 686.

SEC. 12. ESTATE TAX RETURNS.

A return or notice in respect of estate tax imposed by chapter 11 of the Code shall be open to inspection—

- .01 By the executor, or his successor in office, or the duly constituted attorney in fact of such executor or successor.
- .02 In the discretion of the District Director, by any other person upon submission of satisfactory evidence that such person has a material interest either in ascertaining any fact disclosed by the return or notice or in obtaining information as to the payment of the tax.

SEC. 13. GIFT TAX RETURNS.

A return in respect of gift tax imposed by chapter 12 of the Code shall be open to inspection—

.01 By the donor or his duly constituted attorney in fact.

.02 In the discretion of the District Director, by any other person upon submission of satisfactory evidence that such person has a material interest either in ascertaining any fact disclosed by the return or in obtaining information as to the payment of the tax.

SEC. 14. GUIDELINES WITH RESPECT TO WHAT DOCUMENTS MAY BE INSPECTED.

Generally, in addition to the return, inspection will be limited to documents filed by or on behalf of the taxpayer, including any schedules, lists and other written statements which have been filed with the Internal Revenue Service by or on behalf of the taxpayer or which have previously been furnished by the Service to the taxpayer.

The general guidelines with respect to what documents, other than the return, may or may not be open to inspection, and copies furnished by District Directors or the Director of International Operations are as follows:

.01 Schedules, information returns, protests, briefs, face of claims, waivers, and other statements or documents designed to be supplemental to or to become part of the return may be inspected.

.02 Examiners' reports may be inspected to the extent that such reports have previously been furnished to the taxpayer; therefore, the transmittal letter portion of a revenue agent's report, or a separate confidential report which contains information for Service use only, may not be inspected.

.03 Conference reports may not be inspected with the exception of the pages showing recomputation of tax liability.

.04 Work papers of examiners, engineers' reports, cover letters of the reports in which opinions are expressed, reports of special agents and interoffice communications, may not be inspected unless specific authorization is given by the Commissioner of Internal Revenue.

.05 Inspection of claims for refund will be limited to the face of the claim only, since the back of the claim contains Service records.

.06 Typed copies of office copies of notices of adjustment may be furnished; no photostatic copies of notices of adjustment are to be made.

SEC. 15. CHARGES FOR COPIES OF RETURNS AND RELATED DOCUMENTS.

Charges for furnishing copies of returns and related documents and for certifications of such returns and documents will be as follows:

.01 A charge of 50 cents per page will be made for a copy of each return or other document.

.02 For each copy of Form 1040A, or a return or other document of similar size, a charge of 50 cents will be made, even though both sides of the document are furnished.

.03 For each copy of a page which is substantially larger than the size used in the largest income tax return, the basic rate of 50 cents per page may be increased in proportion to the size (in multiples of 25 cents) to such amount that appears reasonable under the circumstances.

.04 For each certification a charge of 50 cents will be made.

.05 A bill for the cost of furnishing copies and preparing certifications will be made at the time the documents are furnished.

SEC. 16. CROSS REFERENCES.

For inspection of returns filed pursuant to the Internal Revenue Code of 1939, see Revenue Ruling 229, C.B. 1953-2, 152. See also Mim. 6747, C.B. 1952-1, 54, for charges for copies of such returns and documents.

26 CFR 601.301: Imposition of taxes, qualification requirements and regulations. Rev. Proc. 62-10¹
(Also Part III-A, Section 5275; 213.171.)

Tax-free alcohol permittees must maintain detailed records showing all tax-free alcohol received and used and must take and record an actual inventory at the end of each calendar month. Permittees should use such records and their file copy of Form 1473, Notice of Shipment of Specially Denatured, Tax-Free, or Recovered Spirits, in the preparation of Form 1451, Record of Tax-Free Alcohol Received and Used.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to supply tax-free alcohol permittees with instructions and aids to assist them in the maintenance of the records on tax-free alcohol and to simplify their task in the preparation of future annual reports on Form 1451, Record of Tax-Free Alcohol Received and Used.

SEC. 2. BACKGROUND.

The Distribution and Use of Tax-Free Alcohol Regulations require that records be kept in sufficient detail to enable any internal revenue officer to verify all transactions and to ascertain that permittees have complied with the law and regulations. These regulations also require that the records be such as to enable permittees to prepare the annual report, Form 1451. Since figures reported on Form 1451 are to be in proof gallons, permittees are required to identify, on their records, the proof of all alcohol together with the actual quantities for each transaction. Regulations also require that permittees take an inventory at the close of each month and keep such inventory as a part of their records.

SEC. 3. BASIC RECORD.

.01 *Alcohol Received.*—The copy of the Form 1473, Notice of Shipment of Specially Denatured, Tax-Free, or Recovered Spirits, which permittees receive covering each shipment of tax-free alcohol will

¹ Based on Industry Circular No. 61-4, dated January 26, 1961.

serve as the basic record of alcohol received. Permittees should make the proper notation on this copy (and on the original which is forwarded to the appropriate Assistant Regional Commissioner, Alcohol and Tobacco Tax) of any losses in transit. The quantity reported on the Form 1473, minus any loss or deficiency in transit, is the quantity which must be reported on Form 1451 as "received."

