Internal Revenue Bulletin

CUMULATIVE BULLETIN 1962-2

JULY-DECEMBER 1962

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Internal Revenue Bulletin

Cumulative Bulletin 1962–2

July–December 1962

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ABBREVIATIONS

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

A,B,C,etc.—The names of individuals.
A.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.
T.I.R.—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 three subparts according to matters issued under the Internal Revenue Code of 1939 (Subpart A), the Federal Firearms Act (Subpart B), and rulings and decisions under other public laws (Subpart C).

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 Tax Conventions. (Public Laws pertaining to internal revenue matters enacted by the Second Session of the 87th Congress on or after May 24, 1962, together with their related Committee Reports and a digest of all tax legislation enacted during the Second Session, which normally would have been included in this Part of this Cumulative Bulletin, have been consolidated and are published in Internal Revenue Cumulative Bulletin 1962–3.)

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 Internal Revenue Service, 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 pub-

lished 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. 97 for 1962 should be cited as "Rev. Rul. 62–97, C.B. 1962–2, 210." Similarly, Revenue Procedure No. 17 for 1962 should be cited as "Rev. Proc. 62–17, C.B. 1962–2,407." Revenue Rulings are keyed to the applicable sections of the Internal Revenue Code and regulations.

Internal Revenue Cumulative Bulletin 1962–2 contains all rulings, decisions, and procedures pertaining to Internal Revenue matters published in the weekly Internal Revenue Bulletins 1962–27 to 1962–53, inclusive, for the period July 1 to December 31, 1962. It includes an index to all matters published during the year in the weekly Internal Revenue Bulletins and consolidated in the Cumulative Bulletins. 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 in 1962.

Public Laws pertaining to Internal Revenue matters enacted by the Second Session of the 87th Congress on or after May 24, 1962, together with their related Committee Reports and a digest of all tax legislation enacted during the Second Session, have been consolidated and are published in Internal Revenue Cumulative Bulletin 1962–3.

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

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 DECEMBER 31, 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 the acquiescences in adverse decisions should be relied on by Revenue officers and others concerned as conclusions of the Service only to the application of the law to the facts in the particular case. Caution should be exercised in extending the application of the decision to a similar case unless the facts and circumstances are substantially the same, and consideration should be given to the effect of new legislation, regulations, and rulings as well as subsequent court decisions and actions thereon. Acquiescence in a decision means acceptance by the Service of the conclusion reached, and does not necessarily mean acceptance and approval of any or all of the reasons assigned by the Court for its conclusions. No announcements are made in the Bulletin with respect to memorandum opinions of The Tax Court.

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

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See footnotes at end of table.

ACQUIESCENCES—Continued

Taxpayer	Docket No.	Report	
		Volume	Page
Vaughan, Floyd C., et ux	57163 69944	36	350
Vaughan, P. W	57164 69942	36	350
Vietzke, Paul C. F., et ux	87819	37	504
Vinocur, David A., transferee of Pittsburgh Milk Co.[8]	40273	26	707
Vinocur, David A., transferee of Pittsburgh Milk Co., Dissolved [8]	48223	26	707
Vinocur, David A., et al., trustees for the benefit of Judy Tucker and Shirley Tucker, transferees of Pittsburgh Milk Co., Dissolved [8]	48228	26	707
Vinocur, Louis M., transferee of Pittsburgh Milk Co.[8]	40275	26	707
Vinocur, Louis M., transferee of Pittsburgh Milk Co., Dissolved [8]	48224	26	707
Vinocur, Morris, transferee of Pittsburgh Milk Co.[8]	40274	26	707
Vinocur, Morris, transferee of Pittsburgh Milk Co., Dissolved [8]	48225	26	707
W. & W. Pickle and Canning Co	82359	36	747
Watson, A. L., estate of, Oscar G. Schaefer, administrator, transferee	63352	36	395
Wellworth Realty Corp	88888	38	330
Whitfield, L. B., et ux	82360 83966	36	747
Wilson, Clarence T., et ux	80793	36	691

The Commissioner does NOT ACQUIESCE in the following decisions:

Taxpayer	Docket No.	Report	
		Volume	Page
Beeghly Fund, Leon A	55061	35	490
Borner, A. Carl, estate of [1 10]	39669	25	584
Borner, Bertha J., executrix of estate of A. Carl Borner [1 10]			
Brockway, Don Murillo, estate of [1 11]	24446	18	488
Carnell, Edward, estate of [1 12]	39556	25	654
Cavanagh, John E., et ux	83525	36	300
Commercial Shearing & Stampling Co	76778 84338 85427	36	433
Gillespie Trust, F. A.[13]	31437	21	739
Herr Arlean I.[2]	78089	35	732
Herr, Robert F.[2]	78090	35	732
Kelley, James B., et al.[14]	64133 64134	32	135

See footnotes at end of table.

NONACQUIESCENCES—Continued

Taxpayer	Docket No.	Report	
		Volume	Page
Lake Forest, Inc.	77061 81891	36	510
Lehman, Robert [15]	28236	17	652
Minzer, Sol, et ux.	63080	31	1130
Moberg, Theodore E., et ux [9]	47880	35	773
Moberg, Vern H., et ux [9]	47925	35	773
Provident Trust Co. of Philadelphia, et al., executors of estate of Edward Carnall [1] [12]	39556	25	654
Safra, Meyer J., et ux [16]	29823	30	1026
Shea, J. J., et ux.	79886	36	577
Sullivan, Dorothy (formerly Dorothy Douglas) [17]	39979 39977	27	306
Union National Bank of Youngstown, Ohio, trustee for the Leon A. Beeghly Fund	55061	35	490
Vease, Elizabeth W., estate of [1] Vease, James L., executor of estate of Elizabeth W. Vease [1]	65408	35	1184
Wier Long Leaf Lunber Co.[18]	6223	9	990
Wilson, L. D., et ux [19]	53094	26	474
Winter, William L., et ux.	76016	36	14

[a] United States Board of Tax Appeals.

[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] Acquiescence relates only to the issue concerning the accrual date of interest on refund of overpayment of income taxes. See Rev. Rul. 62-160, page 139.

[5] 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, C.B. 1962-1, 180.

[6] Nonacquiescence published in C.B. 1941-1, 16, and C.B. 1944, 40, is withdrawn and acquiescence is substituted therefor.

[7] Nonacquiescence published in C.B. 1952-2, 4, is withdrawn and acquiescence is substituted therefor.

[8] Nonacquiescence published in C.B. 1959-1, 6, and 1959-2, 8, is withdrawn and acquiscence substituted therefor.

[9] Acquiescence published in C.B. 1962-1, 4, is withdrawn and nonacquiescence substituted therefor in the issue whether one contract constituted a sale of territorial rights resulting in capital gains. Acquiescence in the last two issues remains unchanged.

[10] Acquiescence published in C.B. 1957-2, 4, is withdrawn and nonacquiescence is substituted therefor.

[11] Acquiescence published in C.B. 1955-2, 4, is withdrawn and nonacquiescence is substituted therefor.

[12] Acquiescence published in C.B. 1956-1, 3, and C.B. 1956-2, 5, is withdrawn and non-acquiescence is substituted therefor.

[13] Acquiescence published in C.B. 1954-2, 4, is withdrawn and nonacquiescence is substituted therefor. See Rev. Rul. 62-107, page 63.

[14] See Rev. Rul. 62-12, C.B. 1962-1, 321.

[15] On the issue whether a partnership, in which petitioner had an interest, realized ordinary income on January 1, 1944, when restrictions terminated on stock options theretofore received by the partnership for services rendered, the acquiescence published in C.B. 1952-1, 3, is withdrawn and nonacquiescence is substituted therefor, effective as of dates indicated in section 1.421-6(a) of the Income Tax Regulations (See TIR 248, Aug. 1960). Acquiescence in the issue whether an annual payment of $5,000 to the mother of petitioner's divorced wife is deductible under section 23(u) of the 1939 Code, published in C.B. 1959-1, 4, and C.B. 1959-2, 5, remains unchanged.

[16] Nonacquiescence relates to the issue whether prior conviction of criminal tax fraud constitutes collateral estoppel with respect to additions to tax for civil fraud. Acquiescence in result only published in C.B. 1959-1, 5, and 1959-2, 6, is withdrawn as to this issue.

[17] 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.

[18] Acquiescence published in C.B. 1948-1, 3, is withdrawn and nonacquiescence is substituted therefor. See Rev. Rul. 62-92, C.B. 1962-1, 29.

[19] Nonacquiescence relates to the issue whether petitioners' share of the profits realized by a partnership, of which they were members, from a transaction involving the cutting of certain timber by the petitioners' corporation, is properly taxable as long-term capital gain.

PART I

RULINGS AND DECISIONS UNDER THE INTERNAL REVENUE CODE OF 1954

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

SUBTITLE A.—INCOME TAXES

CHAPTER 1.—NORMAL TAXES AND SURTAXES

SUBCHAPTER A.—DETERMINATION OF TAX LIABILITY

PART II.—TAX ON CORPORATIONS

SECTION 11.—TAX IMPOSED

26 CFR 1.11: Statutory provisions; tax on corporations.

Extension of existing 30 percent normal-tax rate to July 1, 1963. See T.D. 6610, page 154.

PART IV.—CREDITS AGAINST TAX

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

SECTION 46.—AMOUNT OF CREDIT

Temporary regulations relating to the computation of the limitation on the investment tax credit in the case of members of an affiliated group. See T.D. 6619, page 397.

SECTION 48.—DEFINITIONS; SPECIAL RULES

Temporary regulations relating to the time and manner of filing an election to treat the lessee of new section 38 property as the purchaser for purposes of the investment tax credit. See T.D. 6619, page 397.

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. 62–113

(Also Sections 151, 170; 1.151–2, 1.170–1.)

Treatment, for Federal income tax purposes, of (1) payments made to a missionary from a church fund as reimbursement for travel and living expenses incurred in the service of his church, (2) contributions to the church fund by the parent of the missionary, and (3) direct payments by the parent for the support of the missionary.

Advice has been requested as to the treatment, for Federal income tax purposes, of (1) payments made to a missionary from a church fund as reimbursement for travel and living expenses incurred away from home in the service of the church, (2) contributions to the fund by the parent of the missionary, and (3) direct payments by the parent for the support of the missionary.

In the instant case, the work of the local congregation in the field of missions is carried on by missionaries who are specially called from the congregation to devote their full time to missionary service for a period of specified duration and who are ordained for this purpose. The congregation has a number of missionaries presently serving missions in various parts of the world on a voluntary, noncompensated basis. Some of these missionaries are supported in whole or in part by their parents, some pay their expenses from their personal savings, and some have their traveling and living expenses entirely or partially reimbursed or paid from a church fund maintained for that purpose.

The local congregation, through the contributions of its members, maintains the fund and members are encouraged to make personal contributions to the fund. All contributions to the fund are expended in pursuance of the purposes of the fund and no part thereof is earmarked for any individual.

From this fund, missionaries are reimbursed for certain qualified living and traveling expenses incurred in the service of the church where such expenses are not covered by amounts received by the missionaries directly from their parents, from relatives or friends, or from their own savings. In order to justify reimbursement for his expenses, each missionary is required to submit a monthly report listing his receipts and expenses and in no case is the fund to supply amounts greater than the reports can validate.

The taxpayer's son is one of the missionaries from the local congregation. The son is not married and has no income or means of support except for (1) amounts provided by the taxpayer and (2) the reimbursements of living and traveling expenses made to him by the church from the fund. More than one-half of the son's total support for the calendar year was provided by payments made by the taxpayer directly to him. Although the taxpayer made contributions to the church fund after the son became a missionary, he

had done so over a period of years before his son's departure for the mission and he contemplates continuing to do so.

Question 1. Are amounts paid by the fund to reimburse the missionary for expenses incurred away from home in the service of the church required to be included in the gross income of the missionary?

Answer. Section 61 of the Internal Revenue Code of 1954 and section 1.61-1 of the Income Tax Regulations provide, generally, that gross income includes all income from whatever source derived unless excluded by law.

In the instant case, the missionary is motivated by religious conviction and a desire to donate services to his church. He is engaged in rendering gratuitous services to his church. Under these circumstances, reimbursement by the church to the missionary, or the direct payment by the church, of any of the expenses involved does not constitute income to the missionary but represents the repayment by the church of advances made by the missionary on behalf of, and at the request of, the church. Accordingly, such amounts are not includible in the missionary's gross income for Federal income tax purposes. See Revenue Ruling 57-60, C.B. 1957-1, 25, as modified by Revenue Ruling 60-280, C.B. 1960-2, 12.

Question 2. Are monies contributed by the taxpayer to the fund established by the local congregation deductible as charitable contributions?

Answer. Section 170 of the Code provides for the deduction, in computing taxable income, of charitable contributions, the payment of which is made within the taxable year to certain organizations described therein. Section 262 of the Code provides, generally, that no deduction shall be allowed for personal, living, or family expenses.

If contributions to the fund are earmarked by the donor for a particular individual, they are treated, in effect, as being gifts to the designated individual and are not deductible. However, a deduction will be allowable where it is established that a gift is intended by a donor for the use of the organization and not as a gift to an individual.

The test in each case is whether the organization has full control of the donated funds, and discretion as to their use, so as to insure that they will be used to carry out its functions and purposes.

In the instant case, the son's receipt of reimbursements from the fund is alone insufficient to require a holding that this test is not met. Accordingly, unless the taxpayer's contributions to the fund are distinctly marked by him so that they may be used only for his son or are received by the fund pursuant to a commitment or understanding that they will be so used, they may be deducted by the taxpayer in computing his taxable income in the manner and to the extent provided by section 170 of the Code.

Question 3. May the taxpayer claim a personal exemption deduction for his missionary son?

Answer. Section 151(e) of the Code provides, in general, with certain exceptions relating to children who have not attained the age of 19 and are students, that a taxpayer may claim an exemption of $600 for each dependent (as defined in section 152 of the Code) whose gross income for the calendar year in which the taxable year of the taxpayer begins is less than $600; but, the exemption shall not be allowed for any dependent who has made a joint return with his spouse for the

taxable year beginning in the calendar year in which the taxable year of the taxpayer begins. The term "dependent" as defined in section 152 of the Code includes a son of a taxpayer who, for the calendar year in which the taxable year of the taxpayer begins, received over half of his support from the taxpayer.

Since the reimbursements from the fund are not includible in the missionary's gross income, his gross income for the calendar year is less than $600. Accordingly since the amounts furnished by the taxpayer directly to his son and used for his support constitute more than one-half of his total support for the calendar year, the taxpayer is entitled to a dependency exemption for his son.

(Also Section 451; 1.451–1.) Rev. Rul. 62–136

A taxpayer transfers property to an organization, such as a corporation, trust, fund, or foundation (other than a commercial insurance company), which, from time to time, issues annuity contracts, in exchange for a contract providing for a fixed annuity, paying guaranteed annual payments to the transferor for his lifetime. The present value of the annuity contract, as computed in accordance with the factors used by commercial insurance companies regularly issuing annuities, is greater than the transferor's basis for the property transferred. *Held*, such a transaction is a taxable exchange resulting in gain to the transferor which is taxable in the year of the exchange to the extent that such present value of the payments to be made under the annuity contract exceeds the transferor's basis in the property exchanged. See G.C.M. 1022, C.B. VI–1, 12 (1927).

If the property transferred is a capital asset in the hands of the transferor, the gain will constitute a capital gain in accordance with the provisions of section 1222 of the Internal Revenue Code of 1954.

With respect to the valuation of an annuity contract issued by a corporation, trust, fund, or foundation (other than a commercial insurance company), but based on factors used by commercial insurance companies issuing annuities, see Revenue Ruling 62–137, page 28, of this Bulletin.

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26 CFR 1.61–2: Compensation for services, including fees, commissions and similar items. Rev. Rul. 62–122

(Also Sections 117, 162, 262, 3402; 1.117–4, 1.162–5, 1.262–1, 31.3402(a)–1.)

The statutory pay of a cadet of the United States Coast Guard Academy, under section 508 of the Career Compensation Act of 1949, is includible in his gross income under section 61 of the Internal Revenue Code of 1954 in the year that it is received by the Superintendent of the Academy, or a subordinate, as the attorney or agent of the cadet.

Expenditures made on behalf of a cadet by the Superintendent, or a subordinate, for textbooks and supplies and for uniforms are not deductible by the cadet as ordinary and necessary business expenses under section 162(a) of the Code. However, a cadet may deduct expenditures made on his behalf for insignia, shoulder boards and similar items in computing his taxable income, provided he does not claim the standard deduction or use the optional tax table.

Advice has been requested as to the treatment, for Federal income tax purposes, of statutory pay received by cadets of the United States Coast Guard Academy under section 508 of the Career Compensation Act of 1949, 37 U.S.C. 308, as amended, and as to the treatment of certain expenditures made by, or on behalf of, such cadets from their statutory pay.

Section 508 of the Career Compensation Act of 1949 provides, in part, that cadets of the Coast Guard Academy shall be entitled to receive pay at the rate of 50 per cent of the basic pay established for a commissioned officer in pay grade O–1 with less than two cumulative years' service.

Upon entering the Coast Guard Academy, each cadet is required, under established procedures, to appoint the Superintendent of the Academy as his attorney and agent with full power to receive, account for and expend net pay and allowances, accruing to him while a cadet, to meet his proper obligations, and to consent to have subordinates of the Superintendent perform these functions.

A cadet's statutory pay is credited each month to his deposit account. In addition to specified personal cash allowances, the Superintendent, or a subordinate, directs or authorizes expenditures from this account for a cadet's textbooks, equipment and supplies, uniforms, clothing, laundry, tailor and cobbler services, and for special cadet activities and other personal expenses or obligations of a cadet. The balance remaining in his account is paid to the cadet upon his graduation from the Academy or upon separation from the service.

Article 2–5–04 of the United States Coast Guard Academy Regulations (1958) states, in part, that the pay of a cadet is not in the nature of a salary for services performed and that its primary purpose is to enable him to pay for food, clothing, books and other approved items and to provide an allowance for personal expenses.

The specific issues in this case are whether a cadet is liable for the payment of Federal income tax with respect to his statutory pay and, if so, the extent to which the expenditures made on his behalf are deductible as business expenses.

Section 61(a) of the Internal Revenue Code of 1954 provides that, except as otherwise provided, gross income means all income from whatever source derived, including, but not limited to, compensation for services.

Section 1.61–2(a)(1) of the Income Tax Regulations provides, in part, that pay received by persons in the military or naval forces of the United States is includible in gross income, unless excluded by law.

Section 7701(a)(15) of the Code provides that the term "military or naval forces of the United States" and the term "Armed Forces of the United States" each include the Coast Guard. Therefore, a cadet of the United States Coast Guard Academy is a member of the Armed Forces. Title 10, section 101(4) of the United States Code (1958 Edition) and Title 14, section 41 of the United States Code (1958 Edition), as amended.

Section 117 of the Code provides generally that gross income does not include amounts received as a scholarship or as a fellowship grant. However, an appointment to one of the Armed Forces academies does

not constitute a scholarship for Federal income tax purposes. See Revenue Ruling 55–347, C.B. 1955–1, 21.

Further, there is no other exemption applicable to the pay of cadets or midshipmen of the Armed Forces academies. The fact that the administrative regulations of the Coast Guard Academy treat the pay of a cadet as not being in the nature of a salary for services performed does not alter the basic nature of statutory pay to members of the Armed Forces of the United States as authorized under the Career Compensation Act of 1949.

The power of attorney executed by a cadet authorizing the Superintendent to receive, account for and expend his pay does not have the effect of limiting or deferring a cadet's tax liability, since the agreement allows the Superintendent, or a subordinate, to expend some and, if necessary, all of the cadet's statutory pay as the need or occasion may arise for any proper obligation incurred by the cadet.

The receipt of a cadet's pay by the Superintendent, or a subordinate, on behalf of a cadet as his attorney or agent is, under the circumstances, tantamount to receipt of the entire amount by the cadet for Federal income tax purposes.

Accordingly, it is held that the entire statutory pay of a cadet of the United States Coast Guard Academy is includible in his gross income for Federal income tax purposes in the year of its receipt by the Superintendent of the Academy, or a subordinate, as attorney or agent for the cadet and is subject to the withholding of income tax at source under section 3402 of the Code.

Section 162(a) of the Code provides, in effect, that in computing taxable income 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 1.162–5(b) of the regulations provides, in part, that expenditures made for education required of the taxpayer to meet the minimum requirements for qualification or establishment in his intended trade or business are personal in nature and, therefore, are not deductible as ordinary and necessary business expenses.

Section 1.262–1(b)(8) of the regulations provides, in part, as follows:

> The cost of equipment of a member of the armed services is deductible only to the extent that it exceeds nontaxable allowances received for such equipment and to the extent that such equipment is especially required by his profession and does not merely take the place of articles required in civilian life. For example, the cost of a sword is an allowable deduction in computing taxable income, but the cost of a uniform is not. * * *

In the instant case, a cadet incurs expenses for his education in order to meet the minimum requirements for qualification or establishment in his intended trade or business as an officer in the Coast Guard. Further, the uniforms worn by a cadet are adaptable generally to continued wear to the extent that they replace regular clothing.

Accordingly, it is further held that the cost of textbooks, supplies, and uniforms is not deductible for Federal income tax purposes by a cadet of the Coast Guard Academy. Expenditures for insignia, shoulder boards and similar items are deductible in computing taxable income, provided the cadet does not claim the standard deduction or use the optional tax table.

26 CFR 1.61–6: Gains derived from dealings in property. (Also Section 1221; 1.1221–1.)

Rev. Rul. 62–114 [1]

The Internal Revenue Service will not follow the decision in the case of *Denton J. Rees, et ux.* v. *United States*, 187 Fed. Supp. 924 (1960), affirmed per curiam by the United States Court of Appeals for the Ninth Circuit, 295 Fed. (2d) 817 (1961). This decision held that, in creating a partnership to continue his professional practice as an orthodontist, the payments received by the taxpayer (payable over a period of ten years) from two other professional persons for a partial interest in his practice represent capital gain from the sale of goodwill.

While certiorari was not applied for in the *Rees* case, the Service considers the decision erroneous and inconsistent with the long-established principle, early announced by the United States Court of Appeals for the Sixth Circuit in *E. C. O'Rear* v. *Commissioner*, 80 Fed. (2d) 473 (1935). In that case it was held that a taxpayer may not escape tax on his earnings as ordinary income by an agreement which is in effect an anticipatory assignment of future income.

(Also Sections 212, 262, 1001, 1002; 1.212–1, 1.262–1, 1.1001–1, 1.1002–1.)

Ct. D. 1873

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

1. GAIN OR LOSS—TRANSFER OF PROPERTY PURSUANT TO SEPARATION AGREEMENT—RELEASE OF WIFE'S MARITAL RIGHTS IN PROPERTY—MEASURE OF GAIN.

A transfer of stock by a taxpayer to his former wife pursuant to a separation agreement, later incorporated into a divorce decree, was a taxable event rather than a nontaxable division of property between co-owners. The basis of the stock in the taxpayer's hands was less than the market value on the date of the transfer. The amount realized by the husband is equal to the value of the stock transferred. The conclusion of the Court of Claims that there was no way to measure the fair market value of the property received by the taxpayer in exchange for the stock, i.e., the release of the wife's inchoate marital rights, was erroneous. It must be assumed that the parties acted at arm's length and judged the marital rights of the wife to be equal in value to the property transferred. To base the taxable gain upon the market value of the stock was not shown to be in error.

Nonbusiness Expenses—Legal Fees—Tax Advice to Wife in Connection with Divorce and Property Settlement.

A taxpayer is not entitled to a deduction for fees paid to his wife's attorney for tax advice in connection with predivorce property settlement negotiations. Section 212(3) of the Code, which allows a deduction for the "ordinary and necessary expenses paid . . . in connection with the determination, collection, or refund of any tax," if applicable to this type of tax expense, includes only the expenses of the taxpayer himself and not those of his wife.

2. JUDGMENT REVERSED IN PART AND AFFIRMED IN PART.

Judgment of the United States Court of Claims, 287 Fed. (2d) 168 (1961), reversed in part and affirmed in part.

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[1] Based on Technical Information Release 388, dated June 29, 1962.

SUPREME COURT OF THE UNITED STATES

Nos. 190 and 268.—October Term, 1961

United States, Petitioner,

v.

Thomas Crawley Davis et al., No. 190

Thomas Crawley Davis et al., Petitioners,

v.

United States, No. 268

On writs of certiorari to the United States Court of Claims

[June 4, 1962]

MR. JUSTICE CLARK delivered the opinion of the Court.

These cases involve the tax consequences of a transfer of appreciated property by Thomas Crawley Davis [1] to his former wife pursuant to a property settlement agreement executed prior to divorce, as well as the deductibility of his payment of her legal expenses in connection therewith. The Court of Claims upset the Commissioner's determination that there was taxable gain on the transfer but upheld his ruling that the fees paid the wife's attorney were not deductible. 287 F. 2d 168. We granted certiorari on a conflict in the Courts of Appeals and the Court of Claims on the taxability of such transfers.[2] 368 U.S. 813. We have decided that the taxpayer did have a taxable gain on the transfer and that the wife's attorney's fees were not deductible.

In 1954 the taxpayer and his then wife made a voluntary property settlement and separation agreement calling for support payments to the wife and minor child in addition to the transfer of certain personal property to the wife. Under Delaware law all the property transferred was that of the taxpayer, subject to certain statutory marital rights of the wife including a right of intestate succession and a right upon divorce to a share of the husband's property.[3] Specifically as a "division in settlement of their property" the taxpayer agreed to transfer to his wife, *inter alia*, 1,000 shares of stock in the E. I. du Pont de Nemours & Co. The then Mrs. Davis agreed to accept this division "in full settlement and satisfaction of any and all claims and rights against the husband whatsoever (including but not by way of limitation, dower and all rights under the laws of testacy and intestacy) * * *." Pursuant to the above agreement which had been incorporated into the divorce decree, one-half of this stock was delivered in the tax year involved, 1955, and the balance thereafter. Respondent's cost basis for the 1955 transfer was $74,775.37, and the fair market value of the 500 shares there transferred was $82,250. The taxpayer also agreed orally to pay the wife's legal expenses, and in 1955 he made payments to the wife's attorney, including $2,500 for services concerning tax matters relative to the property settlement.

I.

The determination of the income tax consequences of the stock transfer described above is basically a two-step analysis: (1) Was the transaction a taxable event? (2) If so, how much taxable gain resulted therefrom? Originally the Tax Court (at that time the Board of Tax Appeals) held that the accretion to property transferred pursuant to a divorce settlement could not be taxed as capital gain to the transferor because the amount realized by the satisfaction of the husband's marital obligations was indeterminable and because, even if such benefit were ascertainable, the transaction was a nontaxable division of property. *Mesta* v. *Commissioner*, 42 B.T.A. 933 (1940);

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[1] Davis' present wife, Grace Ethel Davis, is also a party to these proceedings because a joint return was filed in the tax year in question.

[2] The holding in the instant case is in accord with *Commissioner* v. *Marshman*, 279 F. 2d 27 (C.A. 6th Cir. 1960), but is contra to the holdings in *Commissioner* v. *Halliwell*, 131 F. 2d 642 (C.A. 2d Cir. 1942), and *Commissioner* v. *Mesta*, 123 F. 2d 986 (C.A. 3d Cir. 1941) [Ct. D. 1562, C.B. 1942–2, 192].

[3] 12 Del. Code Ann. (Supp. 1960) sec. 512; 13 Del. Code Ann. sec. 1531. In the case of realty, the wife in addition to the above has rights of dower. 12 Del. Code Ann. secs. 502, 901, 904, 905.

Halliwell v. *Commissioner*, 44 B.T.A. 740 (1941). However, upon being reversed in quick succession by the Courts of Appeals of the Third and Second Circuits, *Commissioner* v. *Mesta*, 123 F. 2d 986 (C.A. 3d Cir. 1941); *Commissioner* v. *Halliwell*, 131 F. 2d 642 (C.A. 2d Cir. 1943), the Tax Court accepted the position of these courts and has continued to apply these views in appropriate cases since that time, *Hall* v. *Commissioner*, 9 T.C. 53 (1947); *Patino* v. *Commissioner*, 13 T.C. 816 (1949); *Estate of Stouffer*, 30 T.C. 1244 (1958); *King* v. *Commissioner*, 31 T.C. 108 (1958); *Marshman* v. *Commissioner*, 31 T.C. 269 (1958). In *Mesta* and *Halliwell* the Courts of Appeals reasoned that the accretion to the property was "realized" by the transfer and that this gain could be measured on the assumption that the relinquished marital rights were equal in value to the property transferred. The matter was considered settled until the Court of Appeals for the Sixth Circuit, in reversing the Tax Court, ruled that, although such a transfer might be a taxable event, the gain realized thereby could not be determined because of the impossibility of evaluating the fair market value of the wife's marital rights. *Commissioner* v. *Marshman*, 279 F. 2d 27 (1960). In so holding that court specifically rejected the argument that these rights could be presumed to be equal in value to the property transferred for their release. This is essentially the position taken by the Court of Claims in the instant case.

II.

We now turn to the threshold question of whether the transfer in issue was an appropriate occasion for taxing the accretion to the stock. There can be no doubt that Congress, as evidenced by its inclusive definition of income subject to taxation, *i.e.*, "all income from whatever source derived, including * * * [g]ains derived from dealings in property,"[4] intended that the economic growth of this stock be taxed. The problem confronting us is simply *when* is such accretion to be taxed. Should the economic gain be presently assessed against taxpayer, or should this assessment await a subsequent transfer of the property by the wife? The controlling statutory language, which provides that gains from dealings in property are to be taxed upon "sale or other disposition,"[5] is too general to include or exclude conclusively the transaction presently in issue. Recognizing this, the Government and the taxpayer argue by analogy from transactions more easily classified as within or without the ambient of taxable events. The taxpayer asserts that the present disposition is comparable to a nontaxable division of property between two co-owners,[6] while the Government contends it more resembles a taxable transfer of property in exchange for the release of an independent legal obligation. Neither disputes the validity of the other's starting point.

In support of his analogy the taxpayer argues that to draw a distinction between a wife's interest in the property of her husband in a common-law jurisdiction such as Delaware and the property interest of a wife in a typical community property jurisdiction would commit a double sin; for such differentiation would depend upon "elusive and subtle casuistries which * * * possess no relevance for tax purposes," *Helvering* v. *Hallock*, 309 U.S. 106, 118 (1940), and would create disparities between common-law and community property jurisdictions in contradiction to Congress' general policy of equality between the two. The taxpayer's analogy, however, stumbles on its own premise, for the inchoate rights granted a wife in her husband's property by the Delaware law do not even remotely reach the dignity of co-ownership. The wife has no interest—passive or active—over the management or disposition of her hus-

[4] Internal Revenue Code of 1954 sec. 61(a).

[5] Internal Revenue Code of 1954 secs. 1001, 1002.

[6] Any suggestion that the transaction in question was a gift is completely unrealistic. Property transferred pursuant to a negotiated settlement in return for the release of admittedly valuable rights is not a gift in any sense of the term. To intimate that there was a gift to the extent the value of the property exceeded that of the rights released not only invokes the erroneous premise that every exchange not precisely equal involves a gift but merely raises the measurement problem discussed in Part III, *infra*, p. —. Cases in which this Court has held transfers of property in exchange for the release of marital rights subject to gift taxes are based not on the premise that such transactions are inherently gifts but on the concept that in the contemplation of the gift tax statute they are to be taxed as gifts. *Merrill* v. *Fahs*, 324 U.S. 308 (1945); *Commissioner* v. *Wemyss*, 324 U.S. 303 (1945); see *Harris* v. *Commissioner*, 340 U.S. 106 (1950). In interpreting the particular income tax provisions here involved, we find ourselves unfettered by the language and considerations ingrained in the gift and estate tax statutes. See *Farid-Es-Sultaneh* v. *Commissioner*, 160 F. 2d 812 (C.A. 2d Cir. 1947).

band's personal property. Her rights are not descendable, and she must survive him to share in his intestate estate. Upon dissolution of the marriage she shares in the property only to such extent as the court deems "reasonable." 13 Del. Code Ann. section 1531(a). What is "reasonable" might be ascertained independent of the extent of the husband's property by such criteria as the wife's financial condition, her needs in relation to her accustomed station in life, her age and health, the number of children and their ages, and the earning capacity of the husband. See, *e.g.*, *Beres* v. *Beres*, 52 Del. 133, 154 A. 2d 384 (1959).

This is not to say it would be completely illogical to consider the shearing off of the wife's rights in her husband's property as a division of that property, but we believe the contrary to be the more reasonable construction. Regardless of the tags, Delaware seems only to place a burden on the husband's property rather than to make the wife a part owner thereof. In the present context the rights of succession and reasonable share do not differ significantly from the husband's obligations of support and alimony. They all partake more of a personal liability to the husband than a property interest of the wife. The effectuation of these marital rights may ultimately result in the ownership of some of the husband's property as it did here, but certainly this happenstance does not equate the transaction with a division of property by co-owners. Although admittedly such a view may permit different tax treatment among the several States, this Court in the past has not ignored the differing effects on the federal taxing scheme of substantive differences between community property and common-law systems. *E.g.*, *Poe* v. *Seaborn*, 282 U.S. 101 (1930) [Ct. D. 259, C.B. IX–2, 202 (1930)]. To be sure Congress has seen fit to alleviate this disparity in many areas, *e.g.*, Revenue Act of 1948, 62 Stat. 110, but in other areas the facts of life are still with us.

Our interpretation of the general statutory language is fortified by the long-standing administrative practice as sounded and formalized by the settled state of law in the lower courts. The Commissioner's position was adopted in the early 40's by the Second and Third Circuits and by 1947 the Tax Court had acquiesced in this view. This settled rule was not disturbed by the Court of Appeals for the Sixth Circuit in 1960 or the Court of Claims in the instant case, for these latter courts in holding the gain indeterminable assumed that the transaction was otherwise a taxable event. Such unanimity of views in support of a position representing a reasonable construction of an ambiguous statute will not lightly be put aside. It is quite possible that this notorious construction was relied upon by numerous taxpayers as well as the Congress itself, which not only refrained from making any changes in the statutory language during more than a score of years but re-enacted this same language in 1954.

III.

Having determined that the transaction was a taxable event, we now turn to the point on which the Court of Claims balked, *viz*, the measurement of the taxable gain realized by the taxpayer. The Code defines the taxable gain from the sale or disposition of property as being the "excess of amount realized therefrom over the adjusted basis * * *." I.R.C. (1954) section 1001(a). The "amount realized" is further defined as "the sum of any money received plus the fair market value of the property (other than money) received." I.R.C. (1954) section 1001(b). In the instant case the "property received" was the release of the wife's inchoate marital rights. The Court of Claims, following the Court of Appeals for the Sixth Circuit, found that there was no way to compute the fair market value of these marital rights and that it was thus impossible to determine the taxable gain realized by the taxpayer. We believe this conclusion was erroneous.

It must be assumed, we think, that the parties acted at arm's length and that they judged the marital rights to be equal in value to the property for which they were exchanged. There was no evidence to the contrary here. Absent a readily ascertainable value it is accepted practice where property is exchanged to hold, as did the Court of Claims in *Philadelphia Park Amusement Co.* v. *United States*, 126 F. Supp. 184, 189 (1954), that the values "of the two properties exchanged in an arm's-length transaction are either equal in fact, or are presumed to be equal." Accord, *United States* v. *General Shoe Corp.*, 282 F. 2d 9 (C.A. 6th Cir. 1960); *International Freighting Corp.* v. *Commissioner*, 135 F. 2d 310 (C.A. 2d Cir. 1943). To be sure there is much to be said of the argument

that such an assumption is weakened by the emotion, tension and practical necessities involved in divorce negotiations and the property settlements arising therefrom. However, once it is recognized that the transfer was a taxable event, it is more consistent with the general purpose and scheme of the taxing statutes to make a rough approximation of the gain realized thereby than to ignore altogether its tax consequences. Cf. *Helvering* v. *Safe Deposit & Trust Co.*, 316 U.S. 56, 67 (1942).

Moreover, if the transaction is to be considered a taxable event as to the husband, the Court of Claims' position leaves up in the air the wife's basis for the property received. In the context of a taxable transfer by the husband,[7] all indicia point to a "cost" basis for this property in the hands of the wife.[8] Yet under the Court of Claims' position her cost for this property, *i.e.*, the value of the marital rights relinquished therefor, would be indeterminable, and on subsequent disposition of the property she might suffer inordinately over the Commissioner's assessment which she would have the burden of proving erroneous, *Commissioner* v. *Hansen*, 360 U.S. 446, 468 (1959) [Ct. D. 1838, C.B. 1959–2, 460]. Our present holding that the value of these rights is ascertainable eliminates this problem; for the same calculation that determines the amount received by the husband fixes the amount given up by the wife, and this figure, *i.e.*, the market value of the property transferred by the husband, will be taken by her as her tax basis for the property received.

Finally, it must be noted that here, as well as in relation to the question of whether the event is taxable, we draw support from the prior administrative practice and judicial approval of that practice. See p. —, *supra*. We therefore conclude that the Commissioner's assessment of a taxable gain based upon the value of the stock at the date of its transfer has not been shown erroneous.[9]

IV.

The attorney-fee question is much simpler. It is the customary practice in Delaware for the husband to pay both his own and his wife's legal expenses incurred in the divorce and the property settlement. Here petitioner paid $5,000 of such fees in the taxable year 1955 earmarked for tax advice in relation to the property settlement. One-half of this sum went to the wife's attorney. The taxpayer claimed that under section 212(3) of the 1954 Code, which allows a deduction for the "ordinary and necessary expenses paid * * * in connection with the determination, collection, or refund of any tax," he was entitled to deduct the entire $5,000. The Court of Claims allowed the $2,500 paid taxpayer's own attorney but denied the like amount paid to the wife's attorney. The sole question here is the deductibility of the latter fee; the Government did not seek review of the amount taxpayer paid his own attorney, and we intimate no decision on that point. As to the deduction of the wife's fees, we read the statute, if applicable to this type of tax expense, to include only the expenses of the taxpayer himself and not those of his wife. Here the fees paid her attorney do not appear to be "in connection with the determination, collection, or refund" of any tax of the taxpayer. As the Court of Claims found, the wife's attorney "considered the problems from the standpoint of his client alone. Certainly then it cannot be said that * * * [his] advice was directed to plaintiff's tax problems * * *." 287 F. 2d at 171. We therefore conclude, as did the Court of Claims, that those fees were not a deductible item to the taxpayer.

Reversed in part and affirmed in part.

MR. JUSTICE FRANKFURTER took no part in the decision of these cases.

MR. JUSTICE WHITE took no part in the consideration or decision of these cases.

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[7] Under the present administrative practice, the release of marital rights in exchange for property or other consideration is not considered a taxable event as to the wife. For a discussion of the difficulties confronting a wife under a contrary approach, see Taylor and Schwartz, Tax Aspects of Marital Property Agreements, 7 Tax L. Rev. 19, 30 (1951); Comment, The Lump Sum Divorce Settlement as a Taxable Exchange, 8 U.C.L.A.L. Rev. 593, 601–602 (1961).

[8] Section 1012 of the Internal Revenue Code of 1954 provides that: "The basis of property shall be the cost of such property, except as otherwise provided in this subchapter and subchapters C (relating to corporate distributions and adjustments), K (relating to partners and partnerships), and P (relating to capital gains and losses) * * *."

[9] We do not pass on the soundness of the taxpayer's other attacks upon this determination, for these contentions were not presented to the Commissioner or the Court of Claims.

26 CFR 1.61–9: Dividends.

Guidelines for determining the liability for income tax on dividend payments. See Rev. Rul. 62–201, page 298.

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26 CFR 1.61–11: Pensions. Rev. Rul. 62–179

Pension payments received from the Canadian Government under the Old Age Security Act of Canada by Canadian citizens residing in the United States are includible in the gross income of the recipients for Federal income tax purposes.

Advice has been requested concerning the Federal income tax treatment of pension payments made by the Canadian Government under the Old Age Security Act of Canada, Revised Statutes of Canada, 1952, as amended, to Canadian citizens residing in the United States.

Section 3 of the Old Age Security Act of Canada, as amended, provides, in effect, that every Canadian citizen who has attained the age of 70 years and who meets certain residence requirements in Canada may be paid, upon his properly approved application, a monthly pension of $55 by the Canadian Government. Section 4 of this Act provides that the pension is payable during the life of the pensioner and ceases with the payment for the month in which the pensioner dies.

Section 5 of the Act, as amended by the Act of June 7, 1960, provides, in part, that where a pensioner absents himself from Canada for 6 consecutive months, exclusive of the month in which he left Canada, payment of his pension may be continued for any period he remains out of Canada after those 6 months if he establishes that, at the time he left Canada, he had resided in Canada for at least 25 years after attaining the age of 21 years. Section 3 of the Act of June 7, 1960, provides transitional rules with respect to pensioners who were absent from Canada on the effective date of that Act and whose pension payments were suspended under section 5(1) of the Act as in force before such effective date.

Section 10 of the Act provides the method of collecting revenue for the payment of pensions through the imposition of an old age security tax on the sales price of certain goods and on individuals and corporations liable to pay income tax for the taxable year.

Pension payments received by Canadian citizens under the Old Age Security Act are includible in their gross income for Canadian income tax purposes under the provisions of section 6(1)(a)(iv) of the Income Tax Act of Canada, Revised Statutes of Canada, 1952.

In general, resident alien individuals of the United States are subject to Federal income tax on income derived from sources within or without the United States. See section 1.1–1(b) of the Income Tax Regulations.

Section 61(a) of the Internal Revenue Code of 1954 provides that, except as otherwise provided, gross income means all income from whatever source derived, including among other things, pensions.

Section 1.61–11(a) of the regulations provides that pensions and retirement allowances paid either by the Government or by private persons constitute gross income unless specifically excluded by law.

There is no provision in the Code which provides that old age pensions received by resident aliens of the United States from a foreign government may be excluded from gross income for Federal income tax purposes. Furthermore, Article VI A of the United States-Canada Income Tax Convention, C.B. 1955–1, 624, at 626, modified as to other provisions by the Supplementary Convention of August 8, 1956, C.B. 1957–2, 1014, provides that pensions (including Government pensions) derived from within one of the contracting States by a resident of the other contracting State shall be exempt from taxation in the former State, rather than in the State of residence, so that nothing in the Convention would exempt from Federal income tax a pension paid by the Canadian Government to a citizen of Canada residing in the United States.

In view of the foregoing, it is held that pension payments made by the Canadian Government under the Old Age Security Act of Canada to Canadian citizens residing in the United States are includible in the gross income of the recipients for Federal income tax purposes.

SECTION 62.—ADJUSTED GROSS INCOME DEFINED

26 CFR 1.62–1: Adjusted gross income.

Selective retail sales tax and use tax imposed by the State of Wisconsin. See Rev. Rul. 62–123, page 65.

Deduction by employees of expenses attributable to the use of a personal residence in the performance of their duties. See Rev. Rul. 62–180, page 52.

PART II.—ITEMS SPECIFICALLY INCLUDED IN GROSS INCOME

SECTION 71.—ALIMONY AND SEPARATE MAINTENANCE PAYMENTS

26 CFR 1.71–1: Alimony and separate maintenance payments; income to wife or former wife. (Also Section 215; 1.215–1.) Rev. Rul. 62–106

> A husband's payments of his wife's medical and dental expenses pursuant to a decree of divorce, or an instrument or agreement of the type described in section 71(a) of the Internal Revenue Code of 1954, are 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, where (1) no principal sum is specified in the decree or instrument, or, (2) if specified, is either payable over more than a ten year period or is subject to contingencies of death of either spouse, remarriage of the wife, or change in the economic status of either spouse.

Advice has been requested whether payments of medical and dental expenses of a wife made by her husband pursuant to a decree or instrument of the type specified in section 71(a) of the Internal Revenue

Code of 1954 are includible in the wife's gross income under section 71 of the Code and deductible by the husband under section 215 of the Code.

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

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

Section 71(a)(2) of the Code contains similar provisions relating to periodic payments received by a wife pursuant to written separation agreements and decrees for support.

Section 71(c)(1) of the Code provides as follows:

> GENERAL RULE.—For purposes of subsection (a), installment payments discharging a part of an obligation the principal sum of which is, either in terms of money or property, specified in the decree, instrument, or agreement shall not be treated as periodic payments.

Section 215 of the Code provides, as a general rule, that payments includible in gross income by the wife under section 71 are deductible by the husband.

Sections 71 and 215 of the Code were enacted originally as sections 22(k) and 23(u), respectively, of the Internal Revenue Code of 1939. The purpose of these sections was explained in House of Representatives Report No. 2333, Seventy-seventh Congress, C.B. 1942–2, 372, at 409 and 427, as follows:

> * * * He [the husband] is fully taxable on his entire net income even though a large portion of his income goes to his wife as alimony or as separate maintenance payments. The increased surtax rates would intensify this hardship and in many cases the husband would not have sufficient income left after paying alimony to meet his income tax obligations * * *.
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> * * * * * * *
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> * * * These amendments are intended to treat such payments as income to the spouse actually receiving or actually entitled to receive them and to relieve the other spouse from the tax burden upon whatever part of the amount of such payments is under the present law includible in his gross income. * * *

The specific issue is whether medical or dental payments required to be paid by the husband constitute *periodic payments* within the meaning of section 71 of the 1954 Code.

In the case of *F. Ewing Glasgow* v. *Commissioner*, 21 T.C. 211 (1953), acquiescence, C.B. 1954–1, 4, the taxpayer, pursuant to a written instrument incident to the divorce, paid his wife a prescribed initial payment immediately after the decree was granted. The initial payment included an amount which was to cover medical expenses for which the wife was liable at the time of the divorce or would become liable in the following calendar year. The Tax Court of the United States held that this amount was a lump-sum nonrecurring payment which did not meet the statutory test of a periodic payment as provided in section 22(k) of the 1939 Code.

The court followed its decision in the *Glasgow* case and held, in *Aline S. Fisher, Executrix* v. *Commissioner*, T.C. Memo 1956–98, that dental expenses paid by the husband were not income to the wife. The

separation agreement required the husband to pay dental expenses not to exceed a specified amount incurred by the wife after January 1 of the year following the divorce. Dental expenses in the specified amount were paid by the husband in that year.

The payments in these cases were not treated as periodic payments because they were installment payments of a principal sum specified in the decree, instrument, or agreement. Therefore, these decisions are limited to certain situations where the amount of medical or dental expenses to be paid is specified. They do not apply to payments which (1) are not specified, or, (2) if specified, are either payable over more than a ten-year period or are subject to contingencies of death of either spouse, remarriage of the wife, or change in the economic status of either spouse.

It is not necessary that the decree or written instrument specify the payment of a fixed amount at stated intervals, since section 71(a) of the Code provides that periodic payments are includible in the wife's gross income "whether or not made at regular intervals."

Accordingly, it is held that payments by a husband of his wife's medical and dental expenses, pursuant to a decree of divorce or separate maintenance, or written instrument incident thereto, a written separation agreement, or decree for support, are periodic payments within the meaning of section 71 of the Code where (1) no principal sum is specified in the decree or instrument, or, (2) if specified, is either payable over more than a ten-year period or is subject to contingencies of death of either spouse, remarriage of the wife, or change in the economic status of either spouse.

Such payments are 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. Furthermore, such payments are considered part of the medical expenses of the wife and may be taken into account by her in arriving at the allowable deduction for medical expenses under section 213 of the Code.

In addition, the periodic payments may be made at irregular intervals, and the husband may pay such amounts directly to the provider of the services rather than to his wife. *Robert Lehman* v. *Commissioner*, 17 T.C. 652 (1951), acquiescence, this issue, C.B. 1959–2, 5.

(Also Section 215; 1.215–1.) Rev. Rul. 62–115

Periodic payments made by a husband, domiciled in Idaho, a community property state, to his wife under a court order for her support during separation but prior to their divorce, are includible in the wife's gross income under section 71(a)(3) of the Internal Revenue Code of 1954 and allowable as a deduction to the husband under section 215 of the Code to the extent that they exceed the wife's share of community income for the year in which they are received by her.

Advice has been requested regarding the extent to which the amount paid by a husband to his wife pursuant to court decree, during the period of their separation preceding the date of their divorce, is required to be included in the gross income of the wife under section 71 of the Internal Revenue Code of 1954 and is allowable as a deduction to the husband under section 215 of the Code, when, dur-

ing the period in which the payments are made and received, the parties are domiciled in Idaho, a community property state. Advice has also been requested whether the Federal income tax treatment of such amounts differs where the payments are (1) entirely derived from amounts earned by the husband during the period of separation prior to the date of the divorce, or (2) derived partly from earnings of the husband during such period and partly from the husband's separate funds, or (3) derived partly from the husband's earnings and partly from community funds accumulated by the parties prior to the date of their divorce.

The taxpayers lived as husband and wife in the State of Idaho until their separation in 1957. In that year a State court directed the husband to make payments of $400 to his wife each month for her support and maintenance pending the outcome of the husband's action for divorce. The taxpayers were divorced on June 30, 1958. From January 1, 1958, to the date of the divorce, the husband paid his wife a total of $2,400 pursuant to the court order. During that same period, the husband earned $4,000. For the entire taxable year of 1958, the husband earned a total of $7,000. Each filed a separate Federal income tax return for that year.

Under section 32-906 of Title 32 of the Idaho Code of 1947, all property acquired after marriage by either husband or wife, except property which is separate property under the provisions of sections 32–903, 32–905, or 32–906, is community property in which a wife has been held to have a present vested interest. See *Radermacher* v. *Radermacher*, 61 Idaho 261, 100 P. 2d 955 (1940). That interest has been held to extend to the earnings of the husband. See *Giffen* v. *City of Lewiston*, 6 Idaho 231, 55 Pac. 545 (1898).

In Idaho the marital relationship has been held to continue notwithstanding a separation of the spouses. See *Radermacher* v. *Radermacher*, 59 Idaho 716, 87 P. 2d 461 (1939). However, section 32–909 of the Idaho Code provides that a wife's earnings during separation are her separate property. No similar provision with respect to the husband's earnings during the period of separation is contained in the Idaho Code.

Section 32–704 of the Idaho Code provides, in part, that a court may, in its discretion, require a husband to pay, as alimony, any money necessary to enable the wife to support herself or her children while an action for divorce is pending. The Idaho Code provides that in executing its allowance of alimony under that section the court must first resort to the community property and then to the separate property of the husband.

Section 71(a)(3) of the Internal Revenue Code of 1954 provides that if a wife is separated from her husband, her gross income includes periodic payments (whether or not made at regular intervals) received by her from her husband under a decree entered after March 1, 1954, requiring the husband to make the payments for her support or maintenance, provided separate tax returns are filed by the parties.

Under the general rule provided in section 215 of the Code, a husband described in section 71 of the Code is allowed a deduction for amounts includible under section 71 of the Code in the gross income of the wife, payment of which is made within his taxable year. However, no deduction is allowable with respect to any payment if, by

reason of section 71(d) or 682 of the Code, the amount thereof is not includible in the husband's gross income.

Section 1.71–1(b) of the Income Tax Regulations provides, in part, as follows:

* * * * * * *

(3) Decree for support. (i) Where the husband and wife are separated and living apart and do not file a joint income tax return for the taxable year, paragraph (3) of section 71(a) requires the inclusion in the gross income of the wife of periodic payments (whether or not made at regular intervals) received by her after August 16, 1954, from her husband under any type of court order or decree (including an interlocutory decree of divorce or a decree of alimony pendente lite) entered after March 1, 1954, requiring the husband to make the payments for her support or maintenance. * * *

The regulations further provide that it is not necessary for the wife to be legally separated or divorced from her husband under a court order or decree; nor is it necessary for the order or decree for support to be for the purpose of enforcing a written separation agreement.

The Supreme Court of the United States has held that where a husband and wife are domiciled in a community property state, the law of which provides that the wife has a present vested right in the community property equal to that of her husband, one-half the community income is taxable to the wife. See, for example, *Burns Poe* v. *H. G. Seaborn*, 282 U.S. 101 (1930), Ct. D. 259, C.B. IX–2, 202 (1930).

In Mimeograph 3853, C.B. X–1, 139 (1931), at 140, it is stated:

* * * As the wife's interest in community property under the laws of the States of Idaho, * * * is likewise vested, it follows that the above-mentioned decisions of the Supreme Court are equally applicable to taxpayers domiciled in those States. * * *

One of the "above-mentioned decisions of the Supreme Court" referred to was the *Seaborn* case.

Facts comparable to those involved in the instant case were considered by The Tax Court of the United States in the case of *Marjorie Hunt* v. *Commissioner*, 22 T. C. 228 (1954), acquiescence, C.B. 1954–2, 4. The taxpayer was separated from her husband in 1947 while they were domiciled in California, a community property state. In September of 1948, a California court granted the wife a decree of separate maintenance, which required the husband to pay her a monthly amount for her support and maintenance. Under that decree the husband paid his wife a total of $740 in 1948. The husband deducted that amount on his separate return for 1948 and the wife reported it on her return. However, the wife did not report any portion of her husband's 1948 earnings on her return although he was domiciled in California during the period in question.

Under the California Code as then in effect, a wife had a present vested interest in community income, including a husband's earnings, during continuation of the marriage, and the wife's interest in community property was not destroyed by a decree for separate maintenance, where no division or settlement of the community property was included in such decree. The Tax Court found that there had been no division or settlement of the property and that the wife's interest in the community property had not been destroyed. After holding that the wife was taxable by reason of her community interest on one-

half of the amount earned by the husband in 1948 prior to the date of divorce (an amount in excess of $740), the court considered the question of whether she was also taxable under section 22(k) of the 1939 Code, which corresponds to section 71 of the 1954 Code, on the $740 which she received from her husband. The Tax Court said, at page 233:

> * * * She is liable for Federal income tax on her equal share of the community income, but she cannot be taxed again when a part of that income is placed under her exclusive control pursuant to a decree for support and maintenance. * * *

The court then held that the wife was not taxable under section 22(k) of the 1939 Code on the $740 received from her husband during the taxable year.

The law of California was changed in 1951 to provide that after the rendition of a judgment or decree for separate maintenance, the earnings or accumulations of each party are the separate property of the party acquiring such earnings or accumulations. See California Civil Code, 1949, sec. 169.1. However, in view of the fact that the controlling law in the *Hunt* case contained no such provision with respect to a husband's earnings during separation and since, under the facts of the *Hunt* case, the marital community continued during separation and prior to divorce, as in the instant case, and the wife had a present vested interest in the husband's earnings during such period, the principle established in the *Hunt* decision is applicable in the instant case to the husband's earnings during the period of the separation prior to the divorce.

During the period in 1958, when the parties in the instant case were separated prior to their divorce, the husband paid his wife a total of $2,400 pursuant to court decree and he earned $4,000. Since the wife had a present vested interest in one-half of her husband's earnings of $4,000 during that time, $2,000 of such earnings is includible in her gross income under section 61 of the Code. See the *Seaborn* case, *supra*, and *Christine K. Hill* v. *Commissioner*, 32 T.C. 254 (1959).

Since payments totalling $2,400 were made to the wife pursuant to the court decree, however, her $2,000 share of the earnings does not measure the limit of her taxable income attributable to such payments. Because of the provision of section 32–708 of the Idaho Code, the Internal Revenue Service views such payments as having come from the income of the marital community in the year of receipt. Under the rationale of the *Hunt* decision, *supra*, it is held, therefore, that to the extent that such payments do not exceed the wife's community interest in her husband's earnings on which she is taxable under section 61 of the Code, such payments are not taxable to her under section 71(a)(3) of the Code, regardless of the source of the funds from which such payments are actually made. To the extent that such payments exceed the wife's interest in community income, the rationale of the *Hunt* decision is not applicable. The Service views such excess as a portion of the husband's present interest in the community earnings which become vested in the wife by the court decree. On the facts of the instant case, it is held, therefore, that $400 of the support payments is taxable to the wife under section 71(a)(3) of the Code, regardless of the source of the funds from which such payments are actually made.

In view of the fact that the deduction allowable to the husband under section 215 of the Code applies only to amounts includible in the gross income of the wife under section 71 of the Code, it is further held that only the excess of the payments made by the husband prior to the date of divorce over the wife's share of community income for the taxable year, $400 in this case, is allowable as a deduction to the husband.

(Also Section 215; 1.215–1.) Rev. Rul. 62–187

Where an enlisted member of the Armed Forces of the United States authorizes an allotment of pay to comply with the terms of a court decree ordering him to make payments for the support of his wife and children that portion of each monthly payment which constitutes the basic allowance for quarters retains its nontaxable character whether the payments are made voluntarily or in compliance with the court order; and, if the member and his wife do not make a single return jointly, only the amounts which are deducted from the member's pay are required to be included in the wife's gross income under section 71(a)(3) of the Internal Revenue Code of 1954.

Only the amounts includible in the wife's gross income which are paid within the member's taxable year are deductible by him under section 215 of the Code, provided they otherwise qualify as "periodic payments."

Advice has been requested as to the amount includible in the gross income of the wife of an enlisted member of the Armed Forces of the United States with respect to an allotment which he authorized in compliance with a court decree ordering him to make payments for the support of his wife and children.

The enlisted man concerned is entitled to a basic allowance for quarters which is payable only for such periods as he has in effect an allotment of pay equal to the applicable rate for basic allowance plus $40 per month. See section 302 of the Career Compensation Act of 1949, as amended by sections 2 through 4 of the Dependents Assistance Act of 1950, as amended, 37 U.S.C. 252 (f) and (h).

In the instant case, the member had no allotment in effect when a court heard a motion brought by his wife and found his wife and children without means of support. The court ordered him to make monthly payments to her in an amount which was equal to the basic allowance for quarters plus $40. The decree did not specify any amount as a sum payable for the support of the children.

In order to comply with the court order, the serviceman authorized an allotment for the support of his wife and children. Thereafter, the amount of $40 per month was deducted from his basic pay and his wife received an allotment which included the basic allowance for quarters. See section 302 of the Career Compensation Act of 1949, *supra*.

Section 71(a)(3) of the Internal Revenue Code of 1954 provides that if a wife is separated from her husband, the wife's gross income includes periodic payments received by her from her husband under a decree entered after March 1, 1954, requiring the husband to make the payments for her support or maintenance, provided the husband and wife do not make a single return jointly.

Section 215 of the Code provides 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 of the Code in the gross in-

come of his wife, payment of which is made within the husband's taxable year.

That portion of the monthly payment to dependents of an enlisted member of the Armed Forces of the United States which constitutes the basic allowance for quarters is excludable from gross income of both the serviceman and his dependents. See section 1.61–2(b) of the Income Tax Regulations; I.T. 2219, C.B. IV–2, 41 (1925); I.T. 4092, C.B. 1952–2, 115; and Rev. Rul. 55–572, C.B. 1955–2, 45.

Accordingly, it is held that where an enlisted member of the Armed Forces of the United States authorizes an allotment of pay to comply with the terms of a court decree ordering him to make payments for the support of his wife and children, that portion of each monthly payment which constitutes the basic allowance for quarters retains its nontaxable character whether the payments are made voluntarily or in compliance with the court order; and, if the member and his wife do not make a single return jointly, only the amounts which are deducted from the member's pay are required to be included in the wife's gross income under section 71(a)(3) of the Code.

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

26 CFR 1.72–6: Investment in the contract. Rev. Rul. 62–137

An organization, such as a corporation, trust, fund or foundation (other than a commercial insurance company), from time to time, enters into agreements to pay life annuities of a specified amount to individuals or to their designees in exchange for money or other property. *Held*, the annuity contracts issued by such an organization are sufficiently comparable to individual annuity contracts issued by commercial insurance companies to justify the application of a similar standard of valuation to both. See *Anna L. Raymond* v. *Commissioner*, 40 B.T.A. 244, affirmed 114 Fed. (2d) 140, certiorari denied, 311 U.S. 710. Accordingly, the annuity rates listed in the table below, which have been selected as representative of the annuity rates currently charged by leading commercial insurance companies for individual contracts, will be used as the standard for valuing currently issued annuities (single life) for Federal tax purposes. It must be realized, however, that the table is subject to change depending upon market conditions. Notice of change will be given by publication in the Internal Revenue Bulletin.

If the agreement provides for an annuity which is not a single life annuity, then appropriate rates, comparable to the single-life rates shown in the table below, shall be used in the valuation. In the case of a completed transaction involving such an annuity, the Commissioner of Internal Revenue, Washington 25, D.C., will furnish the rate to the taxpayer concerned upon request. The request must be accompanied by a statement of the date of birth of each annuitant and by copies of the relevant instruments.

The values prescribed herein will apply even though the annuity contract to be valued (or any other contract) is reinsured or coinsured with a commercial insurance company, unless the agreement provides that all or a specified portion of the annuity obligation has been

reinsured by a designated commercial insurance company. In such case, the designated commercial insurance company's individual annuity rate for a comparable contract will be used for the amount of the obligation so reinsured, and the values prescribed herein will apply to any balance of the obligation.

The values prescribed herein will apply for the purpose of determining the aggregate amount of consideration paid for the contract (investment in the contract) for purposes of section 72 of the Internal Revenue Code of 1954.

The provisions of this Revenue Ruling apply to annuity contracts issued by such organizations on or after September 6, 1962, which is 10 days after the date of publication in the Internal Revenue Bulletin. The value of an annuity contract based on any acceptable table prior to the above date will not be changed.

FAIR MARKET VALUE OF ANNUITIES ISSUED BY ORGANIZATIONS (OTHER THAN COMMERCIAL INSURANCE COMPANIES) ON OR AFTER SEPTEMBER 6, 1962

Single Life Rates

Rates for immediate annuity of $1.00 per annum

Age	Rate		Age	Rate	
	Male	Female		Male	Female
32	22.812	25.063	59	13.924	15.942
33	22.566	24.809	60	13.526	15.531
34	22.312	24.550	61	13.125	15.116
35	22.052	24.284	62	12.717	14.696
36	21.785	24.012	63	12.306	14.271
37	21.510	23.734	64	11.889	13.842
38	21.228	23.449	65	11.469	13.409
39	20.940	23.158	66	11.046	12.970
40	20.643	22.858	67	10.641	12.527
41	20.339	22.552	68	10.266	12.078
42	20.027	22.239	69	9.889	11.627
43	19.707	21.919	70	9.512	11.172
44	19.382	21.590	71	9.143	10.715
45	19.049	21.255	72	8.775	10.256
46	18.710	20.911	73	8.408	9.879
47	18.368	20.560	74	8.043	9.502
48	18.019	20.203	75	7.682	9.125
49	17.667	19.838	76	7.323	8.749
50	17.311	19.468	77	6.970	8.374
51	16.950	19.094	78	6.622	8.001
52	16.586	18.714	79	6.281	7.632
53	16.217	18.331	80	5.946	7.266
54	15.845	17.942	81	5.619	6.905
55	15.469	17.550	82	5.299	6.549
56	15.089	17.154	83	4.989	6.200
57	14.705	16.754	84	4.688	5.857
58	14.317	16.351	85	4.397	5.522

The above table gives the rate for a life annuity of $1.00 per annum in annual installments, first payment one year hence. To obtain the rate for an annuity of $1.00 per annum payable in installments at the end of each:

(a) monthly period, add $0.482 to the tabular rate.
(b) quarterly period, add $0.395 to the tabular rate.
(c) semiannual period, add $0.263 to the tabular rate.

For example, the rate for an annuity of $1.00 per annum payable at the end of each quarter during the life of a male aged 56 is $15.089 plus $0.395 or $15.484.

Annuity rate tables for the purpose of valuing annuities issued by an organization such as a corporation, trust, fund or foundation (other than a commercial insurance company) in exchange for money or other property.
Revenue Ruling 62-137, page 28, supplemented.

SECTION 1. PURPOSE.

.01 The purpose of this Revenue Ruling is to provide additional annuity rates for use with Revenue Ruling 62-137, page 28. That Revenue Ruling prescribes a standard to be used in evaluating for Federal tax purposes the annuity agreements issued from time to time by an organization such as a corporation, trust, fund or foundation (other than a commercial insurance company) in exchange for money or other property. It also contains an annuity rate table (single life) for ages 32 to 85, inclusive.