.02 Use of Alcohol.—Each time alcohol is withdrawn from the permittee's supply for any use, an entry should be made on his records, showing the quantity (liquid measure), the proof, and the purpose of removal. Permittees need not convert each separate quantity so removed to proof gallons unless so desired. Instead, they may total the quantity of alcohol of the same proof removed during the period of one calendar month, and then convert the figure representing the month's removals to total proof gallons removed. The resulting total, or combined total if there is alcohol of more than one proof, will be shown in column (g) of Form 1451 for that month.

.03 Monthly Inventory.—At the close of each month, an inventory must be taken of all alcohol remaining in stock. First, the permittee must determine the quantity remaining in each package or tank. If all of the alcohol is of the same proof, he must add these figures and convert the resulting figure to proof gallons. Where there is alcohol of different proofs in stock, the permittee must add the quantity for each proof separately, convert the total quantity for each proof to proof gallons and then total the proof gallons thus obtained. This is the total quantity, in proof gallons, on hand at the end of the month.

.04 Losses or Gains.

1. After completing the above computations, the permittee will now have records showing all alcohol received and used during the month and on hand at the end of the month. (This latter, of course, also becomes the quantity on hand at the beginning of the following month to be reported in column (b) for that month.) From these figures the permittee can determine any gains or losses during the month, as follows:

2. Add the quantity received during the month to the quantity on hand at the beginning of the month, and subtract therefrom the quantity used during the month. If the resulting figure is *less* than the quantity determined from the inventory as on hand at the end of the month, the difference between the two figures represents a gain (Example A). If it is *more* than the quantity revealed by the inventory, it represents a *loss* (Example B).

<i>Example A:</i>	On hand March 1, 1961.....	195 p.g.
	Received during month.....	110 p.g.
	Total	305 p.g.
	Used during month.....	200 p.g.
	Resulting figure	105 p.g.
	Quantity on hand, March 31 as shown by inventory....	106 p.g.
	Gain during month	1 p.g.

Example B:

On hand April 1, 1961-----	106 p.g.
Received during month-----	110 p.g.
Total -----	216 p.g.
Used during month-----	100 p.g.
Losses by casualty or theft-----	2 p.g.*
Resulting figure -----	114 p.g.
Inventory, April 30, 1961-----	112 p.g.
Additional losses during month -----	2 p.g.

* The regulations require that permittees show in their records all losses by theft or casualty or other unusual losses and that entries covering these losses be made in their records at the time of such losses or when they are discovered. Therefore, these known losses must be taken into account in order to determine any additional loss at the end of the month. However, all losses must be totaled and the combined figure (in the example—4 p.g.) entered in column (h) of Form 1451.

.05 Recovered Alcohol or Alcohol Received from the General Services Administration.

1. Permittees receiving alcohol from the General Services Administration or recovering tax-free alcohol must account for such alcohol separately in their records and inventory and make separate entries on Form 1451, appropriately identified. If recovered alcohol is shipped to a distilled spirits plant for restoration, the approximate quantity thereof, in proof gallons, should be entered in column (g), followed by an asterisk, and an explanation of the entry should be shown elsewhere on the form, identifying the distilled spirits plant to which shipment was made.

2. While the above procedures do not cover every transaction, they demonstrate the type of records which can be kept to meet regulatory requirements. The records must be in sufficient detail to show each transaction and to enable permittees to prepare Form 1451. Also, a record of the inventory taken at the close of each month, along with all other records, must be maintained, for a period of three years from the date of the report on Form 1451 covering the transactions. Permittees should observe the instructions on the back of Form 1451 when making entries from their records to the form.

.06 Conversion Table.

1. Use of the table below may prove helpful in converting volume measures to proof gallons for alcohol of 190 or 200 degrees of proof.

Fluid ounces	Volume measures	Wine gallons	Proof gallons 190 proof	Proof gallons 200 proof
4-----	¼ pint-----	0. 031	0. 059	0. 062
8-----	½ pint-----	. 063	. 119	. 125
16-----	1 pint-----	. 125	. 238	. 250
32-----	1 quart-----	. 250	. 475	. 500
64-----	½ gallon-----	. 500	. 950	1. 000
96-----	¾ gallon-----	. 750	1. 425	1. 500
128-----	1 gallon-----	1. 000	1. 900	2. 000
	2 gallons-----	2. 000	3. 800	4. 000
	3 gallons-----	3. 000	5. 700	6. 000
	4 gallons-----	4. 000	7. 600	8. 000
	5 gallons-----	5. 000	9. 500	10. 000
	10 gallons-----	10. 000	19. 000	20. 000
	25 gallons-----	25. 000	47. 500	50. 000
	55 gallons-----	55. 000	104. 500	110. 000

2. In computing proof gallons to the nearest tenth for entry to Form 1451, all fractional parts of five-hundredths or more shall be increased to the next tenth; for example, 4.275 proof gallons will be reported as 4.3 proof gallons. Fractional parts of less than five-hundredths shall be dropped; for example, 4.126 proof gallons will be reported as 4.1 proof gallons.

SEC. 4. INQUIRIES.

Inquiries concerning this Revenue Procedure should refer to its number and should be addressed to the office of the appropriate Assistant Regional Commissioner, Alcohol and Tobacco Tax.

26 CFR 601.305: Offers in compromise.

Rev. Proc. 62-11

(Also Part I, Section 7122, 301.7122-1.)

(Also Part III-A, Section 7122, 301.7122-1.)

(Also Part III-B, Section 7.)