.02 Since publication of that Revenue Ruling, a feasible tabular method has been found for evaluating ordinary joint and survivor annuities (two lives) according to the prescribed standard. This method is illustrated and explained hereinafter. At the same time, it has become apparent that the range of single life rates should be extended.

SEC. 2. SINGLE LIFE ANNUITY PAYABLE ANNUALLY.

Table A shows the rate for an annuity (single life) of $1.00 per annum payable annually at the end of each year during the life of an annuitant of specified age and sex. Thus, the table shows that the rate for a male aged 56 is $15.089. This means that the value, according to the prescribed standard, of an annuity of $1,000 per annum payable annually during the life of a male annuitant aged 56, first payment one year hence, is $1,000 times 15.089 or $15,089.

SEC. 3. ANNUITY PAYABLE OTHER THAN ANNUALLY.

Whether the annuity is a single life or a joint and survivor annuity, to obtain the rate for $1.00 per annum payable in equal installments at the end of each:

(a) monthly period,	add $0.482 to the annual rate.
(b) quarterly period,	add $0.395 to the annual rate.
(c) semiannual period,	add $0.263 to the annual rate.

Thus, the rate for an annuity of $1.00 per annum payable *quarterly* during the life of a male annuitant aged 56, first payment three months hence, is $15.089 (annual rate from Table A), plus 0.395, or $15.484. Accordingly, if the annuity were in the amount of $1,000 per annum, payable quarterly, its value, according to the prescribed standard, would be $1,000 times 15.484, or $15,484.

SEC. 4. PARTIAL JOINT LIFE PREMIUM (TWO LIVES).

.01 A necessary step in the computation of a joint and survivor annuity rate, shown in section 5, is to determine an ancillary value, which is hereinafter referred to as the "partial joint life premium." This step of the computation utilizes Tables B and C.

.02 If one or both of the annuitants is female, it is necessary, before entering Tables B and C, to substitute for each female annuitant a male annuitant 4 years younger; that is, to subtract 4 years from the age of each female annuitant. Tables B and C are then used with male ages only, either actual or substituted.

.03 An "equivalent equal age" corresponding to any two male ages can be determined by means of Table B. This age will consist of a whole number and a decimal. Straight line interpolation between two adjacent premiums in Table C will then give a value, corresponding to the "equivalent equal age," which is the partial joint life premium to be used in the larger computation, section 5, step (2).

Example 1. The partial joint life premium for a male annuitant aged 65 and a female annuitant aged 60 is $9.855, obtained as follows:

	65Male	60Female	
Actual ages			
Subtract 4 years from the age of each female annuitant	—	4	
Male ages	65M	56M	
Difference in male ages is: 65 less 56 or 9 years			
Add: Addition to younger age for a difference in age of 9 years (see Table B)		5.513	
Equivalent equal age		61.513M	
Integral ages below and above 61.513M:—61M, 62M			
Partial joint life premium, two lives both aged 61M, from Table C		$10.038	$10.038
Partial joint life premium, two lives both aged 62M, from Table C		9.682	
Decrease in premium for 1 year of age		$0.356	
Times fractional portion of equivalent equal age		x 0.513	
Decrease for 0.513 of a year of age		$0.183	0.183
Partial joint life premium, two lives both aged 61.513M			$9.855
Partial joint life premium, two lives aged 65M and 56M has the same value			$9.855
Partial joint life premium, two lives aged 65M and 60F also has the same value			$9.855

Example 2. The partial joint life premium for two female annuitants aged 69 and 60 is also $9.855:

	69F	60F
Actual ages		
Subtract 4 years from the age of each female annuitant	4	4
Male ages	65M	56M

From example 1, the partial joint life premium for two lives aged 65 Male and 56 Male is $9.855. Therefore, the partial joint life premium for two lives aged 69 Female and 60 Female is $9.855.

SEC. 5. JOINT AND SURVIVOR ANNUITY PAYABLE ANNUALLY (TWO LIVES.)

.01 The method of computing the rate for an annuity payable annually during the joint lives and the life of the survivor of two persons (a "joint and survivor annuity") is necessarily somewhat involved.

The method consists of the following steps:

(1) Find the *sum* of the two single life rates separately applicable to the annuitants, these rates being taken from Table A.

(2) Compute the appropriate "partial joint life premium," using Tables B and C and the method outlined in section 4.

(3) Subtract Item (2) from Item (1) to obtain the "unadjusted joint and survivor rate."

(4) Extract from Table D the two adjustment factors corresponding to the age and sex of the individual annuitants.

(5) From the unadjusted joint and survivor rate, Item (3), subtract whichever of the adjustment factors of Item (4) is the *smaller*. (If these factors are equal, subtract the amount of one of them.)

The result is the desired rate, that is, the rate for an annuity of $1.00 per annum payable annually during the joint lives and the life of the survivor of the two annuitants, first payment one year hence.

Example 3. The rate for an annuity of $1.00 per annum payable annually during the joint lives and the life of the survivor of a male annuitant aged 65 and a female annuitant aged 60 is $17.082, obtained as follows:

Single life rate, age 65M, from Table A		$11.469
Single life rate, age 60F, from Table A		15.531
(1) Sum of the single life rates		$27.000
(2) Subtract the partial joint life premium for two lives aged 65M and 60F (see example 1)		9.855
(3) Unadjusted joint and survivor rate		$17.145
Adjustment factor, age 65M, from Table D	$0.063	
Adjustment factor, age 60F, from Table D	0.521	
(4) Subtract the smaller of the two adjustment factors		0.063
(5) Required joint and survivor rate		$17.082

Thus the value, according to the prescribed standard, of a joint and survivor annuity of $1,000 payable annually (first payment one year hence) during the joint lives and the life of the survivor of a male annuitant aged 65 and a female annuitant aged 60 is $1,000×17.082, or $17,082.

Example 4. The rate for an annuity of $1.00 per annum payable annually during the joint lives and the life of the survivor of two female annuitants aged 69 and 60 is $17.161, obtained as follows:

Single life rate, age 69F, from Table A		$11.627
Single life rate, age 60F, from Table A		15.531
(1) Sum of the single life rates		$27.158
(2) Subtract the partial joint life premium for two lives aged 69F and 60F (see example 2)		9.855
(3) Unadjusted joint and survivor rate		$17.303
Adjustment factor, age 69F, from Table D	$0.142	
Adjustment factor, age 60F, from Table D	0.521	
(4) Subtract the smaller of the two adjustment factors		0.142
(5) Required joint and survivor rate		$17.161

Thus, the value, according to the prescribed standard, of a joint and survivor annuity of $1,000 payable annually (first payment one year hence) during the joint lives and the life of the survivor of two female annuitants aged 69 and 60 is $1,000 x 17.161, or $17,161.

Example 5. The rate for an annuity of $1.00 per annum payable annually during the joint lives and the life of the survivor of two male annuitants aged 65 and 56 is $16.640, obtained as follows:

Single life rate, age 65M, from Table A		$11.469
Single life rate, age 56M, from Table A		15.089
(1) Sum of the single life rates		$26.558
(2) Subtract the partial joint life premium for two lives aged 65M and 56M (see example 1)		9.855
(3) Unadjusted joint and survivor rate		$16.703
Adjustment factor, age 65M, from Table D	$0.063	
Adjustment factor, age 56M, from Table D	0.300	
(4) Subtract the smaller of the two adjustment factors		0.063
(5) Required joint and survivor rate		$16.640

Thus the value, according to the prescribed standard, of a joint and survivor annuity of $1,000 payable annually (first payment one year hence) during the joint lives and the life of the survivor of two male annuitants aged 65 and 56 is $1,000 x 16.640, or $16,640.

.02 for the method of adjusting the joint and survivor rate in cases where the annuity is payable in semiannual, quarterly, or monthly installments, see section 3.

SEC. 6. RATES SUBJECT TO CHANGE.

Tables A, B, C and D are subject to change depending upon market conditions. Notice of change will be given by publication in the Internal Revenue Bulletin.

SEC. 7. EFFECT ON OTHER DOCUMENTS.

This Revenue Ruling supplements Revenue Ruling 62–137, page 28, and facilitates the valuation of certain annuity agreements according to the standard prescribed therein.

TABLE A

Single Life Rates

Rates for immediate annuity of $1.00 per annum

Age	Rate		Age	Rate	
	Male	Female		Male	Female
6	27. 410		46	18. 710	20. 911
7	27. 284		47	18. 368	20. 560
8	27. 154		48	18. 019	20. 203
9	27. 022		49	17. 667	19. 838
10	26. 885	29. 431	50	17. 311	19. 468
11	26. 744	29. 273	51	16. 950	19. 094
12	26. 601	29. 112	52	16. 586	18. 714
13	26. 454	28. 948	53	16. 217	18. 331
14	26. 304	28. 780	54	15. 845	17. 942
15	26. 149	28. 608	55	15. 469	17. 550
16	25. 990	28. 432	56	15. 089	17. 154
17	25. 828	28. 254	57	14. 705	16. 754
18	25. 661	28. 072	58	14. 317	16. 351
19	25. 490	27. 886	59	13. 924	15. 942
20	25. 316	27. 696	60	13. 526	15. 531
21	25. 135	27. 501	61	13. 125	15. 116
22	24. 951	27. 303	62	12. 717	14. 696
23	24. 762	27. 101	63	12. 306	14. 271
24	24. 567	26. 895	64	11. 889	13. 842
25	24. 368	26. 682	65	11. 469	13. 409
26	24. 163	26. 467	66	11. 046	12. 970
27	23. 952	26. 246	67	10. 641	12. 527
28	23. 737	26. 020	68	10. 266	12. 078
29	23. 514	25. 789	69	9. 889	11. 627
30	23. 286	25. 552	70	9. 512	11. 172
31	23. 053	25. 310	71	9. 143	10. 715
32	22. 812	25. 063	72	8. 775	10. 256
33	22. 566	24. 809	73	8. 408	9. 879
34	22. 312	24. 550	74	8. 043	9. 502
35	22. 052	24. 284	75	7. 682	9. 125
36	21. 785	24. 012	76	7. 323	8. 749
37	21. 510	23. 734	77	6. 970	8. 374
38	21. 228	23. 449	78	6. 622	8. 001
39	20. 940	23. 158	79	6. 281	7. 632
40	20. 643	22. 858	80	5. 946	7. 266
41	20. 339	22. 552	81	5. 619	6. 905
42	20. 027	22. 239	82	5. 299	6. 549
43	19. 707	21. 919	83	4. 989	6. 200
44	19. 382	21. 590	84	4. 688	5. 857
45	19. 049	21. 255	85	4. 397	5. 522

TABLE B

Uniform Seniority Table

Two male lives

Difference in age	Addition to younger age	Difference in age	Addition to younger age
1	.513	31	24.691
2	1.051	32	25.655
3	1.616	33	26.621
4	2.206	34	27.591
5	2.820	35	28.564
6	3.459	36	29.539
7	4.121	37	30.517
8	4.806	38	31.497
9	5.513	39	32.479
10	6.241	40	33.462
11	6.989	41	34.447
12	7.756	42	35.434
13	8.541	43	36.422
14	9.343	44	37.411
15	10.161	45	38.401
16	10.994	46	39.392
17	11.840	47	40.384
18	12.700	48	41.377
19	13.572	49	42.370
20	14.455	50	43.365
21	15.348	51	44.359
22	16.251	52	45.354
23	17.162	53	46.350
24	18.082	54	47.346
25	19.008	55	48.343
26	19.942	56	49.340
27	20.881	57	50.337
28	21.827	58	51.334
29	22.777	59	52.332
30	23.732	60	53.330

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TABLE C

Partial Joint Life Premiums

Two male lives

Equal ages male	Partial premium	Equal ages male	Partial premium
6	23. 416	46	15. 254
7	23. 325	47	14. 913
8	23. 228	48	14. 571
9	23. 125	49	14. 226
10	23. 019	50	13. 880
11	22. 907	51	13. 534
12	22. 791	52	13. 187
13	22. 671	53	12. 839
14	22. 546	54	12. 491
15	22. 416	55	12. 143
16	22. 282	56	11. 795
17	22. 142	57	11. 446
18	21. 998	58	11. 096
19	21. 848	59	10. 745
20	21. 693	60	10. 393
21	21. 532	61	10. 038
22	21. 365	62	9. 682
23	21. 192	63	9. 324
24	21. 014	64	8. 965
25	20. 829	65	8. 606
26	20. 637	66	8. 248
27	20. 439	67	7. 891
28	20. 234	68	7. 536
29	20. 023	69	7. 183
30	19. 804	70	6. 834
31	19. 578	71	6. 490
32	19. 344	72	6. 150
33	19. 103	73	5. 817
34	18. 855	74	5. 489
35	18. 598	75	5. 169
36	18. 334	76	4. 857
37	18. 062	77	4. 553
38	17. 781	78	4. 258
39	17. 492	79	3. 973
40	17. 195	80	3. 698
41	16. 889	81	3. 432
42	16. 575	82	3. 178
43	16. 253	83	2. 934
44	15. 925	84	2. 701
45	15. 591	85	2. 480

TABLE D

Adjustment Factors

For use with joint and survivor annuities only

Age	Male	Female	Age	Male	Female
6	1.616		46	.563	1.111
7	1.589		47	.537	1.068
8	1.563		48	.511	1.026
9	1.537		49	.484	.984
10	1.511	2.626	50	.458	.942
11	1.484	2.584	51	.432	.900
12	1.458	2.542	52	.405	.858
13	1.432	2.500	53	.379	.816
14	1.405	2.458	54	.353	.774
15	1.379	2.416	55	.326	.732
16	1.353	2.374	56	.300	.689
17	1.326	2.332	57	.274	.647
18	1.300	2.289	58	.247	.605
19	1.274	2.247	59	.221	.563
20	1.247	2.205	60	.195	.521
21	1.221	2.163	61	.168	.479
22	1.195	2.121	62	.142	.437
23	1.168	2.079	63	.116	.395
24	1.142	2.037	64	.089	.353
25	1.116	1.995	65	.063	.311
26	1.089	1.953	66	.037	.268
27	1.063	1.911	67	.021	.226
28	1.037	1.868	68	.021	.184
29	1.011	1.826	69	.021	.142
30	.984	1.784	70	.021	.100
31	.958	1.742	71	.025	.058
32	.932	1.700	72	.029	.016
33	.905	1.658	73	.033	.016
34	.879	1.616	74	.037	.016
35	.853	1.574	75	.041	.016
36	.826	1.532	76	.045	.016
37	.800	1.489	77	.049	.016
38	.774	1.447	78	.053	.016
39	.747	1.405	79	.057	.016
40	.721	1.363	80	.061	.016
41	.695	1.321	81	.064	.016
42	.668	1.279	82	.068	.016
43	.642	1.237	83	.072	.016
44	.616	1.195	84	.076	.016
45	.589	1.153	85	.080	.016

PART III.—ITEMS SPECIFICALLY EXCLUDED FROM GROSS INCOME

SECTION 101.—CERTAIN DEATH BENEFITS

26 CFR 1.101-2: Employees' death benefits. Rev. Rul. 62-102 [1]
(Also Section 102; 1.102-1.)

The Internal Revenue Service will no longer contend that section 101(b) of the Internal Revenue Code of 1954 applies to limit to $5,000 the exclusion from gross income of an amount paid to the widow of a

[1] Based on Technical Information Release 371, dated March 19, 1962.

deceased employee, where the payment otherwise qualifies as a gift excludable under section 102(a) of the Code.

The Service has abandoned its former contention in view of adverse decisions in the cases of *Grace P. Reed et al.* v. *United States*, 177 Fed. Supp. 205 (1959), affirmed without opinion, 277 Fed. (2d) 456 (1960); *Virginia Luty Cowan* v. *United States*, 191 Fed. Supp. 703 (1960); *Genevieve E. Frankel et al.* v. *United States*, 192 Fed. Supp. 776 (1961); and *Ellis H. Wilner et al.* v. *United States*, 195 Fed. Supp. 786 (1961). The Government withdrew this argument in its defense of the case of *Florence G. Rice* v. *United States*, 197 Fed. Supp. 223 (1961).

Revenue Ruling 60–326, C.B. 1960–2, 32, is modified accordingly.

The Service will continue to argue that, in extending section 101(b) of the Code to noncontractual payments, Congress assumed that such payments did not qualify as gifts, thereby endorsing the Service's ruling in I.T. 4027, C.B. 1950–2, 9, that widows' payments generally are not gifts.

SECTION 102.—GIFTS AND INHERITANCES

26 CFR 1.102–1: Gifts and inheritances.

Payments received from the former employer of the taxpayer's deceased husband. See Rev. Rul. 62–102, page 37.

SECTION 106.—CONTRIBUTIONS BY EMPLOYER TO ACCIDENT AND HEALTH PLANS

26 CFR 1.106–1: Contributions by employer to accident and health plans. Rev. Rul. 62–199

The taxpayer is a retired employee of a company which maintains a health and accident plan to provide hospital, medical and surgical insurance coverage for its retired employees, as well as its active employees. Under the plan, the company pays two-thirds of the monthly premium costs of the coverage. The balance of the monthly premium costs are paid by the covered active and retired employees. The taxpayer continued coverage under the health and accident plan after retirement by authorizing the company retirement system to deduct his share of the insurance premium costs from his monthly retirement checks. The taxpayer does not own stock in the company.

Held, amounts paid by the company under the plan as its share of the cost of providing hospital, medical and surgical insurance coverage for the retired employee are excludable from his gross income for purposes of section 106 of the Internal Revenue Code of 1954.

SECTION 107.—RENTAL VALUE OF PARSONAGES

26 CFR 1.107–1: Rental value of parsonages. Rev. Rul. 62–117

A resolution of the executive committee of a national church agency can not effectively designate a portion of the salaries of ministers of local congregations of the denomination involved as rental

allowances so as to qualify such portion for an exclusion under section 107 of the Internal Revenue Code of 1954 where each local congregation employs and compensates its own minister. However, the resolution is effective with respect to ministers in the immediate employ of the national church agency.

Advice has been requested whether a resolution of the executive committee of a national church agency, fixing as a rental allowance a portion of the salaries received by all the ministers of the denomination, meets the requirements of section 1.107–1 of the Income Tax Regulations so as to exclude the part of the salaries so designated from the gross income of the ministers under section 107 of the Internal Revenue Code of 1954.

The executive committee of the national church agency passed a resolution designating as a rental allowance a portion of the salaries of ministers "performing services in exercise of their ministry in the control, conduct and maintenance" of local congregations of the denominations involved. The resolution by its terms covered ministers directly employed by the national church agency in executive and administrative positions as well as ministers of the local congregations. These congregations are independent of the executive committee as to policy and conduct of their local affairs.

Section 107 of the Code provides that, in the case of a minister of the gospel, gross income does not include the rental value of a home furnished to him as part of his compensation, or the rental allowance paid to him as part of his compensation, to the extent used by him to rent or provide a home.

Section 1.107–1(b) of the regulations provides, in effect, that any rental allowance paid to a minister must be properly designated as such pursuant to official action taken by the "employing church or other qualified organization."

The resolution in the instant case fulfilled the requirement of an official action with respect to the ministers, otherwise qualified, employed by the national church agency itself and receiving compensation directly from that agency. However, where, as here, the ministers were hired and paid by local congregations, such congregations are the "employing church" and only action taken by them can effectively designate a portion of the ministers' salaries as a rental allowance for purposes of section 107 of the Code.

Accordingly, it is held that the amount designated as a rental allowance in the resolution of the executive committee, while effective so as to qualify a minister in the employ of the national church agency for an exclusion from gross income under section 107 of the Code, is not effective to allow an exclusion under section 107 of the Code for other ministers who are employed and paid by local congregations.

Pursuant to authority contained in section 7805(b) of the Code, the provisions of this Revenue Ruling with respect to ministers of the local congregations will be applied only as to payments made after December 31, 1962.

Rev. Rul. 62–171

Ordained ministers of the gospel who teach or have positions involving administrative and over-all management duties in parochial schools, colleges, or universities which are integral agencies of religious organizations under the authority of a religious body constituting a church or church denomination are in the performance of

their duties as ministers of the gospel for purposes of section 107 of the Internal Revenue Code of 1954. Therefore, they may exclude from their gross income the rental value of homes furnished to them, or rental allowances paid to them, as part of their compensation, to the extent used by them to provide homes.

Advice has been requested whether certain ordained ministers of the gospel employed by parochial schools, colleges, or universities, under the circumstances described below, may exclude from their gross income, under section 107 of the Internal Revenue Code of 1954, the rental value of homes furnished to them, or rental allowances paid to them, as part of their compensation.

The taxpayers are ordained ministers of the gospel employed as teachers and administrators in parochial schools, colleges or universities which are integral agencies of religious organizations under the authority of a religious body constituting a church or church denomination. All of the ordained ministers are authorized to conduct religious worship, to perform sacerdotal functions, and to administer ordinances in accordance with the prescribed rites and rituals of the church denomination, both in connection with and in addition to their other duties.

Those ministers who are employed as teachers in the parochial schools teach both religious and secular subjects. Teaching and sacerdotal functions are largely combined in these parochial schools and teachers are remunerated for both. Some of the ministers employed as teachers in the colleges or universities teach religious subjects, while others teach secular courses. Other ordained ministers are employed as heads of departments of religion or as administrative and executive heads of the parochial schools, colleges or universities.

Section 107 of the Code provides that, in the case of a minister of the gospel, gross income does not include the rental value of a home furnished to him as part of his compensation, or a rental allowance paid to him as part of his compensation, to the extent used by him to rent or provide a home.

Section 1.107–1(a) of the Income Tax Regulations provides, in part, that in order to qualify for the exclusion under section 107 of the Code, the home or rental allowance must be provided as remuneration for services which are ordinarily the duties of a minister of the gospel, and that, in general, the rules provided in paragraph (e) of section 1.1402(c)–1 of the regulations, relating to the Self-Employment Contributions Act of 1954 (chapter 2, subtitle A, Internal Revenue Code of 1954), will be applicable to such determination.

Section 1.1402(c)–1(e)(2)(ii) of the regulations provides, subject to an exception not material here, that services performed by a minister in the exercise of his ministry include the ministration of sacerdotal functions and the conduct of religious worship, and the control, conduct, and maintenance of religious organizations (including the religious boards, societies, and other integral agencies of such organizations), under the authority of a religious body constituting a church or church denomination.

Revenue Ruling 57–107, C.B. 1957–1, 277, holds, in part, that male teachers in parochial schools of a church denomination who, although not duly ordained as "pastors," are inducted into the teaching ministry

as ministers of religion according to the rites of the church and perform full-time services for the church by teaching, preaching, and, when needed, acting for or assisting an ordained pastor in the conduct of religious services, are "duly ordained, commissioned, or licensed ministers of a church" within the contemplation of section 1402(c)(4) of the Self-Employment Contributions Act of 1954, and that their services are performed in the exercise of their ministry.

Revenue Ruling 55–243, C.B. 1955–1, 490, in interpreting the provisions of section 408.215 of Regulations 128, the predecessor of section 31.3121(b)(8)–1(b) of the Employment Tax Regulations, states that it is generally held that services performed by ordained ministers as heads of religious departments and as teachers and administrators on the faculty of a college or university which is an integral agency of a religious organization under the authority of a religious body constituting a church or church denomination are in the exercise of their ministry and are excepted from "employment" under section 1426(b)(9)(A) of the Federal Insurance Contributions Act (subchapter A, chapter 9, Internal Revenue Code of 1939).

The provisions of section 31.3121(b)(8)–1(b) of the Employment Tax Regulations, applicable in determining when a minister is in the exercise of his duties as such for purposes of taxes under the Federal Insurance Contributions Act (chapter 21, subtitle C, Internal Revenue Code of 1954), are substantially identical to those found in section 1.1402(c)–1(e) of the Income Tax Regulations.

In view of the reference in section 1.107–1(a) of the regulations to paragraph (e) of section 1.1402(c)–1 of the regulations, services which are considered to be performed by a minister in the exercise of his ministry for purposes of section 1.1402(c)–1(e) are also, in general, considered as services which are ordinarily the duties of a minister of the gospel for purposes of section 1.107–1(a). But compare the last sentence of section 1.107–1(a) with section 1.1402(c)–1(e)(3)(iii) of the regulations.

Accordingly, based on the foregoing, it is held that the ordained ministers of the gospel in the instant case who teach or have positions involving administrative and over-all management duties in the parochial schools, colleges or universities which are integral agencies of religious organizations under the authority of a religious body constituting a church or church denomination are in the performance of their duties as ministers of the gospel for purposes of section 107 of the Code and they may, therefore, exclude from their gross income the rental value of a home furnished to them as part of their compensation, or rental allowances paid to them, as part of their compensation to the extent used by them to provide a home.

(Also Sections 163, 164; 1.163–1, 1.164–1.) Rev. Rul. 62–212

The amounts of interest and taxes paid by a minister of the gospel in connection with his personal residence are allowable as itemized deductions, under the provisions of sections 163 and 164 of the Internal Revenue Code of 1954, respectively, even though the minister is entitled to a rental allowance exclusion under section 107 of the Code.

SECTION 117.—SCHOLARSHIPS AND FELLOWSHIP GRANTS

26 CFR 1.117–1: Exclusion of amounts received as a scholarship or fellowship grant. Rev. Rul. 62–188

Grants paid to faculty members of the *X* University by the *Y* Fund, a corporation which is managed and operated for the benefit of the educational program of the *X* University, to enable the recipients to engage in study or research at another university during the summer months, are excludable from the gross incomes of the recipients to the extent provided in section 117 of the Internal Revenue Code of 1954, relating to scholarships and fellowship grants, subject to the limitations of section 117(b), where the recipients are not obligated to return to the *X* University at the end of the Summer or to repay the grant, or any part thereof, upon their failure to return, and the grants are based upon (1) the merit of the program of study submitted by the applicant for a grant, and (2) the relative importance of the plan of study submitted in relation to current educational demands.

Advice has been requested whether grants paid to faculty members of the *X* University under the circumstances described below may be excluded from the gross incomes of the recipients under section 117 of the Internal Revenue Code of 1954.

The *Y* Fund is a corporate entity separate and distinct from the *X* University. It is not an educational institution in the ordinary sense, but, in effect, is an endowment fund managed and operated by a Board of Trustees for the benefit of the educational program of the *X* University. However, both the *Y* Fund and the *X* University are organizations of the type described in section 501(c)(3) of the Code and are exempt from tax under section 501(a) of the Code.

As part of its activities, the *Y* Fund initiated a "Summer Faculty Grants" program designed primarily to enable members of the faculty of the *X* University to engage in study or research during the summer months at some other university.

Under the program, applicants must submit plans for projected study to the appropriate members of the Board of Trustees of the *Y* Fund for approval. In the selection of the recipients of the grants, consideration is given to (1) the merit of the plan submitted by the applicant and (2) the relative importance of the plan of study submitted by the applicant in relation to current educational demands. In the past, the trustees of the fund have rejected many applicants because the study plans submitted were not considered suitable by the trustees. Although recipients of grants are members of the faculty of the *X* University, they are under no obligation to return to the university as members of its faculty as a condition precedent to receiving the grant, or to refund any portion thereof, whether or not they return to the university.

Section 117(a) of the Code provides that, in the case of an individual, gross income does not include any amount received as a scholarship at an educational institution (as defined by section 151(e)(4) of the Code), or as a fellowship grant, including the value of contributed services and accommodations, and any amount received to cover certain specified expenses which are incident to a scholarship or to a fellowship grant, but only to the extent that the amount is actually expended for the purposes enumerated therein.

Section 117(b)(1) of the Code provides that, in the case of an individual who is a candidate for a degree at an educational institution, the exclusion provided by section 117(a) of the Code does not apply to that portion of any amount received which represents compensation for services required as a condition to receiving the scholarship or fellowship grant.

If the individual is not a candidate for a degree, section 117(b)(2) provides that the grantor must be an organization described in section 501(c)(3) of the Code, which is exempt from tax under section 501(a) of the Code, or one of the described government agencies or instrumentalities. In such cases, section 117(b)(2)(B) of the Code limits the exclusion to an amount equal to $300 times the number of months for which the recipient received amounts under the grant during such taxable year. No exclusion is allowable for a period of more than 36 months, whether or not consecutive.

Section 1.117–4(c) of the Income Tax Regulations provides, as far as here pertinent, that any amount paid or allowed to, or on behalf of, an individual to enable him to pursue studies or research shall not be considered as received as a scholarship or fellowship grant if such amount represents either compensation for past, present, or future employment services or represents payment for services which are subject to the direction or supervision of the grantor, or research primarily for the benefit of the grantor.

The facts disclose that the primary purpose of the grants concerned is to further the education and training of the recipients in their individual capacities. Although the recipients are employees of the university, they do not receive the grants in the normal course of their employment but must instead submit plans for projected study to the trustees of the fund for approval on the basis of merit or need. They render no services to the university during the periods covered by the grants and are not obligated to do so in the future. Therefore, the grants in question are not compensation for past, present, or future employment services within the meaning of section 1.117–4(c) of the regulations.

Accordingly, it is held that, in the instant case, the grants paid to faculty members of the *X* University by the *Y* Fund, to enable the recipients to engage in study or research at another university during the summer months, are excludable from the gross incomes of the recipients, to the extent provided in section 117 of the Code, subject to the conditions and limitations of section 117(b).

Rev. Rul. 62–205

Stipends received from institutions of higher education for attending counseling and guidance training and language development institutes provided by those institutions by using funds received from the Department of Health, Education, and Welfare, are scholarship or fellowship grants which are excludable from gross income under section 117(a) of the Internal Revenue Code of 1954 by individuals who are candidates for degrees. Stipends received by individuals attending such training institutes who are not candidates for degrees, including the amount of tuition, matriculation, and other fees furnished or remitted, are excludable from gross in-

come to the extent provided by section 117(b)(2)(B) of the Code, if the grantor is an organization of the type enumerated in section 117(b)(2)(A) of the Code.

Advice has been requested whether stipends received by individuals for attending certain training institutes at institutions of higher education provided by the institutions by the use of funds received from the Department of Health, Education, and Welfare are excludable from the recipients' gross income as scholarships or fellowship grants.

Under sections 511 and 611 of the National Defense Education Act of 1958, 20 U.S.C. 491 and 521, the Commissioner of Education is authorized to arrange, by contracts with institutions of higher education, for the operation by them of short-term or regular session institutes for the provision of training to improve the qualifications of personnel engaged in counseling and guidance of students in secondary schools, or teachers in such schools preparing to engage in such counseling and guidance, and for individuals who are engaged in or preparing to engage in the teaching, or supervising or training teachers of any modern foreign language in elementary or secondary schools.

Each individual who is qualified to attend an institute is eligible to receive a stipend for the period of his attendance at such institute, and each such individual with one or more dependents is eligible to receive an additional stipend for each dependent for the period of attendance. The stipends are made available in order to encourage and facilitate advanced study at centers by superior young persons and by mature professional individuals. The grantees do not incur any independent obligation to any educational institution or the United States Government by accepting the stipends.

Section 117(a) of the Internal Revenue Code of 1954 provides that, subject to certain conditions and limitations, amounts received by an individual under a scholarship or a fellowship grant are excludable from gross income. In the case of an individual attending an educational institution, who is working toward a degree, the total amount of the stipend received under the grant is excludable from his gross income.

Section 117(b)(2) of the Code provides, in the case of an individual who is not a candidate for a degree, that the exclusion applies only if the grantor is an organization of the type described in section 117(b)(2)(A) of the Code, and the amount excludable is limited to an amount which is not in excess of $300 per month times the number of months for which the recipient received benefits under the scholarship or fellowship grant during the taxable year. No such exclusion is allowed after the recipient has been entitled to any exclusion for a period of 36 months, whether or not consecutive.

Under section 1.117-3 of the Income Tax Regulations, the terms "scholarship" and "fellowship grant" include the value of any amount received in the nature of a family allowance for dependents. See Rev. Rul. 55-554, C.B. 1955-2, 36.

Accordingly, it is held that stipends received from institutions of higher education for attending counseling and guidance training and language development institutes provided by those institutions, by using funds received from the Department of Health, Education, and

Welfare, are scholarships or fellowship grants which are excludable from gross income under section 117(a) of the Internal Revenue Code of 1954 by individuals who are candidates for degrees.