Procedure for the submission and handling of certain offers in compromise submitted under chapter 51-53 of the Internal Revenue Code of 1954 and the Federal Alcohol Administration Act.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to outline the procedure for the submission and handling of offers in compromise relating to (a) civil and criminal liabilities arising under the Internal Revenue Code of 1954 with respect to alcoholic liquors, tobacco products, cigarette papers and tubes, and firearms; (b) liabilities with respect to administrative forfeiture of personal property seized in connection with liquor, firearms, tobacco, and wagering tax violations; and (c) penalties for violation of the provisions of the Federal Alcohol Administration Act.

SEC. 2. AUTHORITY TO COMPROMISE.

.01 Section 7122 of the Internal Revenue Code of 1954 provides that the Secretary of the Treasury or his delegate may, prior to reference to the Department of Justice for prosecution, compromise civil and criminal cases arising under the internal revenue laws. Section 7 of the Federal Alcohol Administration Act provides authority for the Secretary to compromise liability with respect to penalties for violation of the provisions of the Act.

.02 The Commissioner of Internal Revenue has been delegated authority to compromise cases arising under the internal revenue laws and the Federal Alcohol Administration Act and, to the extent indicated in subsections .03 and .04 of this section, has redelegated such authority with respect to liabilities arising under chapters 51, 52, and 53 of the Internal Revenue Code of 1954 and the Federal Alcohol Administration Act. See Treasury Department Order No. 150-25, dated June 1, 1953.

.03 The Director, Alcohol and Tobacco Tax Division, has been delegated authority to accept or reject offers in compromise of liability with respect to (a) forfeiture of personal property seized in connection with liquor, firearms, tobacco, and wagering tax violations, and (b) penalties for violation of the provisions of the Federal Alcohol

Administration Act. See Commissioner Delegation Order No. 31, C.B. 1956-1, 1015.

.04 Assistant Regional Commissioners, Alcohol and Tobacco Tax, have been delegated authority to accept or reject offers in compromise of (a) tax liabilities arising from (1) illegal production of untaxed distilled spirits, wines or beer, (2) failure to file returns of, or to pay, occupational taxes with respect to distilled spirits, wines, or beer, and (3) failure to pay firearms taxes arising under Chapter 53 of the Internal Revenue Code; (b) liabilities arising under Chapter 52 of the Internal Revenue Code (tobacco products, cigarette papers, and tubes); and (c) criminal liabilities of retail dealers in liquor arising from violations of the internal revenue laws relating to liquor, including the reuse or refilling of liquor bottles. See Commissioner Delegation Order No. 34, C.B. 1956-2, 1375; Delegation Order No. 61, C.B. 1958-1, 683; and Delegation Order No. 62, C.B. 1958-1, 683.

SEC. 3. OFFERS IN COMPROMISE UNDER INTERNAL REVENUE LAW.

.01 Offers shall be submitted in triplicate on Form 656, Offer in Compromise, properly executed, and should generally be accompanied by a remittance representing the amount of the compromise offer, or a deposit if the offer provides for future installment payments. Checks and money orders should be made payable to the Internal Revenue Service. Personal checks may be accepted except when tendered as final payment on an offer which is contingent on immediate or simultaneous release, in whole or in part, of Federal tax liens. If the offer is based on inability to pay, it shall be accompanied by Form 433 or Form 433-AB, Statement of Financial Condition and Other Information. Offers in compromise may be filed with the District Director of Internal Revenue for the district in which the liability was incurred or the offense committed, or may be initially received by an Alcohol and Tobacco Tax officer for transmittal to the District Director.

.02 The District Director will record each offer in compromise, complete all copies of Form 656, and forward the original and one copy of Form 656 and two copies of his record card, Form 2515, with attached Form 433 or Form 433-AB, if any, to the Assistant Regional Commissioner, Alcohol and Tobacco Tax. An abstract and statement giving a brief summation of the facts and circumstances will be prepared in the Assistant Regional Commissioner's office in accordance with current procedures.

.03 An offer in compromise may be withdrawn by the proponent at any time prior to its acceptance or rejection. When an offer is withdrawn, or is rejected, the amount submitted with the offer, including all installments paid, will be refunded, without interest, unless, in the case of tax liability, the proponent has stated or agreed that the amount submitted may be applied to the liability with respect to which the offer was submitted.

.04 When the Assistant Regional Commissioner accepts an offer (or is notified of acceptance by the National Office), he will notify the proponent, by letter, that his offer has been accepted. The letter will identify the offer by serial number, show the specific violation or tax liability which has been compromised, and include an exact statement of any stipulation or agreement made a part of the offer.

.05 When an offer is rejected, the Assistant Regional Commissioner will prepare a letter advising the proponent that his offer has been rejected and that a check refunding the amount submitted is enclosed. The letter will identify the offer by serial number, show the specific violation or tax liability which the proponent sought to compromise, and state the reasons for rejection. The Assistant Regional Commissioner will forward the letter to the District Director, who will issue a check and mail the check and letter to the proponent.

SEC. 4. OFFERS IN COMPROMISE UNDER THE FEDERAL ALCOHOL ADMINISTRATION ACT.