Stipends received by individuals attending such training institutes who are not candidates for degrees, including the amount of tuition, matriculation, and other fees furnished or remitted, are excludable from gross income to the extent provided by section 117(b)(2)(B) of the Code, if the grantor is an organization of the type enumerated in section 117(b)(2)(A) of the Code.

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

Statutory pay of a cadet of the United States Coast Guard Academy. See Rev. Rul. 62–122, page 12.

PART V.—DEDUCTIONS FOR PERSONAL EXEMPTIONS

SECTION 151.—ALLOWANCE OF DEDUCTIONS FOR PERSONAL EXEMPTIONS

26 CFR 1.151–2: Additional exemptions for dependents.

Travel and living expenses of son serving as a missionary. See Rev. Rul. 62–113, page 10.

PART VI.—ITEMIZED DEDUCTIONS FOR INDIVIDUALS AND CORPORATIONS

SECTION 161.—ALLOWANCE OF DEDUCTIONS

26 CFR 1.161–1: Allowance of deductions.

Deduction by employees of expenses attributable to the use of a personal residence in the performance of their duties. See Rev. Rul. 62–180, page 52.

SECTION 162.—TRADE OR BUSINESS EXPENSES

26 CFR 1.162–1: Business expenses. Rev. Rul. 62–133

So-called "payola" payments made to disc jockeys of radio or television musical programs on or after December 6, 1959, are not deductible under section 162 of the Internal Revenue Code of 1954. "Payola" payments made to disc jockeys prior to December 6, 1959, are not deductible under section 162 of the Code in cases in which it is determined that the payments frustrated a sharply defined public policy expressed by a particular state.

Advice has been requested as to the deductibility, for Federal income tax purposes, of so-called "payola" payments made to disc jockeys.

"Payola," as that term is commonly understood, may be defined as the payment of money, or other valuable consideration, to disc jockeys of musical programs on radio and television stations to induce, stimulate or motivate the disc jockey to select, broadcast, "expose" and promote phonograph records in which the payor has a financial interest. In such transactions, there is an express or implied understanding that the disc jockey will conceal the receipt of the "payola" payments from the public.

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

Where an expense qualifies as ordinary and necessary, deduction will not be denied unless the payment of such expense frustrates sharply defined national or state policy proscribing particular types of conduct. See *Thomas B. Lilly et ux* v. *Commissioner*, 343 U.S. 90, Ct.D. 1741, C.B. 1952–1, 16.

On December 6, 1959, the Federal Trade Commission announced by news release that it had issued complaints against certain record manufacturers and record distributors, charging that their "payola" disbursements to disc jockeys deceived the public and restrained competition and, therefore, were in violation of section 5 of the Federal Trade Commission Act, 15 US.C. 45.

Subsequently, the Federal Communications Commission stated, in its Public Notice 85460, dated March 16, 1960, 25 F.R. 2406, that the purpose of section 317 of the Federal Communications Act, 47 U.S.C. 317, requiring announcement of sponsorship where consideration is paid to a radio station for a broadcast, "was clearly to prevent deception on the part of the public growing out of concealment of the fact that the broadcast of particular program material was induced by consideration received by the licensee." Public Law 86–752, September 13, 1960, amended section 317 of the Federal Communications Act to provide for fines and imprisonment of the payor and recipient violators pertaining to "payola." 47 U.S.C. 508.

The Federal Trade Commission announcement of December 6, 1959, was an expression of sharply defined Federal policy against "payola." Accordingly, it is held that "payola" payments made to disc jockeys of radio or television musical programs on or after that date are not deductible as ordinary and necessary trade or business expenses under section 162 of the Code.

Since no sharply defined Federal policy against "payola" was expressed prior to December 6, 1959, a determination whether such payments made to disc jockeys before that date are deductible for Federal income tax purposes will be made on the basis of the particular facts and circumstances of each case. A deduction will not be allowed in a case where "payola" payments made prior to December 6, 1959, are found to have frustrated a sharply defined public policy proscribing particular types of conduct expressed by a particular state. In addition, deduction of "payola" payments will be disallowed in all cases where the taxpayer fails to furnish the Internal Revenue Service with the names and addresses of the persons to whom the payments were made. See Mimeograph 4151, C.B. XIII–1, 47 (1934).

Rev. Rul. 62-156

Expenditures made by a taxpayer engaged in a trade or business, other than as an employee, for advertising designed to encourage the public to register and vote in Federal, state and local elections and to contribute to the campaign funds of the candidate or party of their choice are deductible by the taxpayer under section 162(a) of the Internal Revenue Code of 1954, provided such advertising was intended to be, and was, in fact, politically impartial in character, was reasonably related to future public patronage expected by the taxpayer and, provided also, that such expenditures otherwise meet the requirements of that section of the Code.

Amounts expended by such a taxpayer in sponsoring the politically impartial presentation of a debate among the candidates for a particular political office are also deductible under section 162(a) of the Code, provided, they are reasonably related to the taxpayer's expected future public patronage, and otherwise meet the requirements of that section of the Code.

Where such a taxpayer makes expenditures and incurs costs to encourage its employees to register and vote in Federal, state and local elections by granting them time off with pay for such purposes, and to contribute to the campaign funds of the party or candidate of their choice by maintaining a completely voluntary payroll deduction plan for those wishing to make such contributions, the costs of handling these items are deductible by the taxpayer under section 162(a) of the Code, provided such encouragement of employee political activity is politically impartial in character and such expenditures are reasonably related to the maintenance or improvement of employee morale and otherwise meet the requirements of section 162(a) of the Code.

Advice has been requested whether expenses paid or incurred by the taxpayer, in connection with Federal, state and local elections, for the purposes of: (1) advertising designed to encourage the public to register and vote and to contribute to the political party or campaign fund of a candidate of their choice, (2) sponsoring a political debate among candidates for a particular political office, (3) granting employees time off with pay for registration and voting, and (4) maintaining a payroll deduction plan for employees wishing to make political contributions, are deductible under section 162(a) of the Internal Revenue Code of 1954.

The taxpayer is engaged in a trade or business other than as an employee. It manufactures products which are sold under its own name.

During the taxable year, the taxpayer made several substantial expenditures and incurred a number of costs, in connection with Federal, state and local elections. The extent to which, if at all, each expenditure is deductible by the taxpayer under section 162(a) of the Code is the question presented in the instant case.

In support of a campaign to maximize the number of those voting in Federal, state and local elections, the taxpayer purchased a full page of advertising space in newspapers urging the public to register and vote for the party or candidate of their choice. People were also urged, wherever possible, to contribute money and work for whatever candidate, party, or cause they preferred. The advertisements contained a statement that they were paid for in the interest of encouraging all eligible persons to vote as a demonstration of good citizenship without regard to the specific political choices or preferences expressed at the polls. The advertisements designated the taxpayer as their sponsor.

The taxpayer mailed a similar message to each of its employees encouraging them to register and vote in the elections and to work for, and contribute to, the candidate or party of their choice. As a means of inducing employees to vote, the taxpayer offered, and later gave, each employee who wished to vote two hours time off, with pay, on election day. It also instituted an entirely voluntary plan under which employees could authorize the taxpayer to deduct political contributions from their pay and forward them to whatever political candidate, cause, or party the employee chose to designate.

The taxpayer also sponsored the production and presentation of a debate among the candidates for a particular political office. The program was arranged in a manner intended to give each candidate an equal opportunity to present himself and his views to the public and the "ground rules" for the program were agreed upon in advance by the candidates. At the beginning and end of the program it was announced that the program was paid for by the taxpayer in the hope that it would increase the interest and knowledge of the public regarding the candidates and programs at issue in the elections. The taxpayer expected that sponsorship of the debate would increase its future public patronage by keeping its name before the public.

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

Section 1.162–15(c)(1) of the Income Tax Regulations promulgated under section 162 of the Code provides as follows:

> Expenditures for lobbying purposes, for the promotion or defeat of legislation, for political campaign purposes (including the support of or opposition to any candidate for public office), or for carrying on propaganda (including advertising) related to any of the foregoing purposes are not deductible from gross income. For example, the cost of advertising to promote or defeat legislation or to influence the public with respect to the desirability or undesirability of proposed legislation is not deductible as a business expense, even though the legislation may directly affect the taxpayer's business. On the other hand, expenditures for institutional or "good will" advertising which keeps the taxpayer's name before the public are generally deductible as ordinary and necessary business expenses provided the expenditures are related to the patronage the taxpayer might reasonably expect in the future. For example, a deduction will ordinarily be allowed for the cost of advertising which keeps the taxpayer's name before the public in connection with encouraging contributions to such organizations as the Red Cross, the purchase of United States Savings Bonds, or participation in similar causes. In like fashion, expenditures for advertising which present views on economic, financial, social, or other subjects of a general nature but which do not involve any of the activities specified in the first sentence of this subparagraph are deductible if they otherwise meet the requirements of the regulations under section 162.

Whether the expenses paid or incurred by the taxpayer in connection with an election are deductible is a question of fact, the resolution of which requires a consideration of all the facts and circumstances surrounding each expenditure made or cost incurred.

The deductibility of the taxpayer's expenditures for newspaper advertising urging the public to participate in elections depends, in large measure, upon whether such expenditures are in the nature of good will advertising intended to keep the taxpayer's name before the

public in connection with an organization or cause similar to those described in the regulations, or whether they are made for a purpose for which deduction is prohibited by the regulations.

Amounts spent by a taxpayer for politically impartial advertising encouraging eligible persons in the community to register and vote in elections are expended in the advancement of a cause similar to encouraging the purchase of United States Savings Bonds, as described in section 1.162–15(c)(1) of the regulations. However, expenditures for such activity will be deductible under section 162 of the Code only insofar as they are politically impartial in nature and are reasonably related to future public patronage expected by the taxpayer. For example, if a message is directed to an audience the response of which would reasonably be expected to redound to the benefit of one political group or faction, such a message would not be politically impartial and the expenses incurred with respect thereto would constitute an expenditure for political campaign purposes, which as provided in the above-quoted section of the regulations would not be deductible from gross income.

Although expenses paid or incurred by a taxpayer in encouraging its own employees, like the general public, to register and vote in elections, in granting them time off with pay to register and vote, and in deducting and forwarding employee political contributions, may not be *directly* connected with the anticipated future patronage of the taxpayer by the public, it would not be unreasonable for the taxpayer to expect that such expenditures would improve employee morale and ultimately improve its business. It could also be reasonably anticipated that a reputation for encouraging employees to vote and otherwise exercise their rights and duties as citizens would benefit its business. In the absence of evidence that such expenditures were not politically impartial, or were unreasonable in amount, such expenses come within the meaning of the term "ordinary and necessary" as used in section 162 of the Code.

Amounts expended by the taxpayer for the sponsorship of a debate under the circumstances described above are similar to the taxpayer's expenditures for newspaper advertisements, in that, in each case, the publicity expected by the taxpayer as sponsor of the debate, was reasonably related to future public patronage expected by the taxpayer.

Although section 1.162–15(c) of the regulations contemplates the deduction of expenses paid or incurred in connection with political affairs, provided they manifest political impartiality, that is not to say that total political balance must always be assured to result from such expenditures. For example, all the available evidence in the instant case indicates that the taxpayer's intention in sponsoring the debate was to present a forum in which each candidate would appear and present his views. Genuine attempts were made to present each of the candidates under circumstances as nearly equal as possible, and each of the candidates agreed, in advance, to the format of the program and to the rules for the conduct of the debate. Whatever the outcome of the program from the standpoint of a particular candidate, the results of the program are most reasonably attributable to the candidates themselves, and responsibility for the result is not that of the taxpayer, which merely provided the arena in which those results may have been achieved.

Accordingly, it is held that expenses of the nature described above incurred by the taxpayer to encourage the public and its own employees to register and vote in elections and to work for and contribute to the campaign funds of the candidate or party of their choice, and for the sponsorship of a debate among the candidates for a particular political office, are deductible under section 162(a) of the Code as ordinary and necessary expenses of doing business, provided such encouragement and sponsorship were intended to be, and were, in fact, politically impartial in character, and that such expenditures were reasonably related to the taxpayer's expected future public patronage and otherwise satisfy the requirements of the Code.

Rev. Rul. 62–175 [1]

Attorneys' fees and related legal expenses paid or incurred in unsuccessfully defending a prosecution for a criminal violation of the Sherman Anti-Trust Act are not deductible under section 162 of the Internal Revenue Code of 1954.
G.C.M. 24377, C.B. 1944, 93, modified.

Reconsideration has been given to G.C.M. 24377, C.B. 1944, 93, relating to the deductibility of legal expenses incurred in an unsuccessful defense of a suit brought for violation of the Sherman Anti-Trust Act.

G.C.M. 24377 holds, *inter alia*, that legal expenses incurred by a corporation in defense of a suit brought against it for violation of the Sherman Anti-Trust Act, in which suit the corporation was found guilty, are deductible as ordinary and necessary business expenses to the extent that such expenses were incurred in its own behalf. The holding of G.C.M. 24377 was based, in large measure, upon the decision of the Supreme Court of the United States in the case of *Commissioner* v. *S. B. Heininger*, 320 U.S. 467 (1943), Ct. D. 1596, C.B. 1944, 484, and upon the decision of the Tax Court of the United States in the case of *Longhorn Portland Cement Co.* v. *Commissioner*, 3 T.C. 310 (1944), acquiescence, in part only, C.B. 1944, 18, reversed on another issue, 148 Fed. (2d) 276 (1945), Ct. D. 1665, C.B. 1946–1, 53, certiorari denied, 326 U.S. 728 (1945).

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

As a general rule, legal expenses incurred in the *unsuccessful* defense of a criminal prosecution are not deductible for Federal income tax purposes. See *Burroughs Building Material Co.* v. *Commissioner*, 18 B.T.A. 101 (1930), affirmed, 47 Fed. (2d) 178 (1931), Ct. D. 297, C.B. X–1, 397 (1931); *C. W. Thomas* v. *Commissioner*, 16 T.C. 1417 (1951); and *Thomas A. Joseph et ux* v. *Commissioner*, 26 T.C. 562 (1956). G.C.M. 24377 represents a departure from that general rule.

In the *Heininger* decision, *supra*, the Supreme Court affirmed a decision of the United States Circuit Court of Appeals for the Seventh Circuit which held that lawyers' fees and related legal expenses

[1] Also released as Technical Information Release 400, dated October 1, 1962.

incurred by the taxpayer in contesting the issuance of a fraud order by the Postmaster General were deductible as ordinary and necessary business expenses. The taxpayer was in the business of making and selling false teeth by mail.

After concluding that the taxpayer's legal expenses were both "ordinary and necessary," as those words are used in the Code, the Court stated that if the taxpayer was to be denied a deduction it must be on the ground that the allowance of the deduction would frustrate the sharply defined policies of the statutes authorizing the Postmaster General to issue fraud orders. The Court determined that that would not be the result of permitting the taxpayer the deduction. The Court stated on pages 474 and 475:

> * * * to allow the deduction of respondent's litigation expenses would not frustrate the policy of these statutes; and to deny the deduction would attach a serious punitive consequence to the Postmaster General's finding which Congress has not expressly or impliedly indicated should result from such a finding. We hold therefore that the Board of Tax Appeals was not required to regard the *administrative finding of guilt* under 39 U.S.C. sections 259 and 732 as a rigid criterion of the deductibility of respondent's litigation expenses. [Emphasis added.]

In the *Longhorn* case, *supra*, the Tax Court considered the question whether certain payments made in compromise of a suit brought by the State of Texas against the taxpayers for alleged violations of its anti-trust laws, and attorneys' fees and related expenses paid in connection therewith, were ordinary and necessary expenses paid in carrying on the taxpayer's business. It was held that both the compromise payments made by the taxpayer and his attorneys' fees were properly deductible. The Internal Revenue Service acquiesced on the issue of the deductibility of the attorneys' fees, but appealed on the issue of the deduction of the compromise payments made in settlement of the suit. On this issue the United States Circuit Court of Appeals for the Fifth Circuit later reversed the Tax Court. See *Commissioner* v. *Longhorn Portland Cement Co.*, 148 Fed. (2d) 276 (1945), Ct. D. 1665, C.B. 1946–1, 53.

In both the *Heininger* and the *Longhorn* cases the taxpayers were threatened with a severe if not complete diminishment of their businesses and neither case involved a taxpayer who has *unsuccessfully* defended a *criminal* prosecution. Although the taxpayer in the *Heininger* case was unsuccessful, in the sense that the Postmaster General ultimately issued a fraud order which had the effect of drastically restricting, if not destroying, the taxpayer's mail order business, the taxpayer was the subject of only an administrative finding of guilt. In the *Longhorn* case the ultimate result of the State's prosecution was not an admission or proof of the taxpayer's guilt, but a compromise settlement. In both cases the threat to the taxpayers' business was clearly apparent but no criminal action was involved.

G.C.M. 24377 erroneously applied the rationale of the *Heininger* and *Longhorn* decisions in allowing deduction of legal expenses incurred in the unsuccessful defense of a criminal prosecution. The deduction for legal expenses incurred in the unsuccessful defense of a criminal action brought under the Sherman Anti-Trust Act would frustrate the sharply defined national policy as expressed in such Act.

Accordingly, it is held that attorney's fee and related legal expenses incurred in an unsuccessful defense of a criminal action brought for a violation of the Sherman Anti-Trust Act are not deductible as ordinary and necessary expenses of doing business.

G.C.M. 24377, C.B. 1944, 93, is hereby modified to the extent inconsistent with the foregoing.

(Also Sections 62, 161, 167; 1.62–1, 1.161–1, 1.167(a)–1.) Rev. Rul. 62–180

Guidelines for determining the amount of a deduction, for Federal income tax purposes, to which an individual is entitled for expenses attributable to the portion of his personal residence which he uses in the performance of his duties as an employee.

The Internal Revenue Service has been requested to furnish guidelines for determining the amount of the deduction to which an individual is entitled for the ordinary and necessary expenses attributable to the portion of his personal residence which he uses in the performance of his duties as an employee.

Section 162 of the Internal Revenue Code of 1954 provides, in part, for the deduction of all ordinary and necessary expenses paid or incurred during the taxable year in carrying on a trade or business. Section 163 of the Code provides for the deduction of interest paid or accrued within the taxable year on indebtedness, and section 164 of the Code provides for the deduction of taxes paid or accrued within the taxable year. Section 167 of the Code provides for the deduction as depreciation of a reasonable allowance for exhaustion, wear and tear of property used in a trade or business.

The performance of services as an employee constitutes the carrying on of a trade or business. Therefore, the ordinary and necessary business expenses of an employee in connection with his employment are deductible.

However, in the case of an employee, other than an *outside salesman*, as defined in section 1.62–1(h) of the Income Tax Regulations, section 62 of the Code limits the deductions allowable in computing *adjusted gross income* to expenditures for travel, meals and lodging while away from home in connection with the performance by him of services as an employee, expenses under a reimbursement or other expense allowance arrangement with his employer, and expenses of transportation. Other business expenses of such an employee are deductible only in computing *taxable income* as provided in section 161 of the Code. *Outside salesmen* are permitted by section 62 of the Code to deduct their allowable business expenses in computing *adjusted gross income*.

An employee who, as a condition of his employment, is required to provide his own space and facilities for performance of his duties and regularly uses a portion of his personal residence for that purpose may deduct a pro rata portion of the expenses of maintenance and depreciation on his residence. However, the voluntary, occasional, or incidental use by an employee of a part of his residence in connection with his employment does not entitle him to a business expense deduction for any portion of the depreciation and expenses of main-

taining his residence. See section 1.262–1(b)(3) of the regulations and Example (6) below.

The burden of proof rests upon the taxpayer to establish (1) that, as a condition of his employment, he is required to provide his own space and facilities for performance of some of his duties, (2) that he regularly uses a part of his personal residence for that purpose, (3) the portion of his personal residence which is so used, (4) the extent of such use, and (5) the pro rata portion of the depreciation and expenses for maintaining his residence which is properly attributable to such use.

Records should be maintained by the taxpayer which will provide the data necessary to properly compute the amount of the deduction in accordance with the rules prescribed herein and as illustrated in the examples below. See section 1.162–17(d) of the regulations regarding expenses for which an accounting to the employer is not required. Cancelled checks, receipts and other evidence of the expenses paid should be retained and kept available to substantiate the deductions claimed.

The deductible expenses of an employee, whose conditions of employment are such that he regularly uses a part of his residence in the performance of his duties as an employee, include a pro rata portion of such items as rent, light, taxes, and interest on a mortgage. No portion of purely personal expenses attributable to family household purposes are deductible.

The costs of repairs that do not benefit the portion of the residence used for business purposes are not deductible. Thus, the costs of painting and repairs to rooms, other than the one used for business purposes, are not deductible. However, a pro rata portion of the cost of painting the outside of the residence or repairing the roof, for example, would be deductible. The costs of painting and repairs to a room used exclusively for business purposes would be deductible in full, and a pro rata portion would be deductible if a part of the room was used for business purposes. Expenditures for lawn care, landscaping, etc., are not deductible.

The basis for computing the depreciation allowed or allowable on that portion of a personal residence owned by the taxpayer and used in his trade or business is, at the time of conversion to business use, the lesser of the fair market value or the adjusted basis of the entire residence (exclusive of the land). See section 1.167(f)–1 of the regulations. The adjusted basis is the cost or other basis adjusted for losses, such as casualty losses, and expenditures properly chargeable to capital account, such as improvements or betterments. See section 1.1016–2 of the regulations.

Generally, in computing the reasonable allowance for depreciation, the applicable basis of the residence is reduced by its salvage value. Salvage value is the estimated amount which would be realized at the end of the useful life for business purposes on the assumption that the entire residence is sold or disposed of at that time. Only that part of the remainder which is attributable to the business portion, divided by the number of years it is estimated that the employee will be required to use a portion of his residence in his trade or business, is allowable as a depreciation deduction for the periods such portion is required to be so used. See section 1.167(a)–1 of the regulations.

The portion of a personal residence which is used for business purposes may be part of a room or one or more rooms. It may be used exclusively for business purposes or it may be so used only part of the time. In any event, for the expenses attributable to such an area to be deductible, the use of a particular area must be regular and not merely incidental or occasional.

Where a portion of a residence is devoted to business purposes on a regular basis, the portion of the depreciation and other costs incurred in maintaining the residence, which is properly attributable to the space used in business, is a question of fact to be decided in each case. However, in making an allocation of expenses, it would, if the circumstances warrant, be proper to compare the number of rooms or square feet of space devoted to a business purpose to the total number of rooms or square feet in the residence and apply the ratio thus arrived at to the total of each of the expenses properly attributable to the use of part of the residence for business purposes. Such methods of allocation are not the only methods which may be made. Any other method which is reasonable under the circumstances will be acceptable.

Where a portion of the residence is regularly used for business purposes only part of the time, a further allocation must be made on the basis of the ratio of the time the area is actually used for business purposes to the total time it is available for all uses. See Example (5) below.

The application of the foregoing principles is illustrated by the examples below. In these examples taxes and interest on a mortgage on the taxpayer's residence have been included in the computations only in the case of *outside salesmen* since they may deduct from gross income, in computing adjusted gross income, expenses attributable to the portion of their residence used for business purposes in connection with their employment. Other employees, in the absence of a reimbursement or other expense allowance arrangement, may deduct such expenses only in computing taxable income, and only when they do not use the standard deduction or optional tax table.

Example (1). *A* is employed as an outside salesman, as defined in section 1.62–1(h) of the regulations, by a wholesale jewelry company. As a condition of his employment, he is required by his employer to write his orders, make reports, etc. The company does not provide him with office space; therefore, *A* does this work at home. He owns his residence, which has an area of 2,000 square feet, has furnished one room (10 x 12 feet) as an office and uses it solely in connection with his employment.

Since *A* is an outside salesman and the room he uses solely for business purposes is 6 percent (120/2,000) of the area of his residence, 6 percent of the depreciation and expenses may be attributed to the portion of *A's* residence used for business purposes and is deductible in computing his adjusted gross income.

A's electric bill was $100 for the year. Of this amount $60 is attributable to lighting; $40 is attributable to purely personal uses and is not deductible. *A's* gas bill for the year was $310 of which $250 is attributable to heating his residence; $60 is attributable to purely personal uses and is not deductible. During the year *A* painted the room used for his office, the cost of which was $20.

The computation of the allowable deduction is as follows:

Real estate taxes	$200.00
Light	60.00
Fire insurance on residence	18.00
Heat	250.00
Interest on mortgage	750.00
Depreciation on house	450.00
Total	$1,728.00
Amount attributable to business use: (6% of $1,728.00)	$103.68
Cost of painting room used as an office	20.00
Total amount deductible	$123.68

The balance of the real estate taxes, $188, and interest, $705, is deductible from adjusted gross income in computing taxable income if *A* does not use the standard deduction or optional tax table.

Example (2). *B*, a postal transportation clerk, is required by the United States Post Office Department to maintain distribution schemes, schedules, and examination cards; handle official correspondence; and prepare material for his mobile unit assignment outside his scheduled tour of duty. He is also required to maintain correspondence files, registry records, trip reports, pouch labels, forms for supplies, etc. The Post Office Department does not provide space for these purposes. *B* owns his home and has set aside an area of 60 square feet in one of the rooms which he uses solely for the storage of materials and space for a desk at which he performs the clerical duties required of him outside of his scheduled tour of duty.

Since the area used exclusively for business purposes is 60 square feet and the total area of the residence is 1,500 square feet, 4 percent (60/1,500) of the depreciation and expenses is attributable to business use and is deductible.

B's gas bill was $320 for the year of which $250 is attributable to heating his residence; $70 is attributable to purely personal uses and is not deductible. *B's* electric bill for the year was $65 of which $50 is attributable to lighting; $15 is attributable to purely personal uses and is not deductible.

The allowable deduction is computed as follows:

Heat	$250.00
Light	50.00
Fire insurance on residence	15.00
Depreciation on house	300.00
Total	$615.00
Expenses attributable to business use: (4% of $615.00)	$24.60

The amount of $24.60, plus the amounts of taxes and mortgage interest on *B's* residence, are deductible from adjusted gross income in computing taxable income if *B* does not use the standard deduction or optional tax table.

Example (3). *C*, who is a zone sales supervisor (not an outside salesman) for corporation *X*, is not provided with office space by his employer. One of his duties is the submission of detailed weekly reports to the home office. *C* is unable to work on the reports while traveling, so he prepares them at home. For this purpose he partitioned off 72 square feet in his residence as an office. This space is not used for any other purpose. He owns his residence, which has an area of 3,600 square feet.

Two percent (72/3,600) of the depreciation and expenses would be considered attributable to business use and would be deductible from *C's* adjusted gross income in arriving at his taxable income if he does not use the standard deduction or the optional tax table.

C's gas bill for the year was $370 of which $300 is attributable to heating his residence; $70 is attributable to purely personal uses and is not deductible. *C's* electric bill for the year was $85 of which $70 is attributable to lighting; $15 is attributable to purely personal uses and is not deductible. During the year he paid $150 for repairs to the roof of his home and his gas furnace.

C's allowable deduction is computed as follows:

Heat	$300.00
Light	70.00
Repairs to roof and gas furnace	150.00
Depreciation on house	750.00
Fire insurance on house	20.00
Total	$1,290.00
Amount attributable to business use: (2% of $1,290.00)	$25.80

The amount of $25.80, plus the amounts of taxes and mortgage interest on *C's* residence, are deductible from adjusted gross income in computing taxable income if *C* does not use the standard deduction or optional tax table.

Although *C* had his dining room painted at a cost of $75, none of this amount is deductible, since the space *C* used for business purposes was not benefited by this expenditure.

Example (4). *D*, a corporation executive, can remain at or return to the company's offices when he finds it necessary to work after regular hours. As a matter of personal convenience, however, he takes work to his residence and has furnished one room there as an office in order to have a place where he can work undisturbed.

Since office space is available to him after hours at the company's offices, the expenses attributable to that part of his personal residence which he maintains as an office are, therefore, not ordinary and necessary business expenses and are not deductible.

Example (5). As a condition of his employment, *E*, an outside salesman, is required to do his clerical work on his own time and away from the company office. He does this work at his residence which he rents. He must do this work on a regular basis in order to keep his orders current. He uses the den as an office. The den is also available for family use. He uses the den for business purposes an average of two hours per day. Therefore, two twenty-fourths of the expense allocable to the den is deductible as business expenses. The den is 10 x 15 feet and the total area of the house is 2,000 square feet. Therefore, 7.5 percent (150/2,000) of the expenses is allocable to the den.

E's electric bill for the year was $100 of which $60 is attributable to lighting; $40 is attributable to purely personal uses and is not deductible. *E* spent $285 for oil. Of this amount $250 is attributable to heating his residence; $35 is attributable to purely personal uses and is not deductible.

The allowable deduction from gross income in computing adjusted gross income, for the portion of the expenses attributable to the business use of the den, is computed as follows:

Light	$60.00
Heat	250.00
Rent	2,400.00
Total	$2,710.00
Expenses attributable to the den (7.5% of $2,710.00)	$203.25
Expenses attributable to business use of den (2⅞ of $203.25)	$16.94

Example (*6*). During the course of business each day, *F*, the manager of the sales audit branch of a corporation, is required to submit a daily sales report for the preceding day. Under ordinary circumstances, he has time to finish his report during regular office hours. Occasionally, he is unable to complete the report by the close of business and finds it necessary to work on it after hours. Since the corporation's offices are closed to employees after six o'clock, he takes the report home on these occasions and works on it at a desk in his den.

Since the business use of the den is incidental and occasional rather than regular, the expenses of maintaining his residence which are allocable to the occasional use of the den for business purposes are, therefore, not ordinary and necessary business expenses and are not deductible.

Rev. Rul. 62–194 [1]

So-called "kickback" payments are not deductible by the payer if they are made in violation of a Federal or state law or regulation, or are not otherwise ordinary and necessary business expenses within the meaning of section 162(a) of the Internal Revenue Code of 1954.

The Internal Revenue Service will not follow the decision in the case of *Marlen E. Pew, Jr., et ux.* v. *Commissioner*, T.C. Memorandum Opinion 1961–264, September 20, 1961.

The common kickback situation is where money or property is given to an individual as payment for causing his employer, client, patient, customer, or principal to purchase from, utilize the services of, or otherwise deal with the payer of the kickback. In most cases, the person whose business is being sought or enjoyed by the payer of the kickback is unaware of the payment.

Section 162(a) of the Internal Revenue Code of 1954 provides, in part, "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."

In the case of *Deputy, et al.* v. *du Pont*, 308 U.S. 488 (1940), Ct. D. 1435, C.B. 1940–1, 118, the Supreme Court of the United States held that in order for a business expense to be deductible, for Federal income tax purposes, the expense must be both ordinary and necessary. And in the case of *Tank Truck Rentals, Inc.* v. *Commissioner*, 356 U.S. 30 (1958), Ct. D. 1819, C.B. 1958–1, 502, the Supreme Court stated that a finding of "necessity" cannot be made if allowance of the deduction would frustrate sharply defined National or state policies proscribing particular types of conduct, evidenced by some governmental declaration of them. See, also, *Thomas B. Lilly, et al.* v. *Commissioner*, 343 U.S. 90 (1952), Ct. D. 1741, C.B. 1952–1, 16, and *Boyle, Flagg & Seaman, Inc.* v. *Commissioner*, 25 T.C. 43 (1955). Both of these cases were cited by the Supreme Court in the Tank Truck

[1] Based on Technical Information Release 397, dated September 20, 1962.

Rentals case. The Boyle, Flagg & Seaman case held that kickbacks by an insurance broker of a portion of his insurance commissions to automobile dealers not licensed to sell insurance, for referral of customers, were not deductible because they were paid in violation of the insurance laws of the State of Illinois.

The case of *Dixie Machine Welding & Metal Works, Inc.* v. *United States*, decided by the United States District Court for the Eastern District of Louisiana on June 18, 1962, is an example of a recent application of this principle.

In that case the taxpayer, engaged in the business of repairing ships in the State of Louisiana, paid kickbacks approximating 10 percent of the repair bills to the captains or chief officers of foreign vessels which the taxpayer repaired. The taxpayer contended that such kickbacks were an established and universal practice in the trade, were required to obtain business, and, therefore, constituted ordinary and necessary business expenses, deductible under section 162(a) of the Code.