.01 Violations of the Federal Alcohol Administration Act may be disposed of by acceptance of an offer in compromise, commensurate with the offense (but not in excess of \$500 for each offense), in lieu of the administrative or criminal penalties prescribed by the Act. Remittances shall be in the form of a certified check or post office money order made payable to the Director, Alcohol and Tobacco Tax Division, Internal Revenue Service. Offers shall be submitted in duplicate on Form 656-D, offer in Compromise, to the Assistant Regional Commissioner, Alcohol and Tobacco Tax, for the region where the violation occurred. The Assistant Regional Commissioner will consider the offer and, if he finds it to be complete and in proper form, will forward it and the remittance to the Director, Alcohol and Tobacco Tax Division, for final action.

.02 If the offer is accepted, the Director, Alcohol and Tobacco Tax Division, will notify the proponent of such action and furnish the Assistant Regional Commissioner with a copy of the acceptance letter. The letter will identify the offer by serial number, show the specific violation which has been compromised, and include an exact statement of any stipulation or agreement made a part of the offer.

.03 If the offer is rejected, the Director will notify the Assistant Regional Commissioner of such action and return the remittance to him. The Assistant Regional Commissioner will return the remittance to the proponent with a letter stating the reasons for rejection of the offer.

SEC. 5. PUBLIC INSPECTION OF ACCEPTED OFFERS.

.01 A copy of the abstract and statement relating to each offer accepted in compromise of civil or criminal liability arising under chapter 51 of the Internal Revenue Code of 1954 will be available for public inspection, for a period of one year from date of acceptance, in the office of the District Director for the internal revenue district in which the offer was submitted.

.02 A copy of the abstract and statement relating to each offer accepted in compromise of (a) civil or criminal liability arising under chapter 51 of the Code, or (b) penalties for violation of the Federal Alcohol Administration Act, will be available for public inspection, for a period of one year from date of acceptance, in the office of the Assistant Regional Commissioner, Alcohol and Tobacco Tax, for the region in which the offer was submitted.

.03 The abstract and statement will not contain any information which would disclose trade secrets, processes, operations, style or work, or apparatus, or confidential data, amount or source of income, profits, losses, or expenditures, or any other matter within the prohibition of

section 1905 of Title 18 of the United States Code on Crimes and Criminal Procedure.

SEC. 6. INQUIRIES.

Inquiries concerning this Revenue Procedure should refer to its number and be addressed to the office of the appropriate Assistant Regional Commissioner, Alcohol and Tobacco Tax.

26 CFR 601.301: Imposition of taxes, qualification requirements, and regulations.
(Also Part III-B, Section 5(e)); 27 CFR 4.24.)

Rev. Proc. 62-12¹

Importers of alcoholic beverages may no longer import sparkling wines labeled as "Spanish Champagne" into the United States and they must immediately surrender for cancellation all certificates of label approval previously issued with respect to labels bearing such designations.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to announce that future importations of sparkling wine labeled as "Spanish Champagne" will not be permitted entry into the United States.

SEC. 2. BACKGROUND.

.01 Section 4.24 of the Wine Labeling and Advertising Regulations, 27 CFR Part 4, issued under the provisions of the Federal Alcohol Administration Act, require all semi-generic type designations having geographic significance, such as "Champagne," to be qualified by an appropriate appellation of origin, disclosing the true place of origin, when the product is not produced in the geographical area indicated by such designation. Section 4.24 of the regulations also provides that this is permissible when the product conforms to the requirements of the laws and regulations of the place or region of actual production governing the composition, method of manufacture and designation of wines for home consumption. It is not permissible under any other circumstances.

.02 In the past, certificates of label approval have been issued to importers in the United States authorizing the importation of products designated "Spanish Champagne." This was done on the basis of the understanding of the Internal Revenue Service that the laws of Spain authorized the use of that designation on wines of that type for consumption in Spain.

.03 The Service has now been officially informed by the Embassy of Spain that the Spanish Government does not permit the sale of wine in Spain under the designation "Spanish Champagne." Accordingly, the use of such designation on wines imported into the United States is not permitted under the provisions of the Federal labeling regulations referred to above.

SEC. 3. CONCLUSION.

.01 In view of the foregoing, products may no longer be imported into the United States under the designation "Spanish Champagne."

¹ Based on Industry Circular No. 61-50, dated December 20, 1961.

Importers of alcoholic beverages are requested immediately to surrender for cancellation all certificates of label approval previously issued with respect to labels bearing such designation.

.02 The certificates to be surrendered for cancellation should be forwarded to the Director, Alcohol and Tobacco Tax Division, Washington 25, D.C.

SEC. 4. INQUIRIES.

Correspondence in regard to this Revenue Procedure should refer to its number and be addressed to the Director, Alcohol and Tobacco Tax Division (CP:AT:B), Washington 25, D.C.

26 CFR 601.301: Imposition of taxes, qualification requirements, and regulations.
(Also Part III-B, Section 5; 27 CFR 7.26.)

Rev. Proc. 62-13¹

Alcoholic content statements are prohibited by Federal law and regulations on labels of malt beverages shipped into the State of Washington. However, present stocks of labels bearing alcoholic content statements may be used on containers shipped into Washington until December 31, 1962.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to inform brewers that the laws of the State of Washington have been amended to eliminate the requirement that an alcoholic content statement must appear on the labels of malt beverages sold in that State.

SEC. 2. BACKGROUND.

.01 The laws of the State of Washington previously required all malt beverages to be labeled to show the maximum alcoholic content. Effective February 21, 1961, however, the laws of that State were amended to delete this requirement.

.02 Section 5 of the Federal Alcohol Administration Act, 27 U.S.C. 205(e), and section 7.26 of the Malt Beverages Labeling and Advertising Regulations, 27 CFR Part 7, provide that the alcoholic content of malt beverages shall not be stated on labels unless required by state law. Accordingly, since the laws of the State of Washington no longer require an alcoholic content statement, alcoholic content statements are prohibited by Federal law and regulations on labels of malt beverages shipped into that State.

SEC. 3. CONCLUSION.

In order to permit an orderly transition to new labels, present stocks of labels for malt beverages bearing alcoholic content statements in the manner previously required under Washington law may be used on containers shipped into the State of Washington until December 31, 1962. After such date, statements of alcoholic content should be omitted from all labels affixed to containers filled for shipment into the State of Washington.

¹ Based on Industry Circular No. 61-52, dated December 28, 1961, as amended by Industry Circular No. 62-5, dated February 19, 1962.

SEC. 4. INQUIRIES.

Correspondence in regard to this Revenue Procedure should refer to its number and be addressed to the Director, Alcohol and Tobacco Tax (CP:AT:B), Washington 25, D.C.

26 CFR 601.301: Imposition of taxes, qualification requirements, and regulations.

Rev. Proc. 62-14

(Also, Part III-A, Section 5207; 201.634.)

Procedure for reporting additional data relating to alcohol and spirits of 190 degrees or more of proof on Form 332, Statement by Kinds, Seasons, and Years of Production of Spirits in Bonded Warehouses (Revised April 1962).

SECTION 1. PURPOSE.

This Revenue Procedure describes the method of reporting, for statistical purposes, stocks of spirits of 190 degrees or more of proof.

SEC. 2. BACKGROUND.

Form 332, Statement by Kinds, Seasons, and Years of Production of Spirits in Bonded Warehouses (Revised April 1962), provides for the reporting of a combined total of cane, grain, and fruit spirits of 190 degrees or more of proof. In order that the tax gallons on hand in each classification of these spirits may be determined, proprietors of distilled spirits plants will furnish a breakdown on Form 332, in accordance with section 3 of this Revenue Procedure.

SEC. 3. REPORTING REQUIREMENTS.

Pending further revision of Form 332, proprietors of distilled spirits plants will enter, on the reverse of that form, information concerning stocks of spirits of 190 degrees or more of proof, produced from grain, cane, or fruit as follows:

Spirits of 190 degrees or more of proof

Alcohol and neutral spirits—Grain	_____	tax gallons
Alcohol and neutral spirits—Cane	_____	tax gallons
Alcohol and neutral spirits—Fruit	_____	tax gallons

The first report of this information will be made for the 6-month period ending June 30, 1962. A report will also be made for each 6-month period thereafter.

SEC. 4. INQUIRIES.

Inquiries concerning this Revenue Procedure should refer to its number and be addressed to the office of the appropriate Assistant Regional Commissioner, Alcohol and Tobacco Tax.

26 CFR 601.404: Miscellaneous excise taxes collected by sale of revenue stamps.

Rev. Proc. 62-15

(Also Part I, Section 6801; 47.6801-1.)

Requirements to be met by manufacturers of documentary stamp tax meter machines in order to receive official authorization from

the Internal Revenue Service, under section 47.6801-1 of the Documentary Stamp Tax Regulations, for manufacturing and leasing such machines.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to set forth the requirements to be met in order to obtain authorization from the Internal Revenue Service to manufacture and lease documentary stamp tax meter machines.

SEC. 2. BACKGROUND.

Section 47.6801-1 of the Documentary Stamp Tax Regulations provides, in part, that the Commissioner of Internal Revenue or his delegate shall have the authority to set the standards for and to approve meter machines for use in the sale of documentary stamps.

SEC. 3. APPLICATION.

Any person who desires to manufacture and lease documentary stamp tax meters may apply for authorization in writing to the Commissioner of Internal Revenue. Upon approval, he will be notified in writing by the Service.

SEC. 4. QUALIFICATIONS.

Any person desiring authorization to manufacture and lease documentary stamp tax meter machines must qualify as follows:

.01 Present satisfactory evidence to the Commissioner as to integrity and financial responsibility.

.02 Obtain approval of the specific model to be used. The model must incorporate all of the mechanical features and safeguards set forth in section 5 of this Revenue Procedure.

.03 Maintain manufacturing control and maintenance facilities satisfactory to the Service. Such facilities shall be subject to inspection by the Service. At the time of such inspection, the authorization of the manufacturer may be suspended if conditions are found which indicate that meters, dies or keys are not properly controlled or accounted for.

.04 Maintain adequate facilities to control, distribute and maintain documentary stamp tax meters and to replace them, if necessary.

SEC. 5. SPECIFICATIONS.

To qualify under this Revenue Procedure, documentary stamp meters must incorporate all of the following mechanical features and safeguards:

.01 A documentary stamp meter may be either a complete machine or it may be a detachable portion of a complete machine, provided such detachable portion contains the printing die and registering mechanism. It must be suitable for the user to bring it to the designated Service office for setting as provided in section 6 of Revenue Procedure 62-16, page 451 of this Bulletin.

.02 A documentary stamp meter must be capable of printing a stamp for any amount up to \$999.99. The printing die or die counters, and the counter-actuating mechanism must be inseparable in the unit.