Under the Commercial Bribery Statute of Louisiana, it is unlawful to give or offer to give anything of value to any private agent, employee, or fiduciary without the knowledge and consent of his principal or employer, with intent to influence the agent's, employee's or fiduciary's action in relation to his principal's or employer's affairs. The court found that the owners of ships repaired by the taxpayer were unaware of the kickbacks and, therefore, the Commercial Bribery Statute of the State had been violated. In holding for the Government and denying the taxpayer a deduction for the kickback, the court said:

* * * But taxpayer is not entitled as a matter of right to a deduction for business expenses and where payments such as these sharply contravene state law by being in specific violation of prohibitory statutes and are also contrary to state policy as defined by the decisions of its highest courts, they cannot be permitted as ordinary and necessary business expenses under provisions of the Internal Revenue Code.

Revenue Ruling 58–479, C.B. 1958–2, 60, holds that, under the circumstances therein, payments by a ship chandler to masters or other personnel of foreign vessels were deductible; however, such payments were made with the knowledge and consent of the shipowners, whereas in the *Dixie Machine Welding & Metal Works, Inc.*, case the payments by the taxpayer were made without the knowledge and consent of the shipowners.

Many Federal laws and regulations make kickbacks illegal under certain circumstances and, therefore, they are not deductible where such statutes or regulations are applicable. For example, taxpayers subject to the Federal Trade Commission Act or the Packers and Stockyards Act may not deduct kickbacks paid unless such payments are normal, usual, and customary in the industry and in the community, are appropriate and helpful in obtaining business, and are made with the knowledge and consent of the customer or prospective customer.

In the case of taxpayers subject to the Packers and Stockyards Act, such payments must also be made without unjust discrimination between the taxpayer's customers. See Revenue Ruling 54–27, C.B. 1954–1, 44.

Kickbacks may not be deductible even though there is no Federal or state law or regulation prohibiting their payment. For example, in Revenue Ruling 58–525, C.B. 1958–2, 63, a kickback was paid to an officer of a savings and loan association for his influence in granting a loan to the taxpayer. The payment was made in a secret manner and the officer was not authorized by the savings and loan association to receive such a payment.

It was held that the payment was not deductible because it was not "ordinary" within the meaning of section 162(a) of the Code. The word "ordinary" has consistently been given the connotation of normal, usual, or customary. The transaction which gives rise to the expense must be of common or frequent occurrence in the type of business involved.

Since the payment was made secretly and its receipt was unauthorized, the Service ruled that it was not normal, usual, and customary in the payer's business and, therefore, was not deductible, for Federal income tax purposes.

In the case of *Marlen E. Pew, Jr., et ux.* v. *Commissioner*, T.C. Memorandum Opinion 1961–264, September 20, 1961, the taxpayer in order to retain one of his clients, padded his bills to the client and kicked back the excess to the client's employee manager. In lieu of claiming a deduction for the kickbacks, the taxpayer omitted them from his gross income. The Tax Court of the United States held that the kickbacks were not properly includible in the gross income of the payer-taxpayer even though they passed through his hands.

Although the Government did not carry through its appeal from the decision of the Tax Court in the *Pew* case, the Service will not follow that decision.

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26 CFR 1.162–5: Expenses for education.

Cost of textbooks and supplies of a cadet at the United States Coast Guard Academy. See Rev. Rul. 62–122, page 12.

Rev. Rul. 62–213

Benefit payments under any law administered by the Veterans' Administration shall be exempt from taxation. See 38 U.S.C. 3101 (1958 Edition). Section 1.162–5 of the Income Tax Regulations provides, in part, that expenditures made by a taxpayer for his education are deductible under certain conditions.

Held, expenses for education, paid or incurred by veterans, which are properly deductible for Federal income tax purposes, are not required to be reduced by the nontaxable payments received during the taxable year from the Veterans' Administration.

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26 CFR 1.162–7: Compensation for personal services.
(Also Section 1032; 1.1032–1.)

Rev. Rul. 62–217

A corporation distributed shares of its treasury stock to its employees as compensation for services rendered. The cost basis of the treasury stock to the corporation was less than its fair market value on the date of the distribution to the employees. In filing its Federal income tax

return for the taxable year, the corporation deducted the fair market value of the stock on the date of the distribution as a business expense.

In accordance with the nonrecognition of gain or loss provisions of section 1032(a) of the Internal Revenue Code of 1954 and section 1.1032–1(a) of the Income Tax Regulations, relating to the receipt by a corporation of money or other property in exchange for its own stock (including a transfer of shares as compensation for services), the corporation did not report gain upon the distribution of treasury stock.

Held, the fair market value of the treasury stock on the date of the distribution is deductible as a business expense in accordance with the provisions of section 162(a) of the Code. The nonrecognition of gain or loss provisions of section 1032(a) of the Code have no effect upon a business expense deduction that is otherwise allowable under section 162(a) of the Code.

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

Rev. Rul. 58–453 Supplement XIV

Revenue Ruling 58–453, C.B. 1958–2, 67, outlines conditions under which fixed mileage or per diem allowances, paid by an employer to his employees while in travel status, will be regarded as being equivalent to an accounting under section 1.162–17(b) of the Income Tax Regulations. Official Government rates for such travel in certain areas outside the United States have been revised.

Revenue Ruling 58–453, supplemented.

STANDARDIZED REGULATIONS (GOVERNMENT CIVILIANS, FOREIGN AREAS)[1]

Maximum Per Diem rates in Lieu of Subsistence for Travelers in Foreign Areas

(The asterisks indicate changes in rates effective as of the date shown at the bottom of the page.)

Locality	*Maximum per diem rates*
Aden	$16
Afghanistan:	
Kabul	16
Other	9
Albania	10
Algeria	15
Angola	13
Argentina	19
Australia:	
Melbourne	17
Sydney	17
Other	13
Austria:	
Vienna	16
Other	13
*Bahamas:	
Andros Island:	
(May 1–Nov. 30, incl.)	25
(Dec. 1–Apr. 30 incl.)	40
Other:	
(Apr. 15–Dec. 14, incl.)	17
(Dec. 15–Apr. 14, incl.)	24
Bahrein Island	$14
Belgium	16
Bermuda	20
Bolivia	13
Brazil:	
Belem	18
Brasilia	18
Rio de Janeiro	18
Sao Paulo	18
Other	13
British Guiana	16
British Honduras	16
Brunei	13
Bulgaria	14
Burma:	
Mandalay	11
Rangoon	19
Other	6
Burundi	9
Cambodia	16
Cameroon	20
Canada	17

*Effective Sept. 1, 1962

[1] Formerly issued as Standardized Government Travel Regulations, Appendix I.

Locality	Maximum per diem rates
Canary Islands	$10
Central African Republic	26
Ceylon:	
Colombo	20
Other	9
Chad, Republic of	28
*Chile	16
China:	
Taipei	16
Other	11
Colombia	16
Congo, Republic of (formerly a part of French Equatorial Africa)	23
Congo, Republic of the (formerly listed under Belgian Congo).	
Katanga Province	20
Other	16
Costa Rica	15
Cuba:	
Havana	17
Other	14
Cyprus	12
Czechoslovakia	12
**Dahomey, Republic of	25
Denmark	14
Dominican Republic:	
Santo Domingo:	
(Apr. 16–Dec. 15 incl.)	22
(Dec. 16–Apr. 15 incl.)	25
Other	11
**Ecuador	14
El Salvador	20
Eritrea	13
Estonia	16
Ethiopia	13
Fiji Islands	16
Finland	20
France:	
Alpes Maritimes Department (including Nice)	15
Fontainebleau	15
Marseilles	15
Seine Department (including Paris)	17
Seine et Oise Department	17
Other	13
French Guiana	13
French Somaliland	24
French West Indies	18
Gabon, Republic of	21
Gambia	17
Germany	13
Ghana:	
Accra	24
Other	15
Gibraltar	7
Great Britain and North Ireland	15
Greece	14

Locality	Maximum per diem rates
Guatemala	$16
Guinea	23
Haiti:	
Cap Haitien	11
Port-au-Prince	16
Other	8
Honduras	15
Hong Kong	16
Hungary	7
Iceland	13
India:	
Bombay	13
Calcutta	15
New Delhi	13
Other	9
**Indonesia	6
Djkarta	22
Other	6
Iran:	
Abadan	20
Khorramshahr	20
Khuzistan Province	15
Tehran	20
Other	11
Iraq:	
Baghdad	18
Other	15
Ireland:	
Dublin	15
Other	12
Israel	16
Italy:	
Florence	15
Genoa	15
Milan (including Vergiate and Gallarate)	18
Naples	15
Palermo	15
Rome	18
Trieste	15
Turin	18
Venice	15
Other	12
Ivory Coast:	
Abidjan	23
Other	18
Japan	14
Jerusalem	16
Jordan	10
Kenya	12
Korea:	
Seoul	16
Other	9
Kuwait	14
Laos	15
Latvia	16
Lebanon	16
Liberia:	
Monrovia	29
Roberts Field	18
Other	8

**Effective Aug. 1, 1962.

Locality	Maximum per diem rates
Libya:	
Benghazi	$16
Tripoli	16
Wheelus Field	9
Other	12
Liechtenstein	12
Lithuania	16
Luxembourg	14
Malagasy Republic (formerly Madagascar)	18
Malaya	14
Mali, Republic of	28
Malta	12
Mauritania	20
Mexico:	
Acapulco	15
Mexico, D.F	15
Other	12
Monaco	15
Morocco	12
Mozambique	10
Nepal	11
Netherlands:	
The Hague	16
Other	14
Netherlands Antilles	24
New Caledonia	14
New Zealand:	
Auckland	14
Wellington	14
Other	12
Nicaragua	18
Niger, Republic of	24
Nigeria:	
Lagos	21
Other	16
North Borneo	13
Norway	15
Pakistan	16
Panama:	
Panama City	17
Other	13
Paraguay	12
Peru:	
Lima	15
Other	10
Philippines:	
Manila	13
Other	9
Poland	16
Portugal:	
Azores	7
Lisbon	16
Madeira Islands	7
Other	12
Portuguese Guinea	10
Qatar	25
Rhodesia and Nyasaland, Federation of	14
Rumania	14
Rwanda	9
Sarawak	16
Saudi Arabia:	
Dhahran	$16
Jidda	18
Riyadh	25
Other	10
Senegal, Republic of	19
Sierra Leone	23
Singapore	18
Society Islands:	
Tahiti	18
Other	9
Somali Republic	11
South Africa, Republic of:	
Cape Town	12
Johannesburg	14
Other	10
Southwest Africa	8
Spain (See also Canary Islands):	
Madrid	13
Other	10
Sudan	15
Surinam	18
Sweden	16
Switzerland	15
Syrian Arab Republic	11
Tanganyika	13
Thailand:	
Bangkok	19
Other	9
Togo:	
Lome	20
Other	9
Trust Territories Pacific Islands	11
Tunisia	16
Turkey:	
Ankara	13
Istanbul	15
Other	9
Uganda	10
Union of Soviet Socialist Republics	18
United Arab Republic:	
Cairo	14
Other	10
*Upper Volta, Republic of	20
Uruguay	15
Venezuela:	
Caracas	23
Maracaibo	23
Other	18
Viet-Nam:	
Saigon-Cholon Area	16
Other	9
West Indies:	
Jamaica:	
(Apr. 16–Dec. 14 incl.)	14
(Dec. 15–Apr. 15 incl.)	18
Trinidad	17
Other:	
(Apr. 16–Dec. 14 incl.)	13
(Dec. 15–Apr. 15 incl.)	18
Yugoslavia	11
Other Foreign Localities	9

*Effective Sept. 1, 1962

SECTION 163.—INTEREST

26 CFR 1.163–1: Interest deduction in general.

Deduction by tenant-stockholders of interest paid by a housing cooperative. See Rev. Rul. 62–178, page 91.

Interest paid by a minister who receives a rental allowance and is buying a home. See Rev. Rul. 62–212, page 41.

SECTION 164.—TAXES

26 CFR 1.164–1: Deduction for taxes. (Also Section 461; 1.461–1.) Rev. Rul. 62–107

> Ad valorem taxes imposed by the State of Oklahoma on real estate and personal property accrue, for Federal income tax purposes, as of January 1, except that taxes on unmanufactured farm products accrue as of May 31.
>
> Revenue Ruling 54–564, C.B. 1954–2, 87, is revoked, and G.C.M. 18828, C.B. 1937–2, 87, reinstated.

In view of the decision of the United States Court of Appeals for the Tenth Circuit in *United States* v. *Oklahoma Natural Gas Company*, 285 Fed. (2d) 333 (1960), reconsideration has been given to Revenue Ruling 54–564, C.B. 1954–2, 87, which modified G.C.M. 18828, C.B. 1937–2, 87, relating to the date on which ad valorem taxes imposed by the State of Oklahoma on real estate and personal property accrue for Federal income tax purposes.

G.C.M. 18828 held, in part, that Oklahoma real and personal property taxes accrue, for Federal income tax purposes, as of January 1, except that taxes on unmanufactured farm products accrue as of May 31. G.C.M. 18828 was modified by Revenue Ruling 54–564 to conform to the decisions in *Noble* v. *Jones*, 45 Fed. Supp. 504 (1942), and *F. A. Gillespie Trust* v. *Commissioner*, 21 T.C. 739 (1954), acquiescence, C.B. 1954–2, 4.

In the *Noble* case, where a taxpayer employing the cash receipts and disbursements method of accounting had acquired Oklahoma real property during the calendar taxable year in issue, the United States District Court for the Western District of Oklahoma held that liability for Oklahoma ad valorem taxes on the real estate arose, under an Oklahoma grantor-grantee statute which applied in the absence of a specific agreement between the parties, on October 15, the date the taxes became due and a lien on the property. Since the taxpayer had acquired the property before that date and since he had paid the taxes in the taxable year in issue, they were deductible by him as taxes paid.

In the *Gillespie Trust* case, where a taxpayer employing the cash receipts and disbursements method of accounting had acquired both real and personal property in Oklahoma during the calendar taxable year in issue, the Tax Court of the United States applied the rule of

the *Noble* case to the real and personal property taxes paid thereon by the taxpayer in the taxable year, notwithstanding the fact that the Oklahoma grantor-grantee statute relates solely to real estate taxes. Under a 1941 revision in the grantor-grantee statute, the lien date had become October 1. In both cases, the fact that a lien attached to the property on a certain date determined whether the respective grantors or grantees were liable for the ad valorem property taxes as such and, therefore, were entitled to deductions for "taxes paid" for Federal income tax purposes.

In the *Oklahoma Natural Gas Company* case, the court held that the proper date of accrual, for Federal income tax purposes, of Oklahoma ad valorem taxes on personal property is the date the owner of such property becomes personally liable for the payment of taxes thereon. Similarly, the court held that the proper date of accrual of Oklahoma ad valorem taxes on real property is the date a charge upon the property in the nature of an *in rem* liability arises. In both instances, the proper date of accrual coincides with the date of assessment, which is January 1 of each year. The personal liability arising on January 1 for the personal property taxes is extinguishable only by payment. The charge upon the real property arising on January 1 continues until the taxes are paid. Although the exact amount of neither the personal property taxes nor the real property taxes is known on January 1, it was held that both are determinable with reasonable accuracy as of that date.

It has been concluded that the *Oklahoma Natural Gas Company* decision will be followed and that the decisions in *Noble* and *Gillespie Trust* will no longer be followed. Accordingly, the prior acquiescence in the latter decision is withdrawn and nonacquiescence is substituted therefor. See page 6, this Bulletin.

In view of the decision in the *Oklahoma Natural Gas Company* case, it is held that the ad valorem taxes imposed by Oklahoma on real estate and personal property accrue, for Federal income tax purposes, as of January 1 of each year, the assessment date of such property provided by section 15.6 of Title 68, Oklahoma Statutes, except that taxes on unmanufactured farm products accrue as of May 31, the assessment date provided for such products by section 15.8 of Title 68.

It should be noted, however, that under section 461(c) of the Internal Revenue Code of 1954, a taxpayer who computes taxable income under an accrual method of accounting may, under prescribed circumstances, elect to accrue real property taxes ratably over the period of time to which such taxes relate. See section 1.461–1(c) of the Income Tax Regulations. Also, under section 164(d) of the Code, applicable to taxable years beginning after December 31, 1953, generally, if real property is sold during any real property tax year, the real property tax shall be treated, for Federal income tax purposes, as tax imposed on the seller and purchaser, respectively, in proportion to the part of such year during which each of them owned the property. See section 1.164–6 of the regulations.

Revenue Ruling 54–564, C.B. 1954–2, 87, is revoked. G.C.M. 18828, C.B. 1937–2, 87, is reinstated with respect to the accrual date of Oklahoma real estate and personal property taxes.

(Also Section 62; 1.62–1.) Rev. Rul. 62–123

The selective retail sales tax imposed by the State of Wisconsin pursuant to section 77.52 of Chapter 77 of the Wisconsin Statutes, effective February 1, 1962, on the privilege of selling, leasing or renting certain tangible personal property at retail in the State on or after February 1, 1962, and on the privilege of selling, performing or furnishing certain services at retail in the State on or after February 1, 1962, is deductible by the vendor of the tangible personal property or services under section 164(a) of the Internal Revenue Code of 1954. If the vendor is an individual, the deduction must be taken in arriving at adjusted gross income. See section 62(1) of the Code. In the case of other vendors, the deduction is allowable in computing taxable income. The selective retail sales tax collected by a vendor from a purchaser must be included in the vendor's gross income for Federal income tax purposes.

Where the selective retail sales tax is paid by the purchaser, otherwise than in connection with his trade or business, it is deductible by the purchaser under section 164(c) of the Code, except in the case of an individual who elects to use the standard deduction or the optional tax table.

Where the selective retail sales tax is paid by a purchaser with respect to property purchased for use in his trade or business, it is deductible by him as a business expense if the cost of the property acquired is properly chargeable to expense. If the purchase is of a capital item used in the trade or business, the tax must be capitalized. Where the purchaser is an individual and the sales tax is deductible as a business expense, the deduction must be taken in arriving at adjusted gross income. See section 62(1) of the Code. In the case of purchasers, other than individuals, engaged in a trade or business, the deduction is allowable as a business expense in computing taxable income, unless the amount thereof is properly chargeable to capital account.

The excise tax imposed by the State of Wisconsin pursuant to section 77.53 of Chapter 77 of the Wisconsin Statutes on the storage, use or other consumption in the State of the tangible personal property and services, described in section 77.52 of the Wisconsin Statutes, purchased from any retailer on or after February 1, 1962, is deductible by the purchaser of the personal property and services under section 164(a) of the Code, except that in the case of an individual who elects to use the standard deduction or the optional tax table, no deduction is allowable under section 164(a) of the Code unless the tax is attributable to a trade or business carried on by him. Where the use tax is attributable to a trade or business carried on by an individual, the amount of such tax is deductible as a tax in computing adjusted gross income. In the case of taxpayers other than individuals engaged in trade or business, the use tax is deductible as a tax in computing taxable income. The amount of use tax collected by a vendor from a purchaser should not be included in the vendor's gross income, and no deduction is allowable to the vendor with respect to the amount of such tax remitted by him to the State of Wisconsin.

Rev. Rul. 62–149

A one percent special tax is imposed by Baltimore County, Maryland, on the transfer "* * * of any estate of inheritance or freehold, or any declaration or limitation of use, or any estate above seven years, in Baltimore County. * * *" This tax is imposed pursuant to the power contained in section 11–51 of the Baltimore County Code 1958. However, the law under which the tax is imposed and the regulations thereunder do not state whether the tax is imposed upon the buyer or upon the seller or upon the landlord or the tenant.

Held, the one percent special tax levied and imposed by Baltimore County by Tax Resolution No. 18 (1960) is a tax within the meaning of section 164(a) of the Internal Revenue Code of 1954 and is deductible by the party to the transaction who pays such tax. However, in the case of an individual who elects to use the standard deduction under section 144 of the Code or the optional tax table under section 3 of the Code, no deduction is allowable unless the tax is attributable to a trade or business carried on by him. Where the tax is so attributable, it is deductible from gross income in computing adjusted gross income. See section 62(1) of the Code.

Deduction of real estate taxes on improvements leased by a cooperative housing corporation. See Rev. Rul. 62–177, page 89.

Deduction of taxes paid by a cooperating housing corporation. See Rev. Rul. 62–178, page 91.

Taxes paid by a minister who receives a rental allowance and who owns or is buying a home. See Rev. Rul. 62–212, page 41.

SECTION 165.—LOSSES

26 CFR 1.165–1: Losses. (Also Section 166; 1.166–1.)

Rev. Rul. 62–197[1]

Deductibility of losses sustained by reason of the confiscation by the Cuban Government of property in Cuba owned by United States citizens or domestic corporations.

Advice has been requested concerning the position of the Internal Revenue Service regarding the income tax treatment under the Internal Revenue Code of 1954 of confiscation by the Cuban Government of properties in Cuba owned by United States citizens or domestic corporations. The following situations illustrate some of the problems encountered:

(1) Taxpayer, a United States citizen, owned a home located in Cuba which was used solely as his personal residence. The home was furnished and contained personal items such as furniture,

[1] Also released as Technical Information Release 408, dated November 7, 1962.

jewelry, and clothing. Taxpayer also owned and kept in Cuba an automobile used solely for personal purposes and had substantial amounts of money and numerous items of jewelry in a safe deposit box in a bank in Cuba. Taxpayer learned that the home and its contents, the automobile, and the contents of the safe deposit box had been seized by the Cuban Government.

(2) Taxpayer, a United States citizen, owned as capital assets securities in a corporation operating exclusively in Cuba and whose corporate assets (all of which are in Cuba) were seized by the Cuban Government.

(3) Taxpayer, a United States citizen, owned two farms in Cuba both held by him for more than six months and operated solely for profit. One was operated for him by a resident manager, the other being rented on a yearly basis. Both properties were intervened in by Cuban officials, resulting in the eviction of his resident manager and the cessation of all payments to him of rents and profits.

(4) Taxpayer, a United States citizen, was the owner of a retail store in Cuba at the time the present government came into power. The business was intervened in during 1959 by officials of the Cuban Government who took over the management of the store, and the taxpayer has since that time received no return from his investment therein. The assets of the business were expropriated by decree in 1960. The property taken included inventory and accounts receivable, both previously reflected in gross income, as well as other property such as real estate, furniture and fixtures, and vehicles. The taxpayer had no other gains or losses arising from sales or other dispositions of property in 1959 or 1960. The taxpayer employed the specific charge-off method with respect to bad debts.

(5) *X*, a domestic corporation, owned a sugar plantation with a mill, storage buildings and dwellings for the managers and some of the workers. The Cuban Government seized such properties, including harvested crops (previously reported as inventory) and bank accounts, promising payment to the owner in bonds payable out of a fund related to future purchases of sugar by the United States. During the year of seizure, the corporation had sold at a profit a tract of land used in its trade or business and had no other gains or losses arising from sales or other dispositions of property used in its trade or business.

(6) *T* corporation is a domestic corporation which owns 90 percent of the stock of its subsidiary operating in Cuba. All of the assets of the subsidiary are in Cuba and all have been seized by intervention by the Cuban Government.

(7) *M*, a domestic corporation, has been filing, for a number of years, consolidated returns with its 100-percent-owned domestic subsidiary, *N* corporation, which had 85 percent of its assets in Cuba until the expropriation of such assets by the Cuban Government in 1960. For 1960, *N* corporation had a net operating loss of $8 million and *M* corporation had a $3 million profit.

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(8) *R*, a domestic corporation, owned for several years 100 percent of *S* corporation, a domestic subsidiary which operated in Cuba until the expropriation of its Cuban assets in 1959, at which time it also had non-Cuban assets which rendered it solvent. *R* corporation liquidated *S* corporation pursuant to the provisions of section 332 of the Code and the Income Tax Regulations thereunder.

(9) *Y*, a domestic corporation, owned for several years 100 percent of *Z*, a foreign corporation which for past years has been engaged in business within the United States and which had also conducted business in Cuba until the expropriation of its Cuban assets in 1960. At the time of the exportation of its assets, Z corporation had unused net operating losses attributable to its United States business as well as losses incurred in its Cuban business. Assuming that the requirements of section 367 of the Code were considered satisfied (in view of all other facts and circumstances involved) in an advance ruling issued by the Internal Revenue Service, *Y* corporation liquidated *Z* corporation pursuant to the provisions of section 332 of the Code.

Section 165(a) of the Code provides for the deductibility of losses sustained by taxpayers which are not compensated for by insurance or otherwise. Under section 165(c), losses in the case of an individual are limited to (1) losses incurred in a trade or business, (2) losses incurred in any transaction entered into for profit, though not connected with a trade or business, and (3) losses of property not connected with a trade or business if such losses arise from fire, storm, shipwreck, or other casualty, or from theft. Under section 641(b) of the Code, the same limitation applies to losses of an estate or trust.

Losses sustained through confiscation or seizure of property under the authority of laws of a foreign country are not casualty or theft losses within the meaning of section 165(c)(3) of the Code. See I.T. 4086, C.B. 1952–1, 29, and *William J. Powers* v. *Commissioner*, 36 T.C. 1191 (1961).

Section 165(g) of the Code provides the general rule that a loss on any security (as defined in such subsection) which becomes worthless during the taxable year and which is a capital asset is treated as a loss from the sale or exchange, on the last day of the taxable year, of a capital asset. Subsection (g) further provides that any security in a corporation affiliated (as defined in such subsection) with a domestic corporation is not treated as a capital asset for this purpose if the 95 percent of stock ownership and 90 percent of gross receipts tests stated therein are met.

Section 166 of the Code provides for the deductibility of certain losses arising from bad debts which become worthless during the taxable year. A deduction is allowed for any business debt which becomes totally or partially worthless and, in the case where it has become partially worthless, to the extent it is not recoverable and is charged off during such taxable year. Such deductions are not allowable where the taxpayer employs a reserve for bad debts. A nonbusiness bad debt is deductible by a taxpayer other than a corporation only if it becomes totally worthless during the taxable year, in which event

it is considered a loss from the sale or exchange, during the taxable year, of a capital asset held for not more than six months.

The basis for determining the amount of the deduction under section 165 or 166 of the Code is the adjusted basis provided in section 1011 of the Code for determining the loss from the sale or other disposition of property.

Pursuant to the provisions of section 873(a) of the Code, nonresident alien individuals are not allowed deductions under sections 165 and 166 of the Code where such deductions are not connected with income from United States sources. The same rule applies under section 882(c)(2) of the Code to foreign corporations.

The Internal Revenue Service recognizes that the Cuban Government has taken discriminatory and arbitrary action against the property in Cuba of United States citizens and corporations, including the taking of such property without any realistic effort to provide for prompt and adequate compensation for such taking. The taking of property without compensation is confiscation. It is no less confiscation because there may be an expressed intent to pay at some time in the future. See 3 Hackworth, *Digest of International Law* (1942) 656.

Section 1.165–1(b) of the regulations provides that to be allowable as a deduction under section 165(a) of the Code, a loss must be evidenced by closed and completed transactions, fixed by identifiable events, and actually sustained during the taxable year. Only a bona fide loss is allowable. Substance and not mere form shall govern in determining a deductible loss.

Based on the foregoing, it is the position of the Service that acts of confiscation, whether by way of seizure, intervention in, expropriation, or similar taking of property, by the Cuban Government constitute identifiable events which, in the light of all of the circumstances, have resulted in closed and completed transactions notwithstanding promise of indemnification. An act of confiscation has occurred when the taxpayer has been deprived of ownership of property or the normal attributes of ownership, such as receipt of income and control over the operation or use of the property, with little or no chance of being compensated therefor.

In determining when a loss through confiscation has been sustained for Federal income tax purposes, the Service will recognize as the identifiable event evidencing a closed and completed transaction whichever of the acts of confiscation occur first. The burden of proof is upon the taxpayer to establish by whatever evidence is available the occurrence of the act and the date thereof to support a deduction for a loss. An officially published expropriation decree (or similar document) will in general be considered prima facie evidence of Cuban confiscation as of the date of the decree. Naturally, all other evidence which is available to the taxpayer or the Service will be used, to the extent material, in establishing loss and the date thereof.

In situations in which there has been seizure, intervention in, or similar taking of property by Cuban officials followed by expropriation evidenced by an officially published expropriation decree (or similar document), the loss will be considered to have been sustained at the time of the seizure, intervention, or taking rather than at the later date of the decree, provided that there is evidence sufficient to establish

that the confiscation took place on the date of seizure, intervention, or taking. In situations in which there is not sufficient evidence to establish that the confiscation took place at a date prior to the date of the officially published expropriation decree (or similar document), the date of the decree will be considered as the date of loss. In situations in which there has been no officially published expropriation decree (or similar document), the date of loss may be established by whatever evidence is available, including evidence of a circumstantial nature.

Applying the foregoing principles to the factual situations presented above, the following represent the position of the Service:

(1) No deduction is allowable for the loss of the personal residence, furnishings, jewelry, clothing and other personal items therein, the automobile, and the money and jewelry in the safe deposit box, since the losses were not incurred in the conduct of a trade or business or incurred in any transaction for profit within the meaning of section 165(c) (1) or (2) of the Code, and do not constitute casualty or theft losses within the meaning of section 165(c)(3).

(2) Under section 165(g) of the Code, the taxpayer has a worthless security loss which is treated as a loss from the sale or exchange on the last day of the taxable year of a capital asset. It is to be noted that if, for example, a domestic corporation had assets outside Cuba (including potential United States tax refund claims resulting from the operation of section 172 or other sections of the Code) which exceeded its liabilities (other than liabilities from which the corporation has been relieved as a result of actions of the Cuban Government), the securities would not be considered worthless for the purposes of section 165(g).

(3) The intervention in both farms gives rise to allowable losses under section 165(c)(1) of the Code, which losses are treated in accordance with the provisions of section 1231 of the Code. Section 1231(a) requires the aggregating of all recognized gains and losses on sales, exchanges, and involuntary conversions of property used in the trade or business (as defined in section 1231(b)) and the recognized gains and losses from involuntary conversions of capital assets held for more than six months. Any resulting gains are considered gains from sales or exchanges of capital assets held for more than six months, but any resulting losses are not considered losses from sales or exchanges of such capital assets. Accordingly, the taxpayer's losses will constitute ordinary losses to the extent they, together with other section 1231 losses, exceed taxpayer's section 1231 gains. It is to be noted that section 1231 would be inapplicable if the farms were held for six months or less.

(4) The taxpayer has sustained losses in 1959 in respect of the enumerated assets. Such losses are deductible as ordinary losses under the provisions of section 165(c)(1) of the Code and in accordance with the provisions of section 1231 of the Code with the exception of the loss on accounts receivable, which is deductible under section 166(a) of the Code.

(5) The seizure by the Cuban Government in this instance constitutes an identifiable event and is a closed and completed trans-

action establishing the existence of a loss, for Federal income tax purposes, notwithstanding the promise of eventual payment in Cuban bonds. Such loss is deductible under section 165(a) of the Code and, to the extent that the loss exceeds the gain derived from the sale of the tract of land, it is treated as an ordinary loss under section 1231(a) of the Code.

(6) Under section 165(g) of the Code, *T* corporation has a worthless security loss which is treated as a loss from the sale or exchange, on the last day of the taxable year, of a capital asset. (It is assumed that the subsidiary does not have a potential tax refund claim for any year.) It is to be noted that if *T* corporation owned 95 percent or more of each class of the outstanding stock of the subsidiary, and the 90 percent gross receipts test of section 165(g)(3)(B) had been met, *T* corporation would have sustained an ordinary loss under section 165(g)(3).

(7) Pursuant to sections 172 and 1502 of the Code and the regulations thereunder, the consolidated net operating loss of $5 million may be carried back to 1957 and to the extent unused to 1958 and 1959; additionally, any of such loss remaining unused may be carried forward to the five succeeding taxable years, 1961 through 1965, inclusive, assuming *N* corporation remains a member of the affiliated group for such period.

(8) *R* corporation may utilize the unused net operating loss of *S* corporation to the extent provided for under the provisions of section 381 (a) and (c)(1) of the Code and the regulations thereunder.

(9) *Z* corporation's net operating loss attributable to its United States income may be carried over to *Y* corporation to the extent provided for under section 381 of the Code and the regulations thereunder (especially section 1.381(a)–1(c)). The net operating loss of *Z* corporation attributable to its Cuban income cannot be carried over to *Y* corporation pursuant to section 882 of the Code and the regulations thereunder.

If *Z* corporation were a nonresident foreign corporation, no net operating loss carryover would be allowed in any event, since under section 1.882–3(a)(1) of the regulations *Z* corporation would not be permitted any loss deductions and consequently would have no loss deductions to be carried over.

In any of the foregoing situations in which losses are allowed, it is assumed that the assets did not represent and were not purchased with unreported taxable income, as might have been the case, for example, if such income had been blocked and the taxpayer had elected to defer the reporting of blocked currency income. For the tax consequences of losses in respect to such blocked currency income, see Mim. 6475, C.B. 1950–1, 50.

Any recoveries by taxpayers taking deductions for losses resulting from actions of the Cuban Government will constitute income in the year of recovery, except as provided in section 111 of the Code and the regulations thereunder where the taxpayers did not obtain tax benefits from the deductions. See also section 1033 of the Code and the regulations thereunder, relating to involuntary conversion of property into similar property.

SECTION 166.—BAD DEBTS

26 CFR 1.166-1: Bad debts.

Confiscation of property in Cuba by the Government of Cuba. See Rev. Rul. 62–197, page 66.

Rev. Rul. 62–214 [1]

The Internal Revenue Service will not follow the decision of the United States Court of Appeals for the Ninth Circuit in *Wilkins Pontiac* v. *Commissioner*, 298 Fed. (2d) 893 (1961), which reversed the decision of the Tax Court of the United States, 34 T.C. 1065 (1960).

In that case the taxpayer sold conditional sales contracts for automobiles to a finance company under a guaranty contract requiring the taxpayer to pay any amounts not paid by the purchasers to the finance company. The question involved is whether the taxpayer is entitled to deduct an addition to a reserve for bad debts, with respect to the losses which may occur as a result of the guaranty, from the taxpayer's gross income under section 166(c) of the Internal Revenue Code of 1954, relating to reserves for bad debts.

The position of the Service is that under section 166(c) of the Code and section 1.166–1 (a) and (c) of the Income Tax Regulations, a deduction for an addition to a reserve for bad debts must be based on bona fide debts presently owing to the taxpayer and arising from a debtor-creditor relationship then existing between the taxpayer and the debtor.

The reviewing court in the *Wilkins Pontiac* case interpreted the decision in *Max Putnam et ux* v. *Commissioner*, 352 U.S. 82 (1956), Ct. D. 1800, C.B. 1957–1, 501, to hold that under the above-described arrangement the taxpayer's obligation presently exposes it to a risk of future loss which is described in section 166(a) of the Code and that it, therefore, should be able to take a deduction under section 166(c) of the Code.

It is the view of the Service that the decision of the Ninth Circuit cannot be reconciled with section 166 of the Code, section 1.166–1 (a) and (c) of the regulations, or the decision in the *Putnam* case.

Although there was no basis for requesting certiorari of the Supreme Court of the United States in this case and certiorari was not applied for, the decision will not be followed by the Service as a precedent in the disposition of similar cases pending further judicial test of the Treasury Regulations.

SECTION 167.—DEPRECIATION

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

Television films and tapes produced by a taxpayer and leased for a period prior to sale for television exhibition. See Rev. Rul. 62–141, page 182.

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[1] Based on Technical Information Release 410, dated November 14, 1962.

Deduction by employees of expenses attributable to the use of a personal residence in the performance of their duties. See Rev. Rul. 62–180, page 52.

New guidelines for depreciation have been completed. See Rev. Proc. 62–21, page 418.

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26 CFR 1.167(g)–1: Life tenants and beneficiaries of trusts and estates. — Rev. Rul. 62–132 [1]

The Internal Revenue Service will follow the decision of the United States Court of Appeals for the Sixth Circuit in *Commissioner* v. *William N. Fry, Jr., et al.*, 283 Fed. (2d) 869 (1960), and the decision of the United States Court of Appeals for the Seventh Circuit in *Laird Bell* v. *Harrison, et al.*, 212 Fed. (2d) 253 (1954).

These cases hold that a remainderman of a trust, the corpus of which consists of corporate stock, who purchases the interest of a life beneficiary of the trust, is entitled to recover his cost through amortization over the period of the beneficiary's life expectancy, by ratable annual deductions.

The Service had argued that the purchased life interest became merged with the remainder interest, with the result that the cost of the purchased life interest could be recouped only at the time of the sale or other disposition of the stock.

The Service noted that the transactions in these cases appeared to be bona fide and without a tax avoidance motive. These cases will be followed in the disposition of other cases in which the facts are substantially the same.

SECTION 170.—CHARITABLE ETC., CONTRIBUTIONS AND GIFTS

26 CFR 1.170: Statutory provisions; charitable etc., contributions and gifts. — T. D. 6605 [2]

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

Amendment of the Income Tax Regulations under section 170 of the Internal Revenue Code of 1954 to conform to the Act of August 7, 1956, and sections 10, 11, and 12 of the Technical Amendments Act of 1958, and to make certain other changes.

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

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

On February 28, 1962, notice of proposed rulemaking with respect to the amendment of the Income Tax Regulations (26 CFR Part 1) under section 170 of the Internal Revenue Code of 1954 (relating to

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[1] Based on Technical Information Release 392, dated July 16, 1962.
[2] 27 F.R. 8093.

charitable, etc., contributions and gifts) to conform the regulations to changes made by the Act of August 7, 1956 (Pub. Law 1022, 84th Cong., 70 Stat. 1117 [C.B. 1956–2, 1207]), and sections 10, 11, and 12 of the Technical Amendments Act of 1958 (72 Stat. 1609, 1610 [C.B. 1958–3, 254]), and to make certain clarifying changes therein was published in the Federal Register (27 F.R. 1901). No objection to the rules proposed having been received during the 30-day period prescribed in the notice, the amendment of the regulations as proposed is hereby adopted.

PARAGRAPH 1. Section 1.170 is amended by revising section 170(b) and the historical note. As amended, § 1.170 reads as follows:

§ 1.170 STATUTORY PROVISIONS: CHARITABLE, ETC., CONTRIBUTIONS AND GIFTS.

SEC. 170. CHARITABLE, ETC., CONTRIBUTIONS AND GIFTS. * * *

(b) LIMITATIONS.—

(1) INDIVIDUALS.—In the case of an individual the deduction provided in subsection (a) shall be limited as provided in subparagraphs (A), (B), (C), and (D).

(A) SPECIAL RULE.—Any charitable contribution to—

(i) A church or a convention or association of churches,

(ii) An educational organization referred to in section 503(b)(2), or

(iii) A hospital referred to in section 503(b)(5), or to a medical research organization (referred to in section 503(b)(5)) directly engaged in the continuous active conduct of medical research in conjunction with a hospital, if during the calendar year in which the contribution is made such organization is committed to spend such contributions for such research before January 1 of the fifth calendar year which begins after the date such contribution is made,

shall be allowed to the extent that the aggregate of such contributions does not exceed 10 percent of the taxpayer's adjusted gross income computed without regard to any net operating loss carryback to the taxable year under section 172.

(B) GENERAL LIMITATION.—The total deductions under subsection (a) for any taxable year shall not exceed 20 percent of the taxpayer's adjusted gross income computed without regard to any net operating loss carryback to the taxable year under section 172. For purposes of this subparagraph, the deduction under subsection (a) shall be computed without regard to any deduction allowed under subparagraph (A) but shall take into account any charitable contributions to the organizations described in clauses (i), (ii), and (iii) which are in excess of the amount allowable as a deduction under subparagraph (A).

(C) UNLIMITED DEDUCTIONS FOR CERTAIN INDIVIDUALS.—The limitation in subparagraph (B) shall not apply in the case of an individual if, in the taxable year and in 8 of the 10 preceding taxable years, the amount of the charitable contributions, plus the amount of income tax (determined without regard to chapter 2, relating to tax on self-employment income) paid during such year in respect of such year or preceding taxable years, exceeds 90 percent of the taxpayer's taxable income for such year, computed without regard to—

(i) This section,

(ii) Section 151 (allowance of deductions for personal exemptions), and

(iii) Any net operating loss carryback to the taxable year under section 172.

In lieu of the amount of income tax paid during any such year, there may be substituted for that year the amount of income tax paid in respect of such year, provided that any

amount so included in the year in respect of which payment was made shall not be included in any other year.

(D) DENIAL OF DEDUCTION IN CASE OF CERTAIN TRANSFERS IN TRUST.—No deduction shall be allowed under this section for the value of any interest in property transferred after March 9, 1954, to a trust if—

(i) The grantor has a reversionary interest in the corpus or income of that portion of the trust with respect to which a deduction would (but for this subparagraph) be allowable under this section; and

(ii) At the time of the transfer the value of such reversionary interest exceeds 5 percent of the value of the property constituting such portion of the trust.

For purposes of this subparagraph, a power exercisable by the grantor or a nonadverse party (within the meaning of section 672(b)), or both, to revest in the grantor property or income therefrom shall be treated as a reversionary interest.

(2) CORPORATIONS.—In the case of a corporation, the total deductions under subsection (a) for any taxable year shall not exceed 5 percent of the taxpayer's taxable income computed without regard to—

(A) This section,

(B) Part VIII (except section 248),

(C) Any net operating loss carryback to the taxable year under section 172, and

(D) Section 922 (special deduction for Western Hemisphere trade corporations).

Any contribution made by a corporation in a taxable year to which this section applies in excess of the amount deductible in such year under the foregoing limitation shall be deductible in each of the two succeeding taxable years in order of time, but only to the extent of the lesser of the two following amounts: (i) the excess of the maximum amount deductible for such succeeding taxable year under the foregoing limitation over the contributions made in such year; and (ii) in the case of the first succeeding taxable year the amount of such excess contribution, and in the case of the second succeeding taxable year the portion of such excess contribution not deductible in the first succeeding taxable year.

(3) SPECIAL RULE FOR CORPORATIONS HAVING NET OPERATING LOSS CARRYOVERS.—In applying the second sentence of paragraph (2) of this subsection, the excess of—

(A) The contributions made by a corporation in a taxable year to which this section applies, over

(B) The amount deductible in such year under the limitation in the first sentence of such paragraph (2),

shall be reduced to the extent that such excess reduces taxable income (as computed for purposes of the second sentence of section 172(b)(2)) and increases a net operating loss carryover under section 172 to a succeeding taxable year.

(4) REDUCTION FOR CERTAIN INTEREST.—If, in connection with any charitable contribution, a liability is assumed by the recipient or by any other person, or if a charitable contribution is of property which is subject to a liability, then, to the extent necessary to avoid the duplication of amounts, the amount taken into account for purposes of this section as the amount of the charitable contribution—

(A) Shall be reduced for interest (i) which has been paid (or is to be paid) by the taxpayer, (ii) which is attributable to the liability, and (iii) which is attributable to any period after the making of the contribution, and

(B) In the case of a bond, shall be further reduced for interest (i) which has been paid (or is to be paid) by the taxpayer on indebtedness incurred or continued to purchase or carry such bond, and (ii) which is attributable to any period before the making of the contribution.

The reduction pursuant to subparagraph (B) shall not exceed the

interest (including interest equivalent) on the bond which is attributable to any period before the making of the contribution and which is not (under the taxpayer's method of accounting) includible in the gross income of the taxpayer for any taxable year. For purposes of this paragraph, the term "bond" means any bond, debenture, note, or certificate or other evidence of indebtedness,

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[Sec. 170 as amended by sec. 1, Act of Aug. 7, 1956 (Pub. Law 1022, 84th Cong., 70 Stat. 1117 [C.B. 1956–2, 1207]) and sec. 10, 11, and 12, Technical Amendments Act 1958 (Pub. Law 85–866, 72 Stat. 1609–1610 [C.B. 1958–3, 254])]

PAR. 2. Section 1.170–1 is amended by revising paragraphs (b) and (c) thereof to read as follows:

§ 1.170–1 CHARITABLE, ETC., CONTRIBUTIONS AND GIFTS; ALLOWANCE OF DEDUCTION.

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(b) *Time of making contribution.*—Ordinarily a contribution is made at the time delivery is effected. In the case of a check, the unconditional delivery (or mailing) of a check which subsequently clears in due course will constitute an effective contribution on the date of delivery (or mailing). If a taxpayer unconditionally delivers (or mails) a properly endorsed stock certificate to a charitable donee or the donee's agent, the gift is completed on the date of delivery (or mailing, provided that such certificate is received in the ordinary course of the mails). If the donor delivers the certificate to his bank or broker as the donor's agent, or to the issuing corporation or its agent, for transfer into the name of the donee, the gift is completed on the date the stock is transferred on the books of the corporation.

(c) *Contribution in property.*—(1) *General rules.*—If a contribution is made in property other than money, the amount of the deduction is determined by the fair market value of the property at the time of the contribution. The fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts. If the contribution is made in property of a type which the taxpayer sells in the course of his business, the fair market value is the price which the taxpayer would have received if he had sold the contributed property in the lowest usual market in which he customarily sells, at the time and place of the contribution (and in the case of a contribution of goods in quantity, in the quantity contributed). The usual market of a manufacturer or other producer consists of the wholesalers or other distributors to or through whom he customarily sells, unless he sells only at retail in which event it is his retail customers. If a donor makes a charitable contribution of, for example, stock in trade at a time when he could not reasonably have been expected to realize its usual selling price, the value of the gift is not the usual selling price but is the amount for which the quantity of merchandise contributed would have been sold by the donor at the time of the contribution. Costs and expenses incurred in the year of contribution in producing or acquiring the contributed property are not deductible and are not a part of the cost of goods sold. Similarly, to the extent that costs and expenses incurred in a prior taxable year in producing or acquiring the contributed property are reflected in the cost of goods sold in the year of contribution, cost of goods sold must be reduced by such costs and expenses. Transfers of property to an organization described in section 170(c) which bear a direct relationship to the taxpayer's business and which are made with a reasonable expectation of financial return commensurate with the amount of the transfer may constitute allowable deductions as trade or business expenses rather than as charitable contributions. See section 162 and the regulations thereunder.

(2) *Reduction for certain interest.*—(i) With respect to charitable contributions made after December 31, 1957, section 170(b)(4) requires that the amount of the charitable deduction be reduced for certain interest to the extent necessary to avoid the deduction of the same amount both as an interest deduction under section 163 and as a deduction for charitable contributions under section 170. The reduction is to be determined in accordance with subdivisions (ii) and (iii) of this subparagraph.

(ii) With respect to charitable contributions made after December 31, 1957, in determining the amount to be taken into account as a charitable contribution for purposes of section 170, the amount determined without regard to section 170(b)(4) or this subparagraph shall be reduced by the amount of interest which has been paid (or is to be paid) by the taxpayer, which is attributable to any liability connected with the contribution, and which is attributable to any period of time after the making of the contribution. The deduction otherwise allowable for charitable contributions under section 170 is required to be reduced pursuant to section 170(b)(4) only if, in connection with a charitable contribution, a liability is assumed by the recipient of the contribution or by any other person, or if the charitable contribution is of property which is subject to a liability. Thus, if the contribution is made in property and the transfer is conditioned upon the assumption of a liability by the donee or by some other person, any interest paid (or to be paid) by the taxpayer, attributable to the liability, and with respect to a period after the making of the contribution, will serve to reduce the amount that may be taken into account as a charitable contribution for purposes of section 170. The adjustment referred to in this subdivision must also be made where the contributed property is subject to a liability and the value of the property reflects the payment by the donor of interest with respect to a period of time after the making of the contribution.

(iii) If, in connection with the charitable contribution, after December 31, 1957, of a bond, a liability is assumed by the recipient or by any other person, or if the bond is subject to a liability, then, in determining the amount to be taken into account as a charitable contribution under section 170, the amount determined without regard to section 170(b)(4) or this subparagraph shall, without regard to whether any reduction may be required by subdivision (ii) of this subparagraph, also be reduced for interest which has been paid (or is to be paid) by the taxpayer on indebtedness incurred or continued to purchase or carry such bond, and which is attributable to any period before the making of the contribution. However, the reduction referred to in this subdivision shall be made only to the extent that such reduction does not exceed the interest (including bond discount and other interest equivalent) receivable on the bond, and attributable to any period before the making of the contribution which is not, by reason of the taxpayer's method of accounting, includible in the taxpayer's gross income for any taxable year. For purposes of section 170(b)(4) and this subdivision the term "bond" means any bond, debenture, note, or certificate or other evidence of indebtedness.

(iv) The provisions of this subparagraph may be illustrated by the following examples:

Example (1). A, an individual using the cash receipts and disbursements method of accounting, on January 1, 1960, contributed to a charitable organization real estate having a fair market value of $10,000. In connection with the contribution the charitable organization assumed an indebtedness of $8,000 which A had incurred. A has prepaid two years' interest on that indebtedness (for 1960 and 1961) amounting to $960, and has taken an interest deduction of $960 for such amount. The amount of the gift, determined without regard to this subparagraph, is $2,960 ($10,000 less $8,000, the outstanding indebtedness, plus $960, the amount of prepaid interest). In determining the amount of the deduction for charitable contributions, the value of the gift ($2,960) must be reduced by $960 to eliminate from the computation of such deduction that portion thereof for which A has been allowed an interest deduction.

Example (2). On January 1, 1960, B, an individual using the cash receipts and disbursements method of accounting, purchased for $9,600 a 5½ percent $10,000, 20-year M Corporation bond, the interest on which was payable semiannually on June 30 and December 31. The M Corporation had issued the bond on January 1, 1950, at a discount of $720 from the principal amount. On December 1, 1960, B donated the bond to a charitable organization, and, in connection with the contribution, the charitable organization assumed an indebtedness of $7,000 which B had incurred to purchase and carry the bond. During the calendar year 1960 B paid accrued interest of $330 on the indebtedness for the period from January 1 to December 1, 1960, and has taken an interest deduction of $330 for such amount. No portion of the bond discount of $36 a year ($720 divided by 20 years) has been included in B's income, and of the $550 of annual interest receivable on the bond, he included in income only the June 30 payment of $275. The market value of the bond on the date of the contribution

was $9,902. Such value reflects a proportionate part of the original bond discount ($9,280 plus $393, or $9,673) and of interest receivable of $229 which had accrued from July 1 to December 1, 1960. The amount of the charitable contribution determined without regard to this subparagraph is $2,902 ($9,902, the value of the property on the date of gift, less $7,000, the amount of the liability assumed by the charitable organization). In determining the amount of the allowable deduction for charitable contributions, the value of the gift ($2,902) must be reduced to eliminate from the deduction that portion thereof for which B has been allowed an interest deduction. Although the amount of such interest deduction was $330, the reduction required by this subparagraph is limited to $262, since the reduction is not in excess of the amount of interest income on the bond ($229 of accrued interest plus $33, the amount of bond discount attributable to the eleven-month period B held the bond).

PAR. 3. Section 1.170–2 is amended by revising subparagraph (1) of paragraph (a), by revising subparagraphs (1) and (4) of paragraph (b), and by revising subparagraph (1) and subdivisions (i) and (ii) of subparagraph (2) of paragraph (c). As amended, § 1.170–2 reads as follows:

§ 1.170–2 CHARITABLE DEDUCTIONS BY INDIVIDUALS; LIMITATIONS.—(a) *In general.*—(1) A deduction is allowable to an individual under section 170 only for charitable contributions actually paid during the taxable year, regardless of when pledged and regardless of the method of accounting employed by the taxpayer in keeping his books and records. A contribution to an organization described in section 170(c) is deductible even though some portion of the funds of the organization may be used in foreign countries for charitable or educational purposes. The deduction by an individual for charitable contributions under section 170 is limited generally to 20 percent of the taxpayer's adjusted gross income (computed without regard to any net operating loss carryback to the taxable year under section 172). If a husband and wife make a joint return, the deduction for contributions is the aggregate of the contributions made by the spouses, and the limitation in section 170(b) is based on the aggregate adjusted gross income of the spouses. The 20-percent limitation applies to amounts contributed during the taxable year "to or for the use of" those recipients described in section 170(c). The limitation is computed without regard to contributions qualifying for the additional 10-percent deduction. For examples of the application of the 10 and 20-percent limitation, see paragraph (b)(5) of this section. For special rules reducing amount of certain charitable deductions, see paragraph (c)(2) of § 1.170–1.

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(b) *Additional 10 percent deduction.*—(1) *In general.*—In addition to the deduction which may be allowed for contributions subject to the general 20-percent limitation, an individual may deduct charitable contributions made during the taxable year to the organizations specified in section 170(b)(1)(A) to the extent that such contributions in the aggregate do not exceed 10 percent of his adjusted gross income (computed without regard to any net operating loss carryback to the taxable year under section 172). The additional 10-percent deduction may be allowed with respect to contributions to—

(i) A church or a convention or association of churches,

(ii) An educational organization referred to in section 503(b)(2) and defined in subparagraph (3) of this paragraph,

(iii) A hospital defined in subparagraph (4)(i) of this paragraph, and

(iv) Subject to certain conditions and limitations set forth in subparagraph (4)(ii) of this paragraph, and for taxable years beginning after December 31, 1955, a medical research organization referred to in section 503(b)(5).

To qualify for the additional 10-percent deduction the contribution must be made "to", and not merely "for the use of", one of the specified organizations. A contribution made to a trust, community chest, or other organization referred to in section 170(c), which in turn makes the contribution available to a church, school, hospital, or medical research organization, will not qualify under the 10-percent limitation unless such trust, community chest, or other organization acts merely as an agent of the taxpayer in delivering the contribution. The computation of this additional deduction is not necessary unless the total contributions paid during the taxable year are in excess of the general 20-percent

limitation. Where the total contributions exceed the 20-percent limitation, the taxpayer should first ascertain the amount of charitable contributions subject to the 10-percent limitation, and any excess over the 10-percent limitation should then be added to all other contributions and limited by the 20-percent limitation.

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(4) *Hospital and medical research organization.*—(i) *Hospital.*—The term "hospital", as used in section 170(b)(1)(A), means an organization the principal purposes or functions of which are the providing of hospital or medical care. The term includes Federal and State hospitals otherwise coming within the definition but does not include medical education organizations, or medical research organizations. See, however, subdivision (ii) of this subparagraph, relating to contributions to certain medical research organizations for taxable years beginning after December 31, 1955. A rehabilitation institution or an outpatient clinic may qualify as a hospital if its principal purposes or functions are the providing of hospital or medical care. The term "hospital" does not include convalescent homes or homes for children or the aged, nor does the term include institutions whose principal purposes or functions are to train handicapped individuals to pursue some vocation.

(ii) *Certain medical research organizations.*—(*a*) For taxable years beginning after December 31, 1955, certain charitable contributions made to certain medical research organizations may be taken into account in computing the additional 10-percent limitation. To be so taken into account the charitable contribution must be made to a medical research organization that is directly engaged in the continuous active conduct of medical research in conjunction with a hospital (as defined in subdivision (i) of this subparagraph), and, during the calendar year in which the contribution is made, the organization must be committed to spend the contribution for such active conduct of medical research before January 1 of the fifth calendar year beginning after the date the contribution is made.

(*b*) As used in section 170(b)(1)(A) and this subparagraph, the term "medical research organization" means an organization the principal purpose or function of which is to engage in medical research. Medical research may be defined as the conduct of investigations, experiments, and studies to discover, develop, or verify knowledge relating to the causes, diagnosis, treatment, prevention, or control of physical or mental diseases and impairments of man. To qualify as a medical research organization, the organization must have the appropriate equipment and professional personnel necessary to carry out its principal function.

(*c*) The organization must, at the time of the contribution, be directly engaged in the continuous active conduct of medical research in conjunction with a hospital described in subdivision (i) of this subparagraph. The organization need not be formally affiliated with a hospital to be considered engaged in the active conduct of medical research in conjunction with a hospital, but it must be physically connected, or closely associated, with a hospital. In any case, there must be a joint effort on the part of the research organization and the hospital pursuant to an understanding that the two organizations shall maintain continuing close cooperation in the active conduct of medical research. For example, the necessary joint effort will normally be found to exist if the activities of the medical research organization are carried on in space located within or adjacent to a hospital provided that the organization is permitted to utilize the facilities (including equipment, case studies, etc.) of the hospital on a continuing basis in the active conduct of medical research. A medical research organization which is closely associated, in the manner described above, with a particular hospital or particular hospitals, may be considered to be pursuing research in conjunction with a hospital if the necessary joint effort is supported by substantial evidence of the close cooperation of the members of the research organization and the staff of the particular hospital or hospitals. The active participation in medical research by the staff of the particular hospital or hospitals will be considered as evidence of the requisite joint effort. If the organization's primary purpose is to disburse funds to other organizations for the conduct of research by them, or, if the organization's primary purpose is to extend research grants or scholarships to others, it is not directly engaged in the active conduct of medical research, and contributions to such an organization may not be taken into account for purposes of the additional 10-percent limitation.

(*d*) A charitable contribution to a medical research organization may be taken into account in computing the additional 10-percent limitation only if the

organization is committed to spend such contribution for medical research in conjunction with a hospital on or before the first day of the fifth calendar year which begins after the date the contribution is made. The organization's commitment that the contribution will be spent within the prescribed time only for the prescribed purposes must be legally enforceable. A promise in writing to the donor in consideration of his making a contribution that such contribution will be so spent within the prescribed time will constitute a commitment. The expenditure of contributions received for plant, facilities, or equipment, used solely for medical research purposes shall ordinarily be considered to be an expenditure for medical research for purposes of section 170(b) and this section. If a contribution is made in other than money, it shall be considered spent for medical research if the funds from the proceeds of a disposition thereof are spent by the organization within the five year period for medical research; or, if such property is of such a kind that it is used on a continuing basis directly in connection with such research, it shall be considered spent for medical research in the year in which it is first so used.

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(c) *Unlimited deduction for individuals.*—*(1) In general.*—(i) The deduction for charitable contributions made by an individual is not subject to the 10 and 20-percent limitations of section 170(b) if in the taxable year and each of 8 of the 10 preceding taxable years the sum of his charitable contributions paid during the year, plus his payments during the year on account of Federal income taxes, is more than 90 percent of his taxable income for the year (or net income, in years governed by the Internal Revenue Code of 1939). In determining the applicability of the 10 and 20-percent limitations of section 170(b) for taxable years beginning after December 31, 1957, there may be substituted, in lieu of the amount of income tax paid during any year, the amount of income tax paid in respect of such year, provided that any amount so included for the year in respect of which payment was made shall not be included for any other year. For the purpose of the first sentence of this paragraph, taxable income under the 1954 Code is determined without regard to the deductions for charitable contributions under section 170, for personal exemptions under section 151, or for a net operating loss carryback under section 172. On the other hand, for this purpose net income under the 1939 Code is computed without the benefit only of the deduction for charitable contributions. See section 120 of the Internal Revenue Code of 1939. The term "income tax" as used in section 170(b)(1)(C) means only Federal income taxes, and does not include the taxes imposed on self-employment income, on employees under the Federal Insurance Contributions Act (chapter 21 of the Code) or on railroad employees and their representatives under the Railroad Retirement Tax Act (chapter 22 of the Code) by chapters 2, 21, and 22, respectively, or corresponding provisions of the Internal Revenue Code of 1939. For purposes of section 170(b)(1)(C) and this paragraph, the amount of income tax paid during a taxable year shall be determined (except as provided in subdivision (ii) of this subparagraph) by including all payments made by the taxpayer during such taxable year on account of his Federal income taxes (whether for the taxable year or for preceding taxable years). Such payments would include any amount paid during the taxable year as estimated tax for that year, payment of the final installment of estimated tax for the preceding taxable year, final payment for the preceding taxable year, and any payment of a deficiency for an earlier taxable year, to the extent that such payments do not exceed the tax for the taxable year for which payment is made. Any payment of income tax with respect to which the taxpayer receives a refund or credit shall be reduced by the amount of such refund or credit. Any such refund or credit shall be applied against the most recent payments for the taxable year in respect of which the refund or credit arose.

(ii) For any taxable year beginning after December 31, 1957, the applicability of the 10 and 20-percent limitations of section 170(b) may be determined either with reference to the income tax paid during the year or any prior year, or with reference to the income tax paid in respect of any such year or prior years. The 90-percent test of section 170(b)(1)(C) may be applied for the taxable year, or for any one or more of the preceding 10 taxable years, by taking into account the income taxes paid in respect of that year or years, and for the balance of the 10 years by taking into account the income tax payments made during those years. Thus, a taxable year which qualifies under either of the two permissible methods shall be considered as a qualifying year irrespective of whether the

taxable year begins before or after December 31, 1957. However, a particular income tax payment may only be taken into account once, either with respect to the year of liability or for the year of payment.

(2) *Joint returns.*—(i) *Joint return for current taxable year.*—If a husband and wife make a joint return for any taxable year, their deduction for charitable contributions is not subject to the 10- and 20-percent limitations of section 170(b), if, under the rules of subparagraph (1) of this paragraph, in the taxable year and in each 8 of the 10 preceding taxable years (regardless of whether separate or joint returns were filed), the aggregate charitable contributions of both spouses paid during the year, plus their aggregate payments during the year on account of Federal income taxes (or, if the taxable year begins after December 31, 1957, the aggregate tax paid in respect of such taxable year or any preceding taxable year) exceed 90 percent of their aggregate taxable incomes for the year.

(ii) *Separate return by spouse or by unremarried widow or widower.*—If a spouse, or the unremarried widow or widower of a deceased spouse, makes a separate return for any taxable year, his deduction for charitable contributions is not subject to the 10- and 20-percent limitations of section 170(b), if, under the rules of subparagraph (1) of this paragraph, in the taxable year and each of 8 of the 10 preceding taxable years—

(*a*) For which the taxpayer filed a joint return with his spouse, either their aggregate charitable contributions and payments of Federal income taxes made during the taxable year (or if the taxable year begins after December 31, 1957, made in respect of such taxable year or any preceding taxable year) exceed 90 percent of their aggregate taxable income for that year, or the taxpayer's separate charitable contributions and payments of Federal income taxes allocable to his separate income and made during the taxable year (or if the taxable year begins after December 31, 1957, made in respect of such taxable year or any preceding taxable year) exceeds 90 percent of his separate taxable income for that year, and

(*b*) For which the taxpayer did not file a joint return with his spouse, the aggregate of his charitable contributions and payments of Federal income taxes made during the taxable year (or, if the taxable year begins after December 31, 1957, the payments of income taxes made in respect of such taxable year or any preceding taxable year) exceeds 90 percent of his taxable income for that year.

For the purpose of the preceding sentence, the word "spouse" does not include a spouse from whom the taxpayer has been divorced.

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PAR. 4. Section 1.170–3 is amended by revising paragraph (a), and paragraph (c) of § 1.170–3 is amended by adding subparagraphs (3) and (4) thereto. As amended, § 1.170–3 reads as follows:

§ 1.170–3 CONTRIBUTIONS OR GIFTS BY CORPORATIONS.—(a) *In general.*—The deduction by a corporation in any taxable year for charitable contributions, as defined in section 170(c), is limited to 5 percent of its taxable income for the year, computed without regard to:

(1) The deduction for charitable contributions,

(2) The special deductions for corporations allowed under part VIII (except section 248), subchapter B, chapter 1 of the Code,

(3) Any net operating loss carryback to the taxable year under section 172, and

(4) The special deduction for Western Hemisphere trade corporations under section 922.

A contribution by a corporation to a trust, chest, fund, or foundation organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes or for the prevention of cruelty to children or animals is deductible only if the contribution is to be used in the United States or its possessions for those purposes. See section 170(c)(2). For the purposes of section 170, amounts excluded from the gross income of a corporation under section 114 (relating to sports programs conducted for the American National Red Cross) are not to be considered contributions or gifts. For reduction or disallowance of certain charitable, etc., deductions, see paragraphs (c)(2), (e) and (f) of § 1.170–1.