.03 In each documentary stamp meter, there must be two accurate and dependable counting devices, one ascending and registering the total tax amounts which have been imprinted by the machine and the

other descending and registering the balance of the tax amount unused. The descending register must actuate a locking mechanism preventing further operation of the meter after the register has been reduced to an amount less than \$100.00. The descending register must be so constructed as to be easily set at the designated Service office for a total value of documentary stamps up to \$99,999.99.

.04 The printing die must be approved by an authorized Service representative. Such die must include, as part of the printing surface, the name or identifying symbol of its manufacturer, the identification number of the meter machine and spaces so that, when the machine is activated, it will automatically print on each stamp the date, a stamp serial number and the money value of the stamp. There should be associated with such die a timing or date setting device which must be easily accessible to the user without requiring access to the mechanism of the meter. The printing mechanism must be so constructed and shielded as to prevent fraudulent imprints. Each meter machine manufacturer will use only one design for the printing surface of dies which are intended to be used in meter machines to print documentary stamps. Such design must be approved by the Commissioner or his delegate.

.05 The meter die or printing plate and numerals must be made of suitable durable material which will provide a sharp legible impression. Also the die, plate and numerals must be of such durability as not to soften or disintegrate while in normal use. The die or plate must be well-fitted and so securely fastened to the printing mechanism that it will not normally become loose or detached or otherwise interfere with the proper operation of the meter.

.06 The entire mechanism must be encased in a durable or permanent-type housing. The descending register must be accessible, to the person authorized by the Service to set the meter, by means of a door equipped with a suitable lock and with mechanism for an Internal Revenue Service seal. The ascending register and all other related internal mechanism must be so shielded as not to be accessible even when the door is open. The readings of both registers and the consecutive imprint serial number must be visible through closed windows, so as to be easily obtainable at any time between operations. The housing must be of such construction that it is impossible (1) to alter the readings of the ascending register or to alter the serial stamp numbering device, except by normal operation, or (2) to gain access to the internal mechanism, except by a representative of the Service authorized to set the descending register.

.07 The entire mechanism must be of such solid substantial and dependable design and construction as to protect the Federal Government against loss of revenue from fraud, manipulation, misoperation, or breakdown.

.08 The ink used in the meter must be indelible and of a quality approved by an authorized Service representative.

.09 The meter must be so designed that it may be used to imprint a stamp either directly on a document or on paper tape which can be affixed to a document. The paper tape used for this purpose must be a protected paper of a quality equal to that normally used for bank checks and must have a durable adhesive on the reverse side.

SEC. 6. TESTING AND APPROVAL.

.01 *Submission of model.*—Prior to approval, each model proposed for manufacture must be submitted to the Service for tests of the meter at the expense of the manufacturer.

.02 *Restriction on distribution.*—Meters may not be distributed or used for payment of documentary stamp tax until a complete unit made to production drawings and specifications has been submitted, tested, and approved, except as may be specifically authorized for preliminary field testing.

.03 *Deposit of specimen meter.*—The manufacturer of the meter must deposit a sample of each production model with the Service, and no changes affecting the basic features or safeguards may be made thereafter without the approval of the Service.

.04 *Tests after approval.*—If requested by the Service, additional meters from current manufacture must be supplied for testing at the expense of the manufacturer.

SEC. 7. SAFEGUARDS.

.01 *Materials and workmanship.*—All meters must closely adhere to the quality in materials and workmanship of the approved production model and must be manufactured with suitable jigs, dies, tools, etc., to assure proper maintenance and interchangeability of parts.

.02 *Breakdown tests.*—At reasonably frequent intervals, the manufacturer must take meters at random from production and subject them to breakdown tests to make certain that quality and performance standards are being maintained.

.03 *Protection of printing dies and keys.*—During the process of fabricating parts and assembling documentary stamp meters, the manufacturer must exercise special care to prevent the loss or theft of keys, meters, dies or component parts. All printing dies and keys produced shall be accounted for, the dies by assembly into meters or by mutilation or destruction recorded and certified by an officer of the manufacturer, the keys by transfer to authorized Service representatives or by mutilation or destruction recorded and certified by an officer of the manufacturer.

.04 *Destruction of meter stamps.*—All meter stamps printed in the process of testing dies and meters must be collected and destroyed by an officer of the manufacturer. The manufacturer will maintain a record of the machine number, serial number and date of all stamps destroyed.

.05 *Inspection of new and rebuilt meters.*—All new and rebuilt meters must be carefully inspected before leaving the manufacturer's meter service station.

.06 *Keys and setting equipment.*—The meter manufacturer must furnish keys and other essential equipment for setting his meters to each Service representative authorized to set documentary stamp meters. These items shall be protected and not furnished to any persons except those authorized by the Commissioner to set documentary stamp meters.

SEC. 8. DISTRIBUTION.

.01 *Facilities.*—Each authorized manufacturer must maintain adequate facilities for the distribution, maintenance and control of docu-

mentary stamp meters. All such facilities will be subject to inspection by the Service.

.02 *Controls.*—Each authorized manufacturer is required to:

(1) Retain title permanently to all meters of his manufacture except those which may be sold to a department or agency of the United States Government.

(2) Lease meters only to users who have been granted permission by the Service to use these meters.

(3) Deliver each meter only to the Service office designated in the approved Form 2969, Application and Permit to Use Documentary Stamp Tax Meter, which meter is to be set and sealed by the proper Service representative before release to an approved user.

(4) Take special precautions in the transportation, storage and maintenance of the meters to prevent their reaching the hands of unauthorized persons.

(5) Report immediately the loss or theft of any of his meters or the recovery of any stolen meters to the local police and to the District Director for the district in which the meter is located.

(6) Maintain at a central headquarters within the United States a complete record by identification number of all meters manufactured, showing all movements of each and the users thereof from the time it is produced until it is scrapped, and the readings of the ascending register and the last consecutive imprint serial number each time it is checked into or out of service through the Service office designated by Form 2969 to set the meter. These records must be available for inspection at any time by the Internal Revenue Service. Upon the sale of a meter machine to a United States Government agency, as authorized in section 8.02(1) above, such record keeping requirements will be suspended upon presentation of notice of the sale to the Commissioner or his delegate. The records must not be destroyed until at least three years after the meter is scrapped.

(7) Cancel the lease agreement with any user whose meter authorization is cancelled by the Service and promptly remove the meter from the user's premises.

(8) Maintain a permanent record, which shall include signed receipt cards, by identification number of all meter keys issued to Service representatives authorized to set meters. Such records are required to be certified to by an officer of the manufacturer.

(9) Examine each meter withdrawn from service for mechanical failure and report to the Service the mechanical condition or fault which caused the failure and the action taken to correct it.

SEC. 9. MAINTENANCE.

.01 The manufacturer must maintain his meters in proper operating condition for users by repairing or replacing them when necessary or desirable to forestall mechanical breakdown.

.02 The manufacturer will provide each meter user with a meter record book of a style approved by the Service and will furnish a new or additional one when necessary.

.03 The manufacturer will at all times, have a sufficient stock of approved ink and approved protected paper tape to keep each user's meter in a proper operating condition.

SEC. 10. INSPECTION.

The manufacturer must inspect, at least once each six months, all of his meters in service. Inspections must be sufficiently thorough to determine that each meter is clean and in proper operating condition, that it is recording its operations correctly and accurately, and that neither the Internal Revenue Service seal nor any seal placed on it by the manufacturer to prevent access to the mechanism has been removed or tampered with. Any irregularities found in the operation of a meter at any time or any improper usage of a meter must be reported immediately to the District Director, and appropriate steps must be taken to remove the meter from service.

SEC. 11. REPAIR OF INTERNAL MECHANISM.

Repair or reconditioning of meters involving access to internal mechanism must be performed only within a factory or suitable meter repair department under the direct control and supervision of the manufacturer. Each meter requiring internal repair must be checked out of service through the Service office designated to set the meter before it is opened or any internal repairs are undertaken and such meter must be checked back into service through a Service office.

SEC. 12. REVOCATION.

Among the reasons for which a manufacturer's authorization may be revoked are the following:

- (1) If the manufacturer, any of his employees or representatives engages in any scheme or enterprise involving misuse of stamp meters, keys or dies for meters that results in loss of revenue to the Federal Government.

- (2) If the manufacturer fails to maintain standards for control, distribution and maintenance of the documentary stamp tax meters required by this Revenue Procedure. (The manufacturer's facilities shall be subject to inspection to determine if the requirements are met.)

- (3) If the machine proves to be unsatisfactory or if it is found to be susceptible to fraud.

SEC. 13. SUSPENSION.

The Service may require a manufacturer to suspend production and distribution of any model of documentary stamp tax meter pending an investigation to determine whether his authorization should be continued, modified or revoked. The manufacturer will be informed of the facts which may warrant adverse action and will be given an opportunity to be heard and to demonstrate or achieve compliance with the requirements of the Service within a reasonable, specified time limit.

SEC. 14. INQUIRIES.

Inquiries concerning this Revenue Procedure should refer to its number and be addressed to the Commissioner of Internal Revenue, Washington 25, D.C., Attention: D:S:P.

26 CFR 601.404: Miscellaneous excise taxes collected by sale of revenue stamps. (Also Part I, Section 6801; 47.6801-1.)

Rev. Proc. 62-16

Standards and instructions governing the use of meter machines in the sale of documentary stamps, as authorized by section 47.6801-1 of the Documentary Stamp Tax Regulations.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to establish standards and to provide instructions for the use of meter machines in the sale of documentary stamps.

SEC. 2. BACKGROUND.

Section 47.6801-1 of the Documentary Stamp Tax Regulations authorizes the Commissioner of Internal Revenue or his delegate to set the standards for and to approve meter machines for use in the sale of documentary stamps and to prescribe instructions and requirements governing the circumstances and conditions under which such machines may be used. That section of the regulations provides that, in addition to the documentary stamps customarily sold and used for the payment of taxes imposed under chapter 34 of the Internal Revenue Code of 1954, stamps produced by authorized documentary stamp meter machines shall be proper for such use.

SEC. 3. APPROVAL OF METERS.

No documentary stamp meter may be authorized for use unless the model of that meter has been approved by the Internal Revenue Service. Manufacturers of meters may obtain this approval under the standards and instructions set forth in Revenue Procedure 62-15, page 445, this Bulletin. Each District Director of Internal Revenue will maintain information regarding those models which have been approved for use in his district. Persons desiring to use meters will enter into lease arrangements with a manufacturer of an approved meter.

SEC. 4. PERMISSION TO USE.