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(c) *Charitable contributions carryover of corporations.* * * *

(3) A corporation having a net operating loss carryover (or carryovers) must apply the special rule of section 170(b)(3) and this subparagraph before computing under subparagraph (1) of this paragraph the charitable contributions carryover for any taxable year subject to the Internal Revenue Code of 1954. In determining the amount of charitable contributions that may be deducted in the two taxable years succeeding the year of the contribution, the excess of contributions made by a corporation in the year of contribution over the amount deductible in such year must be reduced by the amount by which such excess reduces taxable income (for purposes of determining the net operating loss carryover under the second sentence of section 172(b)(2)) and increases a net operating loss carryover to a succeeding taxable year. Thus, if the excess of the contributions made in a taxable year over the amount deductible in the taxable year is utilized to reduce taxable income for such year for purposes of determining the net operating loss deduction for such year, thereby serving to increase the amount of the net operating loss carryover to a succeeding year or years, no charitable contributions carryover will be allowed. If only a portion of the excess charitable contributions is so used, the charitable contributions carryover will be reduced only to that extent.

(4) The application of the rule of subparagraph (3) of this paragraph may be illustrated by the following example:

Example. A corporation which reports its income on the calendar year method makes a charitable contribution of $10,000 during the taxable year 1960. Its taxable income for 1960 is $80,000 (computed without regard to any net operating loss deduction and computed in accordance with section 170(b)(2) without regard to any deduction for charitable contributions). The corporation has a net operating loss carryover from 1959 of $80,000. In the absence of the net operating loss deduction the corporation would have been allowed a deduction for charitable contributions of $4,000 (5 percent of $80,000). After the application of the net operating loss deduction the corporation is allowed no deduction for charitable contributions, and there is a tentative charitable contribution carryover of $10,000. For purposes of determining the net operating loss carryover to 1961 the corporation computes its taxable income for its prior taxable year 1960 under section 172(b)(2) by deducting the $4,000 charitable contribution. Thus, after the $80,000 net operating loss carryover is applied against the $76,000 of taxable income for 1960 (computed in accordance with section 172(b)(2)), there remains a $4,000 net operating loss carryover to 1961. Since the application of the net operating loss carryover of $80,000 from 1959 reduces the taxable income for 1960 to zero, no part of the $10,000 of charitable contributions in that year is deductible under section 170(b)(2). However, in determining the amount of the allowable charitable contributions carryover to the taxable years 1961 and 1962, the $10,000 must be reduced by the portion thereof ($4,000) which was used to reduce taxable income for 1960 (as computed for purposes of the second sentence of section 172(b)(2)) and which thereby served to increase the net operating loss carryover to 1961 from zero to $4,000.

PAR. 5. Paragraph (a) of § 1.673(b)–1 is revised to read as follows:

§ 1.673(b)–1 INCOME PAYABLE TO CHARITABLE BENEFICIARIES.—(a) Pursuant to section 673(b) a grantor is not treated as an owner of any portion of a trust under section 673, even though he has a reversionary interest which will take effect within 10 years, to the extent that, under the terms of the trust, the income of the portion is irrevocably payable for a period of at least 2 years (commencing with the date of the transfer) to a designated beneficiary of the type described in section 170(b)(1)(A).

PAR. 6. Paragraph (c) of § 1.681(a)–2 is revised to read as follows:

§ 1.681(a)–2 LIMITATION ON CHARITABLE CONTRIBUTIONS DEDUCTION OF TRUSTS WITH TRADE OR BUSINESS INCOME.

* * * * * * *

(c) *Examples.* (1) The application of this section may be illustrated by the following examples, in which it is assumed that the Y charity is not a charitable organization qualifying under section 170(b)(1)(A) (see subparagraph (2) of this paragraph):

* * * * * * *

(2) If, in the examples in subparagraph (1) of this paragraph, the Y charity were a charitable organization qualifying under section 170(b)(1)(A), then the deduction allowable under section 512(b)(11) would be computed at a rate of 30 percent.

PAR. 7. Subparagraph (1) of paragraph (a) of § 1.681(b)–1 is revised to read as follows:

§ 1.681(b)–1 LIMITATION ON CHARITABLE CONTRIBUTIONS DEDUCTION OF TRUSTS ENGAGED IN PROHIBITED TRANSACTIONS.—(a) *In general.*—(1) If a trust has engaged in a "prohibited transaction," the charitable contributions deduction which would otherwise be allowable to the trust under section 642(c) is limited by section 681(b)(1) to 20 percent of the taxable income of the trust (computed without any charitable contributions deduction), except that an additional deduction of up to 10 percent of such taxable income is allowed for amounts actually paid to organizations qualifying under section 170(b)(1)(A). There is no requirement that amounts subject to the 20-percent limitation be actually paid, if they are set aside or are to be used exclusively for charitable or other purposes so that they would be deductible under section 642(c).

PAR. 8. Paragraph (b) of § 1.681(c)–1 is revised to read as follows:

§ 1.681(c)–1 LIMITATION ON CHARITABLE CONTRIBUTIONS DEDUCTION OF TRUSTS ACCUMULATING INCOME.

* * * * * * *

(b) *Extent of limitation.*—If a trust is subject to the limitations of section 681(c) for any taxable year, the charitable deduction which would otherwise be allowable to the trust under section 642(c) is limited to amounts actually paid out during the taxable year, and is limited to 20 percent of the taxable income of the trust (computed without any charitable deduction), except that an additional deduction of up to 10 percent of such taxable income is allowed for amounts actually paid to organizations qualifying under section 170(b)(1)(A).

PAR. 9. Paragraph (b) of § 1.702–1 is revised to read as follows:

§ 1.702–1 INCOME AND CREDITS OF PARTNER.

* * * * * * *

(b) *Character of items constituting distributive share.*—The character in the hands of a partner of any item of income, gain, loss, deduction, or credit described in section 702(a)(1) through (8) shall be determined as if such item were realized directly from the source from which realized by the partnership or incurred in the same manner as incurred by the partnership. For example, a partner's distributive share of gain from the sale of depreciable property used in the trade or business of the partnership shall be considered as gain from the sale of such depreciable property in the hands of the partner. Similarly, a partner's distributive share of partnership "hobby losses" (section 270) or his distributive share of partnership charitable contributions to organizations qualifying under section 170(b)(1)(A) retains such character in the hands of the partner.

(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).)

WILLIAM H. LOEB,
Acting Commissioner of Internal Revenue.

Approved August 9, 1962.

STANLEY S. SURREY,
Assistant Secretary of the Treasury.

(Filed by the Division of the Federal Register on August 14, 1962, 8:52 a.m., and published in the issue of the Federal Register for August 15, 1962, 27 F.R. 8093)

674924°—63——7

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

Contributions to a church missionary fund which makes payments to the taxpayer's missionary son. See Rev. Rul. 62–113, page 10.

SECTION 171.—AMORTIZABLE BOND PREMIUM

26 CFR 1.171–1: Amortizable bond premium. Rev. Rul. 62–127[1]

The Internal Revenue Service will follow the decision of the United States Court of Appeals for the Sixth Circuit in *Herbert Humphreys et ux.* v. *Commissioner*, 301 Fed. (2d) 33 (1962), reversing T.C. Memo. 1961–9, with respect to the issue whether taxpayers are entitled to an amortizable bond premium deduction under section 171 of the Internal Revenue Code of 1954 where the purchase of bonds did not have an investment purpose. The decision in the *Humphreys* case is in accord with an earlier decision of the Seventh Circuit in *Maysteel Products, Inc.* v. *Commissioner*, 287 Fed. (2d) 429 (1961), and cases in other Circuits. The issue involved will not be further litigated.

It should be noted, however, that the decision not to further litigate in the specific situation above described in no way affects the position of the Service that a transaction, in general, will not be recognized for tax purposes if it is a sham or otherwise lacks economic reality.

PART VII.—ADDITIONAL ITEMIZED DEDUCTIONS FOR INDIVIDUALS

SECTION 212.—EXPENSES FOR PRODUCTION OF INCOME

26 CFR 1.212–1: Nontrade or nonbusiness expenses.

Fees paid to wife's attorney for tax advice in connection with divorce and property settlement. See Ct. D. 1873, page 15.

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

26 CFR 1.213: Statutory provisions; medical, dental, etc., expenses T. D. 6604[2]

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

Amendment of regulations under section 213 of the Internal Revenue Code of 1954, relating to the deduction for medical, dental, etc., expenses.

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[1] Based on Technical Information Release 390, dated July 6, 1962.

[2] The publication of this Treasury Decision in 27 F.R. 6972, dated July 24, 1962, contains (1) instructions for modifying the notice of proposed rulemaking published in 26 F.R. 10449, dated November 4, 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 THE 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 rulemaking regarding amendment of the Income Tax Regulations under section 213 of the Internal Revenue Code of 1954, relating to the deduction for medical, dental, etc., expenses, to conform to section 3 of the Act of May 14, 1960 (Public Law 86–470, 74 Stat. 133 [C.B. 1960–1,800]), and to clarify the tax treatment under section 213 of certain capital expenditures, was published in the Federal Register (26 F.R. 10449). After consideration of all such relevant matter as was presented by interested persons, the following amendment of the regulations is hereby adopted.

PARAGRAPH 1. Section 1.213 is amended by revising subsection (a) of section 213 and by revising the historical note at the end thereof. These revised provisions read as follows:

§ 1.213 STATUTORY PROVISIONS; MEDICAL, DENTAL, ETC., EXPENSES

SEC. 213. MEDICAL, DENTAL, ETC., EXPENSES.

(a) ALLOWANCE OF DEDUCTION.—There shall be allowed as a deduction the following amounts of 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 (as defined in section 152):

(1) If neither the taxpayer nor his spouse has attained the age of 65 before the close of the taxable year—

(A) The amount of such expenses for the care of any dependent who—

(i) Is the mother or father of the taxpayer or of his spouse, and

(ii) Has attained the age of 65 before the close of the taxable year, and

(B) The amount by which such expenses for the care of the taxpayer, his spouse, and such dependents (other than any dependent described in subparagraph (A)) exceed 3 percent of the adjusted gross income.

(2) If either the taxpayer or his spouse has attained the age of 65 before the close of the taxable year—

(A) The amount of such expenses for the care of the taxpayer and his spouse,

(B) The amount of such expenses for the care of any dependent described in paragraph (1)(A), and

(C) The amount by which such expenses for the care of such dependents (other than any dependent described in paragraph (1)(A) exceed 3 percent of the adjusted gross income.

* * * * * * *

[Sec. 213 as amended by secs. 16 and 17, Technical Amendments Act 1958 (72 Stat. 1613) [P.L. 85–866 C.B. 1958–3, 254]; sec. 3, Act of May 14, 1960 (Pub. Law 86–470, 74 Stat. 133) [C.B. 1960–1, 800]]

PAR. 2. Section 1.213–1 is amended by revising subdivision (i) of subparagraph (3) and subparagraph (4) of paragraph (a), revising subparagraph (2) of paragraph (b), and revising subdivision (iii) of subparagraph (1) of paragraph (e). As amended, these provisions read as follows:

§ 1.213–1 MEDICAL, DENTAL, ETC., EXPENSES.—(a) *Allowance of deduction.* * * *

(3)(i) For medical expenses paid (including expenses paid for medicine and drugs) to be deductible, they must be for medical care of the taxpayer, his spouse, or a dependent of the taxpayer and not be compensated for by insurance or otherwise. Expenses paid for the medical care of a dependent, as defined in

section 152 and the regulations thereunder, are deductible under this section even though the dependent has gross income of $600 or more for the taxable year. Where such expenses are paid by two or more persons and the conditions of section 152(c) and the regulations thereunder are met, the medical expenses are deductible only by the person designated in the multiple support agreement filed by such persons and such deduction is limited to the amount of medical expenses paid by such person.

* * * * * * *

(4)(i) Where either the taxpayer or his spouse has attained the age of 65 before the close of the taxable year, the 3-percent limitation on the deduction for medical expenses does not apply with respect to expenses for medical care of the taxpayer or his spouse. Moreover, for taxable years beginning after December 31, 1959, the 3-percent limitation on the deduction for medical expenses does not apply to amounts paid for the medical care of a dependent (as defined in section 152) who is the mother or father of the taxpayer or of his spouse and who has attained the age of 65 before the close of the taxpayer's taxable year. Whether or not the 3-percent limitation applies, all amounts paid by the taxpayer for medicine and drugs are subject to the 1-percent limitation provided by section 213(b) and paragraph (b) of this section, and the total medical expenses deductible under section 213 are subject to the limitations described in section 213(c) and paragraph (c) of this section and, where applicable, to the limitations described in section 213(g) and § 1.213–2.

(ii) The age of a taxpayer shall be determined as of the last day of his taxable year. In the event of the taxpayer's death, his taxable year shall end as of the date of his death. The age of a taxpayer's spouse shall be determined as of the last day of the taxpayer's taxable year, except that, if the spouse dies within such taxable year, her age shall be determined as of the date of her death. Likewise, the age of the taxpayer's dependent who is the mother or father of the taxpayer or of his spouse shall be determined as of the last day of the taxpayer's taxable year but not later than the date of death of such dependent.

(iii) The application of subdivision (i) of this subparagraph may be illustrated by the following examples:

* * * * * * *

Example (3). D and his wife, E, made a joint income tax return for the calendar year 1960, and reported adjusted gross income of $30,000. On December 13, 1960, D attained the age of 65. During the year 1960, D's father, F, who was 87 years of age, received over half of his support from, and was a dependent (as defined in section 152) of, D. However, D could not claim an exemption under section 151 for F because F had gross income from rents in 1960 of $800. D paid the following medical expenses in 1960, none of which were compensated for by insurance or otherwise: Hospital and doctor bills for D and E, $3,500; hospital and doctor bills for F, $2,850; medicine and drugs for D and E, $225, and for F, $225. Since none of the medical expenses are subject to the 3-percent limitation, the amount of medical expenses to be taken into account (before computing the maximum deduction) is $6,500, computed as follows:

Hospital and doctor bills—for D and E		$3,500
Hospital and doctor bills—for F		2,850
Medicine and drugs—for D and E	$225	
Medicine and drugs—for F	225	
Total medicine and drugs	450	
Less: 1 percent of adjusted gross income ($30,000)	300	
Allowable expenses for medicine and drugs		150
Total medical expenses taken into account		6,500

Since an exemption cannot be claimed for F on the 1960 return of D and E, their deduction for medical expenses (assuming that section 213(g) does not apply) is limited to $5,000 for that year ($2,500 multiplied by the two exemptions allowed for D and E under section 151(b)). See paragraph (c) of this section.

Example (4). Assume the same facts in Example (3), except that D furnished the entire support of his father's twin sister, G, who had no gross income during 1960 and for whom D was entitled to a dependency exemption. In addi-

tion, D paid $2,200 to doctors and hospitals during 1960 for the medical care of G. No part of the $2,200 was for medicine and drugs, and no amount was compensated for by insurance or otherwise. For purposes of the maximum limitation under section 213(c), the maximum deduction for medical expenses on the 1960 return of D and E is limited to $7,500 ($2,500 multiplied by 3, the number of exemptions allowed under section 151, exclusive of the exemptions for old age or blindness). The medical expenses to be taken into account by D and E for 1960 and the maximum deductions allowable for such expenses are $7,800 and $7,500, respectively, computed as follows:

Medical expenses per example (3)		$6,500
Add: Expenses paid for G	$2,200	
Less: 3 percent of adjusted gross income ($30,000)	900	1,300
Total medical expenses taken into account		7,800
Maximum deduction for 1960 ($2,500 multiplied by 3 exemptions)		7,500
Medical expenses not deductible		$300

(b) *Limitation with respect to medicine and drugs.* * * *

(2) The 1-percent limitation is applicable to all amounts paid by a taxpayer during the taxable year for medicine and drugs. Moreover, this limitation applies regardless of the fact that the amounts paid are for medicine and drugs for the taxpayer, his spouse, or dependent parent (the mother or father of the taxpayer or of his spouse) who has attained the age of 65 before the close of the taxable year. In a case where either a taxpayer or his spouse has attained the age of 65 and the taxpayer pays an amount in excess of 1 percent of adjusted gross income for medicine and drugs for himself, his spouse, and his dependents, it is necessary to apportion the 1 percent of adjusted gross income (the portion which is not taken into account as expenses paid for medical care) between the taxpayer and his spouse on the one hand and his dependents on the other. The part of the 1 percent allocable to the taxpayer and his spouse is an amount which bears the same ratio to 1 percent of his adjusted gross income which the amount paid for medicine and drugs for the taxpayer and his spouse bears to the total amount paid for medicine and drugs for the taxpayer, his spouse, and his dependents. The balance of the 1 percent shall be allocated to his dependents. The amount paid for medicine and drugs in excess of the allocated part of the 1 percent shall be taken into account as payments for medical care for the taxpayer and his spouse on the one hand and his dependents on the other, respectively. A similar apportionment must be made in the case of a dependent parent (65 years of age or over) of the taxpayer or his spouse. The application of this subparagraph may be illustrated by the following example:

* * * * * * *

(e) *Definitions.*—(1) *General.* * * *

(iii) Capital expenditures are generally not deductible for Federal income tax purposes. See section 263 and the regulations thereunder. However, an expenditure which otherwise qualifies as a medical expense under section 213 shall not be disqualified merely because it is a capital expenditure. For purposes of section 213 and this paragraph, a capital expenditure made by the taxpayer may qualify as a medical expense, if it has as its primary purpose the medical care (as defined in subdivisions (i) and (ii) of this subparagraph) of the taxpayer, his spouse, or his dependent. Thus, a capital expenditure which is related only to the sick person and is not related to permanent improvement or betterment of property, if it otherwise qualifies as an expenditure for medical care, shall be deductible; for example, an expenditure for eye glasses, a seeing eye dog, artificial teeth and limbs, a wheel chair, crutches, an inclinator or an air conditioner which is detachable from the property and purchased only for the use of a sick person, etc. Moreover, a capital expenditure for permanent improvement or betterment of property which would not ordinarily be for the purpose of medical care (within the meaning of this paragraph) may, nevertheless, qualify as a medical expense to the extent that the expenditure exceeds the increase in the value of the related property, if the particular expenditure is related directly to medical care. Such a situation could arise, for example, where a taxpayer is advised by a physician to install an elevator in his residence so that the taxpayer's wife who is afflicted with heart disease will not be required to climb stairs. If the cost of install-

ing the elevator is $1,000 and the increase in the value of the residence is determined to be only $700, the difference of $300, which is the amount in excess of the value enhancement, is deductible as a medical expense. If, however, by reason of this expenditure, it is determined that the value of the residence has not been increased, the entire cost of installing the elevator would qualify as a medical 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 July 17, 1962.

STANLEY S. SURREY,
Assistant Secretary of the Treasury.

(Filed by the Division of the Federal Register on July 17, 1962, 8:47 a.m., and published in the issue of the Federal Register for July 24, 1962, 27 F.R. 6972)

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26 CFR 1.213–1: Medical, dental, etc., expenses. Rev. Rul. 62–189

Where a taxpayer has been advised by a physician that a wig is essential to the mental health of his daughter who has lost all of her hair as a result of disease, the taxpayer may deduct the cost of the wig as a medical expense, subject to the limitations prescribed in section 213 of the Internal Revenue Code of 1954.

Revenue Ruling 55–261, item 16, C.B. 1955–1, 307, at 312, distinguished.

Advice has been requested whether the cost of a wig acquired for a daughter who has lost all of her hair as a result of disease is deductible as a medical expense.

In the instant case the taxpayer's daughter was afflicted with a disease which, in a few years, caused her to lose all of her hair, including her eyebrows and eyelashes. This condition was having a marked effect upon her mental health. The taxpayer sought the advice of her doctor, and the doctor prescribed a wig in the belief that it would be essential to her mental health. On the basis of such advice, the taxpayer purchased a wig for her.

Section 213(a) of the Internal Revenue Code of 1954 allows as a deduction expenses paid during the taxable year, not compensated for by insurance or otherwise, for medical care of the taxpayer, his spouse, or a dependent, subject to certain limitations.

Section 1.213–1(e)(1)(ii) of the Income Tax Regulations provides, in part, that deductions for expenditures for medical care allowable under section 213 will be confined strictly to expenses incurred primarily for the prevention or alleviation of a physical or mental defect or illness.

The facts in the instant case are distinguishable from those underlying the conclusion reached in item 16 of Revenue Ruling 55–261, C.B. 1955–1, 307, at page 312, in which it was held that wigs and other named items are personal expenses. Such conclusion is applicable where the facts disclose that the expenditures for such items are made for the preservation of general health or for the alleviation of physical or mental discomfort which is unrelated to some particular disease

or defect. In the instant case, however, the daughter's doctor had advised that the wig was essential to her mental health.

Accordingly, it is held that where a taxpayer has been advised by a physician that a wig is essential to the mental health of his daughter who has lost all of her hair, the taxpayer may deduct the cost of the wig as a medical expense, subject to the limitations prescribed in section 213 of the Code.

Revenue Ruling 55–261, item 16, C.B. 1955–1, 307 at 312, distinguished.

Rev. Rul. 62–210

The taxpayer's son has a congenital defect which results in a severe malocclusion of his teeth. An orthodontist recommended that the child take lessons in playing a clarinet, as he considered continued practice with this instrument therapeutic treatment towards alleviating the specific condition. *Held*, an amount which does not exceed the minimum cost of a clarinet of a quality sufficient to give effect to the therapeutic treatment recommended by the orthodontist and the cost of lessons necessary for the son to play the instrument to the degree required to obtain the benefits of the treatment may qualify as medical expenses within the meaning of section 213 of the Internal Revenue Code of 1954. Such amounts paid are deductible by the taxpayer to the extent provided in that section.

SECTION 215.—ALIMONY, ETC., PAYMENTS

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

Deduction by a husband of payments of wife's medical and dental expenses made pursuant to a decree or instrument of the type specified in section 71(a) of the Code. See Rev. Rul. 62–106, page 21.

Treatment of payments made, under a court order, by a husband to his wife during the period preceding their divorce, where the parties were domiciled in a community property state. See Rev. Rul. 62–115, page 23.

Allotment of pay of a member of the United States Army for support of his wife and children under court order. See Rev. Rul. 62–187, page 27.

SECTION 216.—DEDUCTION OF TAXES, INTEREST, AND BUSINESS DEPRECIATION BY COOPERATIVE HOUSING CORPORATION TENANT-STOCKHOLDER

26 CFR 1.216–1: Amounts representing taxes and interest paid to cooperative housing corporation.
(Also Section 164; 1.164–1.)

Rev. Rul. 62–177

Tenant-stockholders of a cooperative housing corporation which leased land and an apartment building erected thereon are not entitled to a deduction, under section 216 of the Internal Revenue Code

of 1954, for their proportionate share of real estate taxes on the apartment building required to be paid by the corporation under the terms of the lease, even though the estimated useful life of the building is substantially shorter than the term of the lease.

Advice has been requested whether, under the circumstances below, tenant-stockholders of a cooperative housing corporation are entitled to a deduction under section 216 of the Internal Revenue Code of 1954 for their proportionate share of real estate taxes paid with respect to an apartment building leased by the corporation, where the estimated useful life of the building is substantially less than the term of the lease and the lease agreement required that the corporation pay such taxes.

A corporation has entered into an arms-length agreement to lease a parcel of land and the existing apartment building thereon for a period of seventy years. The estimated useful life of the building is substantially shorter than the term of the lease. The lessee corporation is a cooperative housing corporation within the meaning of section 216(b)(1) of the Code and its stockholders are tenant-stockholders within the meaning of section 216(b)(2). The lease obligates the lessee to pay, in addition to the "annual rental" on the property, all real estate taxes assessed against the land and building.

Section 216 of the Code provides that a tenant-stockholder in a cooperative housing corporation shall be allowed a deduction for amounts paid or accrued to the corporation within his taxable year representing his proportionate share of real estate taxes paid or incurred by the corporation. To be proportionately deductible by the tenant-stockholders, such taxes must be allowable as a deduction to the corporation under section 164 of the Code.

Section 1.162–11(a) of the Income Tax Regulations provides, in part, that taxes paid by a tenant to or for a landlord for business property constitute additional rents deductible by the tenant as an ordinary and necessary business expense only in connection with the carrying on of a trade or business. Such additional rent is taxable income to the landlord, who may deduct the amount of taxes pursuant to section 164.

Section 164(a) of the Code provides that, as a general rule, there shall be allowed as a deduction taxes paid or accrued within the taxable year.

Section 1.164–1 of the Income Tax Regulations states, in part, as follows:

Deduction for taxes.—Except as otherwise provided in this section and in sections 1.164–2 to 1.164–8, inclusive, taxes imposed by the United States, any State, * * * or a political subdivision of any of the foregoing, * * * are deductible from gross income for the taxable year in which paid or accrued * * *. In general, taxes are deductible only by the person upon whom they are imposed.

In the case of *Offutt Housing Company* v. *County of Sarpy et al*, 351 U.S. 253 (1956), a lessee of a tract of land from the Federal Government for a term of seventy-five years erected improvements on the land which had an estimated useful life of thirty-five years. The lease provided that the buildings and improvements should become part of the real estate and that, upon expiration or termination of the lease, all improvements made upon the leased premises would remain the property of the Government without compensation.

The lessee was required to pay a nominal rental on the land. The Supreme Court of the United States held that the lessee-petitioner was required to pay state and local personal property taxes on the improvements. It was the view of the Court that while the Government had technical title to the improvements it was only a "paper title," and that the petitioner was subject to being taxed on his lessee's interest. That interest was viewed as being the entire worth of the improvements.

The rationale of the *Offutt Housing Company* case is not applicable to the instant case because, here, the lessor of the property was entitled to receive a substantial benefit from the improvements, over the term of the lease, in the form of rent. Thus, even though the useful life of the improvements on the leased property is substantially shorter than the term of the lease, it cannot reasonably be maintained that the lessee corporation was entitled to the sole enjoyment of the entire worth of the improvements.

It is also clear that the payment of the real estate taxes by the lessee corporation is a part of the price exacted by the lessor for the use or enjoyment of the leased premises. Payment of such amounts is the equivalent of the payment of rent, the deduction of which is not allowable under section 164 of the Code. And, since such amounts are not allowable as a deduction under that section of the Code, the requirements contained in section 216 of the Code for deduction by tenant-stockholders of the lessee corporation have not been met.

Accordingly, it is held that, since payments made by the lessee corporation in the instant case with respect to the real estate taxes on the leased property are not allowable to the corporation as a deduction under section 164 of the Code, tenant-stockholders of the corporation are not entitled to a deduction for their proportionate share of amounts paid by the corporation with respect to such real estate taxes.

(Also Sections 163, 164; 1.163–1, 1.164–1.) Rev. Rul. 62–178

A cooperative housing corporation, which leases land and constructs thereon at its own expense an apartment building with an estimated useful life substantially shorter than the terms of the lease, may deduct, under section 164 of the Internal Revenue Code of 1954, real estate taxes it pays or incurs with respect to the building pursuant to the terms of the ground lease, even though legal title to the building is vested in the lessor of the land. The cooperative may also deduct, under section 163, interest which it pays or incurs on the indebtedness which it contracts to finance the construction of the building. Consequently, the tenant-stockholders of the cooperative may deduct amounts which they pay to the corporation representing their proportionate shares of such taxes and interest, provided they do not elect to use the standard deduction or the optional tax table.

Advice has been requested as to the deductibility of amounts representing certain real estate taxes and interest paid to a cooperative housing corporation by its tenant-stockholders under the circumstances described below.

A corporation leased a parcel of land for a term of 99 years and erected thereon an apartment building having an estimated life of 50 years. The lease provides that any and all buildings and improvements placed on the land by the corporation shall, as soon as erected

or installed, be and become property of the landlord and, at the end of the term, shall be surrendered to the landlord. Under the terms of the lease, the corporation is required to pay all real estate taxes imposed upon the building by any governmental authority. The corporation qualifies as a cooperative housing corporation under section 216(b)(1) of the Internal Revenue Code of 1954 and the stockholders qualify as tenant-stockholders under section 216(b)(2) of the Code.

During the taxable year, the corporation paid real estate taxes with respect to the building and interest on its indebtedness contracted to erect the building. In turn, each tenant-stockholder of the corporation made rental payments to the corporation which included his proportionate share of the aforementioned taxes and interest paid by the corporation on a mortgage given in connection with the construction of the building.

The specific issue in this case is whether the tenant-stockholders may deduct, under section 216 of the Code, the amounts they paid to the corporation during the taxable year which represent their proportionate shares of the interest and the real estate taxes paid by the corporation with respect to the building.

Section 216(a) of the Code, relating to the deduction of taxes and interest paid to cooperative housing corporations, provides as follows:

> (a) ALLOWANCE OF DEDUCTION.—In the case of a tenant-stockholder (as defined in subsection (b)(2)), there shall be allowed as a deduction amounts (not otherwise deductible) paid or accrued to a cooperative housing corporation within the taxable year, but only to the extent that such amounts represent the tenant-stockholder's proportionate share of—
>
> (1) the real estate taxes allowable as a deduction to the corporation under section 164 which are paid or incurred by the corporation on the houses or apartment building and on the land on which such houses (or building) are situated, or
>
> (2) the interest allowable as a deduction to the corporation under section 163 which is paid or incurred by the corporation on its indebtedness contracted—
>
> (A) in the acquisition, construction, alteration, rehabilitation, or maintenance of the houses or apartment building, or
>
> (B) in the acquisition of the land on which the houses (or apartment building) are situated.

Since the cooperative is directly liable on the loan procured to finance the construction of the building, it is clear that it is entitled to deduct, under section 163(a), interest paid or accrued with respect to the loan. See Rev. Rul. 58–129, C.B. 1958–1, 93.

Section 164(a) of the Code provides, in substance, that there shall be allowed as a deduction in computing taxable income, taxes paid or accrued within the taxable year.

Section 1.164–1 of the regulations provides, in part, that in general taxes are deductible only by the person upon whom they are imposed.

Generally, taxes paid by a tenant to or for the landlord for business property constitutes "additional rent" deductible by the tenant as a business expense under section 162 of the Code, rather than as "taxes" under section 164 of the Code, since the obligation to pay the taxes is that of the landlord and not of the tenant. See section 1.162–11 of the regulations.

However, the facts of the instant case, with respect to the building, distinguish it from the usual situation where a tenant is required to

pay taxes on leased property. In the instant case, the lessor receives no rental income attributable to the building, and the useful life of the building which the lessee erected with its own funds is substantially shorter than the term of the lease. Under these circumstances the enjoyment of the entire worth of the building is in the cooperative lessee, and in consequence the cooperative may be treated as owner of the building for purposes of section 164. See, *Offutt Housing Company* v. *County of Sarny*, 351 U.S. 253 (1956). Thus, to the extent that the corporation pays the taxes upon the value of the building, it is paying taxes upon its own property which are deductible under section 164 of the Code.

Accordingly, it is held that the interest and taxes, in the instant case, are allowable as deductions to the corporation under sections 163 and 164 of the Code, respectively. Since the corporation qualifies as a cooperative housing corporation under section 216(b)(1) of the Code, and the stockholders qualify as tenant-stockholders under section 216(b)(2) of the Code, the tenant-stockholders of the corporation are entitled to deduct, under section 216(a) of the Code, the amounts they paid to the corporation during the taxable year which represent their proportionate shares of such interest and taxes, provided they do not elect to use the standard deduction or the optional tax table.

PART IX.—ITEMS NOT DEDUCTIBLE

SECTION 262.—PERSONAL, LIVING, AND FAMILY EXPENSES

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

Cost of uniforms of a cadet at the United States Coast Guard Academy. See Rev. Rul. 62–122, page 12.

Fees paid to wife's attorney for tax advice in connection with divorce and property settlement. See Ct. D. 1873, page 15.

SUBCHAPTER C.—CORPORATE DISTRIBUTIONS AND ADJUSTMENTS

PART I.—DISTRIBUTIONS BY CORPORATIONS

Subpart A.—Effects on Recipients

SECTION 301.—DISTRIBUTIONS OF PROPERTY

26 CFR 1.301–1: Rules applicable with respect to distributions of money and other property.

The effective date of a distribution made by a corporation to a shareholder. See Rev. Rul. 62–131, page 94.

Subpart B.—Effects on Corporation

SECTION 312.—EFFECT ON EARNINGS AND PROFITS

26 CFR 1.312–6: Earnings and profits.

A computation made by a corporation for the purpose of dividend payments. See Rev. Rul. 62–131, below.