.01 A prospective user of a documentary stamp meter must obtain the permission of the District Director for the district in which the meter will be used. To request this permission, the prospective user must file Form 2969, Application and Permit to Use Documentary Stamp Tax Meter. This form may be obtained from the District Director or from the meter manufacturer's representative.

.02 If the District Director approves the application, he will retain the original application and will send endorsed copies to (1) the applicant, (2) the meter manufacturer, and (3) the Internal Revenue office designated to set the meter.

SEC. 5. METERED STAMPS.

.01 Documentary stamp meters can be set to print a stamp in any denomination up to \$999.99. These stamps are printed with an indelible ink approved for such use by the Internal Revenue Service. It is the user's responsibility to see that each stamp is printed to clearly and legibly show its value, serial number, the date and the identification number of the meter being used. If the stamp is illegible in respect to its serial number, date or meter machine number, the user

may, on the stamp or adjoining thereto, set forth the matter or matters which are illegible and sign his name in respect thereto. If the amount of such stamp is not entirely clear, but is legible to the extent that the amount can be determined, the stamp may be submitted for refund as provided in section 11 of this Revenue Procedure. However, stamps on which the amount cannot be determined will not be acceptable as a basis for refund claim except under such facts and circumstances as will enable the District Director or other Service representative designated by the Commissioner to determine with accuracy the amount that such stamp should show.

.02 The metered stamp may be printed either directly on a document (such as a deed) or on a gummed tape of special protected paper. The method to be used depends upon the convenience of the user. Each metered stamp which is printed on tape must be affixed to the appropriate document by use of the adhesive on the tape, and then it must be cancelled. See section 7 below.

.03 The ink and the special protected paper tape to be used in the meter are to be furnished by the manufacturer who leases the meter.

SEC. 6. SETTING OF THE METER.

.01 Each District Director will designate the Internal Revenue offices within his district which are authorized to set documentary stamp meters. Each approved Form 2969 will indicate the office at which the applicant's meter may be set.

.02 After approval of an application for permission to use a meter, the applicant must arrange to meet the meter manufacturer's representative at the Internal Revenue office designated to set the meter. The meter cannot be delivered to the user by the manufacturer's representative until it has been set and sealed at the designated Internal Revenue office. The user must present at that office (1) his endorsed copy of Form 2969, (2) a completed Form 2970, Order for Setting Documentary Stamp Tax Meter, and (3) a remittance in the amount for which he wishes to have the machine set. The maximum total amount for which a meter can be set is \$99,999.99.

.03 Each time thereafter when the user wishes to have the meter reset, he must bring to the designated Internal Revenue office (1) the meter, (2) a Meter Record Book (provided by the meter manufacturer), (3) a completed Form 2970, and (4) a remittance. The meter will be reset and sealed, and the Meter Record Book will be returned to the user.

.04 If a user wishes to have a receipt for his remittance, he may submit Form 2970 in duplicate so that one copy may be endorsed and returned to him as a receipt.

SEC. 7. CANCELLATION OF STAMPS.

.01 A stamp which is printed on gummed tape and affixed to a document must be cancelled in the manner prescribed by section 47.6804-2(a) of the regulations which states that a person using or affixing a stamp shall cancel it and so deface it as to render it unfit for reuse by marking it with his initials and the day, month, and year when the affixing occurs. Such marking shall be made by writing or stamping in indelible ink or by perforating with a machine or punch. However, the stamp shall not be so defaced as to prevent ready determination of its denomination and genuineness.

.02 Under the provisions of section 47.6804-2(b) of the regulations, it is not necessary that the user cancel a stamp printed directly on a document by an authorized meter machine.

SEC. 8. CONTROL OF METER.

.01 The user must maintain in the Meter Record Book a daily record of use of the meter. This record is for the protection of the user as well as for the protection of the Federal government. At the end of each calendar month (irrespective of whether the meter has been used during that month), the user must remove the original daily record from the Meter Record Book and send it to the Internal Revenue office which set the meter. The meter should be presented to that office at least once each year for inspection, if it has not been presented during that time for resetting.

.02 The permission to use a documentary stamp meter may be revoked at any time by the District Director, (1) if the meter has been used in any scheme to defraud the Federal government, (2) if the user fails to comply with instructions, or (3) if the meter has not been used for more than two years.

SEC. 9. MECHANICAL FAILURE.

The user should report immediately to the manufacturer's representative any mechanical failure of a meter. If the meter must be repaired, the user must take the meter and the Meter Record Book to the Internal Revenue office which set the meter. The amount of unused stamp value in the meter may be transferred to another meter, or it may be refunded to the user.

SEC. 10. DISCONTINUANCE OF METER.

When the user discontinues the use of a meter, he must return it to the Internal Revenue office which set the meter, in order to have the amount of unused stamp value in the meter transferred to another meter or refunded to the user. If the user desires that this unused amount be refunded, he must submit Form 843, Claim, when he returns the meter. The user may not transfer the meter to another person for use.

SEC. 11. UNUSED STAMPS.

The meter user may file a claim for refund with respect to any unused or erroneously issued stamps. To be eligible for refund, the amounts of such stamps must be determinable to the satisfaction of the District Director or such other official as designated by the Commissioner to pass upon such claim. The claim must be filed on Form 843 and must be supported by submitting the stamps or by furnishing any information required by the District Director.

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