Subpart C.—Definitions; Constructive Ownership of Stock

SECTION 316.—DIVIDEND DEFINED

26 CFR 1.316–1: Dividends. Rev. Rul. 62–131
(Also Sections 301, 312; 1.301–1, 1.312–6.)
(Also Part II, Sections 115(a), 115(b); Regulations 118, Sections 39.115(a)–1, 39.115(b)–1.)

The date of payment, rather than the date of declaration, constitutes the date of distribution of a dividend. Accordingly, the taxable status of a distribution and its effect on the earnings and profits of the declaring corporation will be determined by reference to the earnings and profits of the corporation for the corporation's taxable year of payment, if the distribution is out of current earnings and profits, or on the date of payment, if the distribution is out of accumulated earnings and profits. For sources of distributions in general, see section 1.316–2 of the Income Tax Regulations.

SECTION 318.—CONSTRUCTIVE OWNERSHIP OF STOCK

26 CFR 1.318: Statutory provisions constructive ownership of stock.

Information to be furnished by individuals, domestic corporations, etc., with respect to certain foreign corporations. See T.D. 6621, page 288.

PART III.—CORPORATE ORGANIZATIONS AND REORGANIZATIONS

Subpart A.—Corporate Organizations

SECTION 351.—TRANSFER TO CORPORATION CONTROLLED BY TRANSFEROR

26 CFR 1.351: Transfer to corporation controlled by transferor.

A transfer by an individual business (or a partnership) to a corporation. See Rev. Rul. 62–128, page 139.

For the tax treatment of a transfer to a controlled corporation followed by successive section 355 spin-off. See Rev. Rul. 62–138, below.

Subpart B.—Effects on Shareholders and Security Holders

SECTION 355.—DISTRIBUTION OF STOCK AND SECURITIES OF A CONTROLLED CORPORATION

26 CFR 1.355–2: Limitations. Rev. Rul. 62–138
(Also Section 351; 1.351–1.)

> Where pursuant to a prearranged plan a corporation, engaged in the active conduct of two separate businesses for more than five years, transfers one of the businesses to a new corporation and distributes the stock of the new corporation to its sole shareholder, a corporation also engaged in the active conduct of a separate business for more than five years, and that corporation in turn distributes the stock of the new corporation to its shareholders, each such distribution comes within the provisions of section 355 of the Internal Revenue Code of 1954.

Advice has been requested whether, under a single plan, successive distributions of the stock of a corporation, first by a subsidiary to its parent corporation and then by the parent corporation to its shareholders, come within the purview of section 355 of the Internal Revenue Code of 1954.

A banking corporation, actively engaged in the banking business for a period of more than five years, also owned all of the outstanding stock of a realty corporation acquired more than five years ago. The realty corporation owned and operated four parcels of developed realty which it used in the active conduct of several rental businesses for a period of more than five years. Two of these parcels are contiguous and the buildings thereon, being physically connected, are operated as an integrated unit. The banking corporation has its offices on the first floor of one of these buildings; the other floors, some ten in all, are leased to business and professional concerns. The remaining two parcels are located in other areas of the same city and contain residential apartment buildings. These two parcels were operated as a separate rental business.

Because operation of the apartment buildings was totally unrelated to the banking corporation's activities, the banking regulatory authorities advised the banking corporation to divest itself of this holding. Since the sale of this realty was considered inadvisable for business reasons, a plan was adopted under which the realty corporation would transfer the two apartment buildings to a newly created subsidiary in exchange for all of its capital stock. Such stock then would be distributed by the realty corporation to the banking corporation which, in turn, would distribute the stock of the new corporation to its shareholders.

This plan was consummated. At the time of the distribution, no known intention existed on the part of the shareholders of the banking corporation to sell, or otherwise dispose of, any part of their stock interests or to dispose of any of the businesses conducted by the banking corporation or its subsidiary.

Section 351 of the Code provides, in substance, that no gain or loss will be recognized on the transfer of property to a transferee corporation solely in exchange for its stock or securities where the transferor is in "control" of the corporation immediately after the transfer. Section 351(c) of the Code provides that, in determining control, the fact that any corporate transferor distributes part or all of the stock which it receives in the exchange to its shareholders shall not be taken into account.

Section 355 of the Code provides, in part, that where a corporation distributes all of the shares of a "controlled corporation" to its shareholders, with respect to its stock, and the transaction is not used principally as a device for the distribution of earnings and profits, no gain or loss will be recognized to the shareholders on receipt of the stock if immediately after the distribution, both the distributing corporation and the "controlled corporation" are engaged in the active conduct of a trade or business.

Section 355(b)(2) of the Code provides, in substance, that a corporation is deemed to be engaged in the active conduct of a trade or business if such trade or business has been actively conducted by such corporation throughout the five-year period preceding the distribution or, during that period, was not acquired, directly or indirectly through use of other corporations, in a transaction in which gain or loss was recognized in whole or part.

Section 1.355-2(c) of the Income Tax Regulations provides, in part, that the application of section 355 is limited to certain specified distributions with respect to the stock or securities of controlled corporations incident to such readjustment of corporate structures as is required by business exigencies and which, in general, effect only a readjustment of continuing interests in property under modified corporate forms. Section 355 contemplates a continuity of the entire business enterprise under modified corporate forms and a continuity of interest in all or part of such business enterprise on the part of those persons who, directly or indirectly, were the owners of the enterprise prior to the distribution.

In the instant case the transfer of the two apartment buildings to the newly created subsidiary in exchange for all of its stock is within the purview of section 351 of the Code. This section is applicable even though the transferor corporation distributed, as part of an integrated transaction, all or part of the shares received in the exchange to its shareholders. Moreover, it is immaterial whether such distribution is taxable or nontaxable. See Senate Report No. 1622, 83d Cong., 2d Sess., 265 (1954).

Under the facts of this case, the successive distributions are each within the purview of section 355 of the Code. In each case, the active business requirement of that section is satisfied and the final result both in respect to corporate separation and the distribution of the stock, is justified by valid business purpose prompting the transaction. Thus, the remaining question is whether the transaction, when viewed as a whole, meets the continuity-of-interest requirements of section 355 of the Code.

Section 355 of the Code specifically permits the pro rata distribution of the stock of a subsidiary tax-free under certain circumstances. In other words, it permits the removal of one corporate entity between the shareholders and the business enterprise conducted by a controlled subsidiary. Thus, the statute looks through corporate entities to the underlying economic activities to permit a division of separate corporate businesses in realistic terms rather than in terms of a single corporate entity. In line with this approach, section 1.355–2 of the regulations provides, in part, that the continuity of interest contemplated is a continuity of ownership by those persons who, directly or indirectly, were the owners of the enterprise prior to the distribution.

In the instant case, there is no change in the aggregate interests held by the banking corporation's shareholders, no new parties in interest were added as a result of the transaction and none were eliminated. The shareholders after the transaction held the same enterprises in modified corporate form as before the transaction and the corporate enterprises were continued as such.

Based on the facts of this case, it is held that (1) under the provisions of section 351 (a) and (c) of the Code, no gain or loss is recognized to the realty corporation upon the transfer of the two apartment buildings to the new corporation in exchange for all the stock of that corporation; and (2) under section 355(a)(1) of the Code, no gain or loss is recognized to either the banking corporation or its shareholders upon receipt of the stock of the new corporation. Accordingly, each shareholder's basis in the stock of the banking corporation and the stock of the new corporation held after the distribution is equal to his basis in the stock of the banking corporation held immediately prior to the distribution, allocated in proportion to the fair market value of each of the stocks at the time of the distribution in accordance with the provisions of section 358 of the Code.

Subpart D.—Special Rule; Definitions

SECTION 367.—FOREIGN CORPORATIONS

26 CFR 1.367–1: Foreign corporations.

Filing of a statement executed under the penalties of perjury. See T.D. 6622, page 188.

SECTION 368.—DEFINITIONS RELATING TO CORPORATE REORGANIZATIONS

26 CFR 1.368–3: Records to be kept and information to be filed with returns.

Copy of plan of reorganization and statement executed under the penalties of perjury. See T.D. 6622, page 188.

PART V.—CARRYOVERS

SECTION 382.—SPECIAL LIMITATIONS ON NET OPERATING LOSS CARRYOVERS

26 CFR 1.382(a): Statutory provisions; special limitations on net operating loss carryovers; purchase of a corporation and change in its trade or business.
(Also Section 394; 1.394.)

T. D. 6616 [1]

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

Regulations under sections 382 and 394 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 28, 1960, notice of proposed rulemaking with respect to regulations under sections 382 and 394 of the Internal Revenue Code of 1954 (relating, respectively, to special limitations on net operating loss carryovers and effective date of part V, subchapter C, chapter 1) was published in the Federal Register (25 F.R. 13775). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the following regulations are hereby adopted.

§ 1.382(a) STATUTORY PROVISIONS; SPECIAL LIMITATIONS ON NET OPERATING LOSS CARRYOVERS; PURCHASE OF A CORPORATION AND CHANGE IN ITS TRADE OR BUSINESS.

SEC. 382. SPECIAL LIMITATIONS ON NET OPERATING LOSS CARRYOVERS.

(a) PURCHASE OF A CORPORATION AND CHANGE IN ITS TRADE OR BUSINESS.—

(1) IN GENERAL.—If, at the end of a taxable year of a corporation—

(A) Any one or more of those persons described in paragraph (2) own a percentage of the total fair market value of the outstanding stock of such corporation which is at least 50 percentage points more than such person or persons owned at—

(i) The beginning of such taxable year, or

(ii) The beginning of the prior taxable year,

(B) The increase in percentage points at the end of such taxable year is attributable to—

(i) A purchase by such person or persons of such stock, the stock of another corporation owning stock in such corporation, or an interest in a partnership or trust owning stock in such corporation, or

[1] The publication of this Treasury Decision in 27 F.R. 10733, dated November 3, 1962, contains (1) instructions for modifying the notice of proposed rulemaking in 25 F.R. 13775, dated December 28, 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.

(ii) A decrease in the amount of such stock outstanding or the amount of stock outstanding of another corporation owning stock in such corporation, except a decrease resulting from a redemption to pay death taxes to which section 303 applies, and

(C) Such corporation has not continued to carry on a trade or business substantially the same as that conducted before any change in the percentage ownership of the fair market value of such stock,

the net operating loss carryovers, if any, from prior taxable years of such corporation to such taxable year and subsequent taxable years shall not be included in the net operating loss deduction for such taxable year and subsequent taxable years.

(2) DESCRIPTION OF PERSON OR PERSONS.—The person or persons referred to in paragraph (1) shall be the 10 persons (or such lesser number as there are persons owning the outstanding stock at the end of such taxable year) who own the greatest percentage of the fair market value of such stock at the end of such taxable year; except that, if any other person owns the same percentage of such stock at such time as is owned by one of the 10 persons, such person shall also be included. If any of the persons are so related that such stock owned by one is attributed to the other under the rules specified in paragraph (3), such persons shall be considered as only one person solely for the purpose of selecting the 10 persons (more or less) who own the greatest percentage of the fair market value of such outstanding stock.

(3) ATTRIBUTION OF OWNERSHIP.—Section 318 (relating to constructive ownership of stock) shall apply in determining the ownership of stock, except that section 318(a)(2)(C) shall be applied without regard to the 50 percent limitation contained therein.

(4) DEFINITION OF PURCHASE.—For purposes of this subsection the term "purchase" means the acquisition of stock, the basis of which is determined solely by reference to its cost to the holder thereof, in a transaction from a person or persons other than the person or persons the ownership of whose stock would be attributed to the holder by application of paragraph (3).

§ 1.382(a)-1 PURCHASE OF A CORPORATION AND CHANGE IN ITS TRADE OR BUSINESS.—(a) *In general.*—(1) Section 382(a) provides for the complete elimination of the net operating loss carryovers of a corporation (hereinafter called a "loss corporation") if certain circumstances exist. In general, section 382(a) applies only if, at the end of a loss corporation's taxable year, there has been a change (occurring in specified ways) since the beginning of such year, or since the beginning of the prior taxable year, of at least 50 percent in the ownership of the corporation's outstanding stock (hereinafter called a "change of ownership"), and only if the corporation has not continued to carry on substantially the same trade or business as that conducted before such change. If section 382(a) is applicable at the end of a taxable year, then the entire net operating loss carryovers from prior taxable years of such corporation are excluded in computing the net operating loss deduction for such taxable year and for subsequent taxable years.

(2) For purposes of this section, (i) section 318(a) shall apply in determining ownership of stock, except that section 318(a)(2)(C) shall be applied without regard to the 50-percent limitation contained therein, and (ii) stock acquired by the exercise of an option shall be considered as having been acquired on the date the option was acquired. Thus, if A acquires on December 15, 1959, an option to purchase 50 percent of the outstanding stock of X Corporation and if A acquires

the stock by exercising the option on January 15, 1961, A will be considered as having purchased the stock on December 15, 1959.

(3) For the definition of the term "stock" as used in this section, see § 1.382(c)–1.

(b) *Circumstances under which section 382(a) is applicable.*—Section 382(a) applies if, at the end of a taxable year of a loss corporation, all of the following circumstances exist:

(1) Any one or more of those persons described in paragraph (c) of this section own, actually and constructively, a percentage of the total fair market value of the outstanding stock of such corporation which is at least 50 percentage points more than such person or persons owned at the beginning of such taxable year or at the beginning of the prior taxable year;

(2) The increase in percentage points referred to in subparagraph (1) of this paragraph is attributable to (i) a purchase or purchases (as defined in section 382(a)(4) and paragraph (e) of this section) by the person or persons specified in subparagraph (1) of this paragraph of such stock or the stock of another corporation owning stock in such loss corporation, (ii) the purchase or purchases by such person or persons of an interest in a partnership or trust owning stock in such loss corporation, (iii) a decrease in the amount of outstanding stock of such loss corporation or in the amount of outstanding stock of another corporation owning stock in such loss corporation, except a decrease resulting from a redemption to pay death taxes to which section 303 applies, or (iv) a combination of the transactions described in subdivisions (i), (ii), and (iii) of this subparagraph; and

(3) The loss corporation has not continued to carry on a trade or business substantially the same as that conducted before any increase in percentage points described in subparagraph (2) of this paragraph.

(c) *Description of person or persons.*—(1) The persons specified in paragraph (b)(1) of this section shall be the 10 persons who own, actually and constructively, the greatest percentage of the fair market value of the outstanding stock of a loss corporation at the end of a taxable year (or such lesser number as there are persons owning the outstanding stock at the end of such taxable year), except that if any two or more persons own the same percentage of such stock and it is necessary to include one such person in order to select the 10 persons, then all of such persons shall be included. Any such persons so selected who are so related that stock owned by one is attributed to another under the constructive ownership rule specified in paragraph (a)(2) of this section shall be considered as only one person solely for the purpose of selecting such 10 persons. Although considered as one person for purposes of selecting such 10 persons, such related persons are considered as separate persons for all other purposes of section 382(a).

(2) In selecting the 10 persons (more or less) described in subparagraph (1) of this paragraph, the following procedure shall be used:

(i) First, determine those persons who own, actually and constructively, stock of the loss corporation and determine the fair market value of the stock owned, actually and constructively, by such persons.

(ii) Second, select from such persons the number of persons required by the first sentence of subparagraph (1) of this paragraph.

(iii) Third, if any of the persons so selected are so related that stock of one is attributed to another under the rule specified in paragraph (a) (2) of this section, such persons shall be considered as one person.

(iv) Fourth, if, as the result of considering two or more persons as one person, the number of persons previously selected drops below ten, additional persons shall be selected in the manner prescribed in subdivision (ii) of this subparagraph.

(v) Finally, if any such additional persons are related under the rule specified in paragraph (a) (2) of this section to persons previously selected, or to one another, then the principles of subdivisions (iii) and (iv) of this subparagraph shall again be applied.

(3) The application of this paragraph may be illustrated by the following example:

Example. (i) Assume that the outstanding stock of a loss corporation (based on fair market value) is owned, actually and constructively, at the end of a taxable year by the following individuals and partnership:

Person	Percentage of stock actually owned	Percentage of stock owned actually and constructively
A	15	15
B (A's wife)	0	15
C (A's son)	0	15
D (A's daughter)	0	15
GH (a partnership)	0	20
E	16	20
F	15	15
G (a 50 percent partner in GH)	10	15
H (a 50 percent partner in GH)	10	15
I	5	5
J	5	5
K	5	5
L (E's grandson)	4	4
M	4	4
N	3	3
O	2	2
P	2	2
Q	2	2
R	2	2

(ii) The persons selected under subparagraph (2) (ii) of this paragraph are the following 12 persons: A, B, C, D, partnership GH, E, F, G, H, I, J, and K (I, J, and K must all be included because each owns the same percentage of stock). However, A, B, C, and D are considered as one person for purposes of this paragraph because they are related under the rule specified in paragraph (a) (2) of this section, and G, H, and partnership GH are considered as one person for the same reason. Therefore, it is necessary to select three additional persons, L, M, and N, in order to reach the required number of ten. However, since L is related to one of the persons previously selected, he cannot be considered a separate person. It therefore becomes necessary to select an additional person and since O, P, Q, and R each owns the same percentage of stock, they all must be selected. Accordingly, the 10 persons (more or less) who own the greatest percentage of the

fair market value of the outstanding stock are individuals A through R and partnership GH.

(d) *Change of ownership.*—(1) The determination of whether a change of ownership has occurred under section 382(a) is made as of the close of a taxable year of a loss corporation. A "change of ownership" has occurred only if the stock ownership of the 10 persons (more or less) selected under paragraph (c) of this section has increased at least 50 percentage points during a prescribed period and such increase is attributable to a transaction or transactions described in section 382(a)(1)(B) and in paragraphs (e), (f), and (g) of this section. The aggregate increase of at least 50 percentage points may occur at any one time during the taxable year or during the prior taxable year, or may take place in several transactions occurring during such 2-year period. An increase of 50 percentage points is not the same thing as an increase of 50 percent. Thus, a stockholder who owns 4 percent of the fair market value of the stock of a corporation and who increases his ownership to 6 percent has had a 50-percent increase in ownership but an increase in percentage points of only 2.

(2) (i) It is unnecessary to determine whether a "change of ownership" has occurred unless, as of the end of any taxable year (hereinafter called a "current taxable year"), the loss corporation has changed its trade or business after the date of the first increase in percentage points during such taxable year, or during the prior taxable year, which would be taken into account under subparagraph (3) of this paragraph in determining whether a "change of ownership" has occurred.

(ii) If, as of the end of the current taxable year, the loss corporation has changed its trade or business after the date of the first increase in percentage points during such current year, then in determining whether a "change of ownership" has occurred it is first necessary to compare ownership of the outstanding stock at the end of the current taxable year with such ownership at the beginning of such current taxable year. If a "change of ownership" has not occurred as a result of such comparison, then it is necessary to compare ownership of the outstanding stock at the end of the current taxable year with such ownership at the beginning of the prior taxable year.

(iii) If, as of the end of the current taxable year, the loss corporation has not changed its trade or business after the date of the first increase in percentage points during such current year, but the corporation has changed its trade or business after the date of the first increase in percentage points during the prior taxable year, then in determining whether a "change of ownership" has occurred it is necessary to compare ownership of the outstanding stock at the end of the current taxable year with such ownership at the beginning of the prior taxable year.

(iv) For purposes of subdivisions (ii) and (iii) of this subparagraph, an increase in percentage points means only an increase in percentage ownership which would be taken into account under subparagraph (3) of this paragraph in determining whether a "change of ownership" has occurred.

(v) A loss corporation has changed its trade or business during a period between one date and another date only if, as of the later date, the corporation has not continued to carry on a trade or business sub-

stantially the same as that conducted immediately before the earlier date. See paragraph (h) of this section for rules relating to change in trade or business.

(3) In determining whether a "change of ownership" has occurred, the following procedure shall be used:

(i) First, as of the close of a taxable year, the percentage of the total fair market value of stock owned, actually and constructively, by each of the 10 persons (more or less) selected under paragraph (c) of this section shall be computed. For this purpose, each person included in selecting such 10 persons shall be treated as a separate person even though any such persons are considered as only one person under such paragraph (c) in selecting the 10 persons who own the greatest percentage of the fair market value of the outstanding stock.

(ii) Second, the percentage of the total fair market value of stock owned, actually and constructively, by each of such persons as of the beginning of the current taxable year or the prior taxable year, whichever is applicable, shall be computed.

(iii) Third, after computing the percentage of the total fair market value of stock owned by each of the persons as of the close of the current taxable year and as of the beginning of the applicable year, a comparison shall be made between the percentages owned by each such person as of each such date.

(iv) Fourth, with respect to each person who sustained an increase in percentage ownership, the portion of such increase which is attributable to a transaction or transactions described in paragraphs (e), (f), and (g) of this section shall be determined.

(v) Finally, the increases in percentage ownership attributable to such transaction or transactions shall be totaled and the resulting figure shall be used in determining whether a "change of ownership" has occurred.

(4) This paragraph may be illustrated by the following examples:

Example (1). Assume that a loss corporation has changed its trade or business during the current taxable year ending on December 31, 1960. Assume further that the following table shows the percentage of the fair market value of the outstanding stock owned by each stockholder as of December 31, 1960, and the percentages owned by such stockholders as of January 1, 1960, and January 1, 1959. The percentage of stock actually owned is followed in parentheses by the percentage owned actually and constructively under section 318(a). It is assumed that all increases in actual ownership are attributable to a purchase or purchases of stock described in paragraph (e) of this section.

(i) The 10 persons (more or less) who own the greatest percentage of the fair market value of the outstanding stock on December 31, 1960 (as selected under paragraph (c) of this section), are A through N and S. Each of such persons is treated as a separate person in computing increases in percentage ownership.

(ii) A and B each owns, actually and constructively, 23 percent of the outstanding stock on December 31, 1960, 15 percent on January 1, 1960, and 15 percent on January 1, 1959. Therefore, as of December 31, 1960, A and B each has sustained an increase of 8 percentage points since January 1, 1960, and a similar increase since January 1, 1959. A's increase is not attributable to a purchase by him. B's in-

Stockholder	December 31, 1960	January 1, 1960	January 1, 1959
A	10 (23)%	15 (15)%	15 (15)%
B (A's wife)	10 (23)	0 (15)	0 (15)
C	10 (25)	10 (25)	0 (0)
D (C's wife)	5 (25)	5 (25)	0 (10)
E (Son of C and D)	5 (20)	5 (20)	0 (0)
F (Daughter of C and D)	5 (20)	5 (20)	0 (0)
G	10 (10)	10 (10)	0 (0)
H	5 (5)	0 (0)	0 (0)
I	5 (5)	0 (0)	0 (0)
J	5 (5)	0 (0)	0 (0)
K	5 (5)	0 (0)	0 (0)
L	5 (5)	5 (5)	5 (5)
M	4 (4)	0 (0)	0 (0)
N	4 (4)	0 (0)	0 (0)
O	3 (3)	3 (3)	3 (3)
P	3 (3)	3 (3)	3 (3)
Q	3 (3)	3 (3)	3 (3)
R (Grandson of A and B)	3 (3)	0 (0)	0 (0)
S (D's father)	0 (15)	0 (15)	10 (10)

crease, however, is attributable to a purchase by her of 10 percent of the outstanding stock. Therefore, B's increase of 8 percentage points is taken into account in determining whether a "change of ownership" has occurred.

(iii) C owns, actually and constructively, 25 percent of the outstanding stock on December 31, 1960, 25 percent on January 1, 1960, and none on January 1, 1959. Therefore, as of December 31, 1960, C has sustained no increase since January 1, 1960, but he has sustained an increase of 25 percentage points since January 1, 1959. Of this increase 10 percentage points are attributable to a purchase by C.

(iv) D owns, actually and constructively, 25 percent of the outstanding stock on December 31, 1960, 25 percent on January 1, 1960, and 10 percent on January 1, 1959. Therefore, as of December 31, 1960, D has sustained no increase since January 1, 1960, but she has sustained an increase of 15 percentage points since January 1, 1959. Of this increase 5 percentage points are attributable to a purchase by D.

(v) E and F each owns, actually and constructively, 20 percent of the outstanding stock on December 31, 1960, 20 percent on January 1, 1960, and none on January 1, 1959. Therefore, as of December 31, 1960, E and F each has sustained an increase of 20 percentage points since January 1, 1959, of which 5 percentage points in each case are attributable to a purchase.

(vi) G has sustained an increase of 10 percentage points since January 1, 1959, all of which are attributable to a purchase by G.

(vii) H, I, J, and K each has sustained an increase of 5 percentage points since January 1, 1960, and a similar increase since January 1, 1959, all of which are attributable to purchases.

(viii) L has sustained no increase in percentage points.

(ix) M and N each has sustained an increase of 4 percentage points since January 1, 1960, and a similar increase since January 1, 1959, all of which are attributable to purchases.

(x) S has sustained an increase of 5 percentage points since January 1, 1959, but the increase is not attributable to a purchase by S.

(xi) The aggregate increase in percentage ownership (attributable to purchases) since January 1, 1960, is 36 percentage points (8 points from B, 5 each from H, I, J, and K, and 4 each from M and N).

(xii) Since an aggregate increase (attributable to transactions described in paragraph (e)) in stock ownership of at least 50 percentage points has not occurred since January 1, 1960, the beginning of the taxable year, it is necessary to determine whether such an increase has occurred since January 1, 1959, the beginning of the prior taxable year. The aggregate increase in percentage ownership (attributable to purchases) since January 1, 1959, is 71 percentage points (8 from B, 10 each from C and G, 5 each from D, E, F, H, I, J, and K, and 4 each from M and N). Therefore, section 382(a) applies as of December 31, 1960, to eliminate any net operating loss carryovers from 1959 and earlier taxable years to 1960 and subsequent taxable years.

Example (2). Assume that a loss corporation has changed its trade or business during the current taxable year ending on December 31, 1960. Assume further that the following table shows the percentage of the fair market value of the outstanding stock owned by each stockholder as of December 31, 1960, and the percentages owned by such stockholders as of January 1, 1960. The percentage of stock actually owned is followed in parentheses by the percentage owned actually and constructively under section 318(a). It is assumed that all increases in actual ownership are attributable to a purchase or purchases of stock described in paragraph (e) of this section.

Stockholder	December 31, 1960	January 1, 1960
Partnership AB	20 (100)%	0 (40)%
A (a 50-percent partner in AB)	40 (70)	40 (40)
B (a 50-percent partner in AB)	30 (70)	0 (20)
C (B's wife)	10 (70)	0 (20)

(i) Since there are less than 10 stockholders as of December 31, 1960, all of such stockholders are included among the persons who own the greatest percentage of stock.

(ii) Since partnership AB owns, actually and constructively, 100 percent of the outstanding stock on December 31, 1960, and 40 percent on January 1, 1960, AB has sustained an increase of 60 percentage points. Of this increase 20 percentage points are attributable to a purchase by AB.

(iii) A has sustained an increase of 30 percentage points, but none of such increase is attributable to a purchase by A.

(iv) B has sustained an increase of 50 percentage points, of which 30 are attributable to a purchase by B.

(v) C has sustained an increase of 50 percentage points, of which 10 are attributable to a purchase by C.

(vi) Since there has been an aggregate increase (attributable to transactions described in paragraph (e) of this section) of 60 percentage points since January 1, 1960, section 382(a) applies as of December 31, 1960, to eliminate any net operating loss carryovers from 1959 and earlier taxable years to 1960 and subsequent taxable years.

Example (3). (i) Assume that on June 15, 1959, A, an individual, purchases (within the meaning of section 382(a)(4) and paragraph

(e) of this section) 100 percent of the outstanding stock of X Corporation, a loss corporation which makes its return on the basis of the calendar year. On June 30, 1959, A transfers such stock to Y Corporation, the entire outstanding stock of which is owned by A. During September 1959, the business of X Corporation is changed.

(ii) Since, as of December 31, 1959, A is considered under section 318(a) as owning 100 percent of the outstanding stock of X Corporation and he owned none of such stock on January 1, 1959, and since A's increase in percentage points is attributable to a purchase of such stock by him, section 382(a) applies as of December 31, 1959, to eliminate any net operating loss carryovers from 1958 and earlier taxable years to 1959 and subsequent taxable years.

(e) *Meaning of "purchase".*—(1) In determining whether a "change of ownership" has occurred, an increase in stock ownership which is attributable to an acquisition of stock by the person sustaining the increase (whether the stock acquired is stock of the loss corporation or of a corporation owning stock in the loss corporation) shall be taken into account only if such increase is attributable to a purchase (or purchases) by such person, as defined in section 382(a)(4) and this paragraph. There is a "purchase" of stock only if—

(i) The basis of such stock is determined solely by reference to its cost to the acquirer thereof, and

(ii) Immediately before its acquisition the ownership of such stock would not be attributed to the acquirer by application of the constructive ownership rule of paragraph (a)(2) of this section.

For purposes of subdivision (i) of this subparagraph, if the basis of the stock is determined by reference to its basis in the hands of the transferor thereof or of another person, or by reference to the basis of property (other than cash or its equivalent) exchanged for such stock, then the basis of such stock is not determined solely by reference to its cost to the acquirer. Thus, an acquisition of stock by gift or bequest is not a purchase. However, if stock is received in a taxable exchange, its basis is considered to be determined solely by reference to its cost to the acquirer. Thus, if A owns a house which he exchanges for stock in a loss corporation, the basis of the stock is determined solely by reference to its cost to A. For purposes of subdivision (ii) of this subparagraph, if, immediately before any acquisition of stock, the acquirer would be considered under the constructive ownership rule of paragraph (a)(2) of this section as owning less than 100 percent of the stock owned by the transferor, then the acquirer shall be considered as owning, immediately before such acquisition, only that proportion of the stock so acquired as is equal to the proportion of the total stock owned by the transferor which the acquirer would be so considered as owning at such time. Thus, if A acquires stock from B, his wife, A has not made a "purchase" because all the stock so acquired would be considered as owned by A immediately before the acquisition. However, if C and D (who are otherwise unrelated) are equal partners in a partnership and if C acquires 50 shares of stock from D, only 25 of such shares will be considered as owned by C immediately before the acquisition.

(2) If a person acquires stock (or an interest in a partnership, trust, or estate) with a view to invoking the constructive ownership

rule of paragraph (a)(2) of this section so that a later acquisition of stock by, or from, such person will not qualify as a "purchase" under section 382(a)(4), the earlier acquisition will be disregarded solely for the purpose of determining whether the later acquisition is a "purchase". Moreover, in determining whether an acquisition of stock is a "purchase" under section 382(a)(4), negligible holdings of stock or of an interest in a partnership, trust, or estate will be disregarded. This subparagraph may be illustrated by the following example:

Example. A owns all or part of the outstanding stock of X Corporation, a loss corporation. A desires to sell his stock to Y Corporation and Y Corporation desires to purchase such stock. However, Y Corporation wishes to avoid the provisions of section 382(a). Therefore, A buys stock of Y Corporation and thereafter Y Corporation acquires for cash all or part of A's stock in X Corporation. Since the purpose of A's acquisition of stock in Y Corporation is avoidance of the provisions of section 382(a), such acquisition is ignored and Y Corporation's acquisition from A of stock in X Corporation is considered a "purchase" under section 382(a)(4).

(f) *Increase in percentage points attributable to an indirect purchase of stock.*—(1) An increase in percentage points may be attributable to a purchase of stock of a corporation which owns stock of the loss corporation. For example, if X Corporation owns 100 shares of stock of Y Corporation and if A purchases 20 percent in value of the outstanding stock of X Corporation, this will be considered a purchase by A of 20 shares of stock of Y Corporation.

(2) An increase in percentage points may also be attributable to a purchase of an interest in a partnership or trust which owns stock of the loss corporation. For example, if a partnership owns 100 shares of the stock of Y Corporation, a purchase by A of a 20-percent interest in the partnership will be considered a purchase by A of 20 shares of the stock of Y Corporation. Similarly, if a trust owns 100 shares of stock of a loss corporation, and if A purchases an interest in the trust which on an actuarial basis is worth 20 percent, this will be considered a purchase by A of 20 shares of stock of the loss corporation.

(g) *Increase in percentage points attributable to a decrease in outstanding stock.*—(1) An increase in percentage points may be attributable to a decrease in the amount of outstanding stock of a loss corporation. For example, if A and B each owns 50 percent in value of the outstanding stock of X Corporation, a redemption by X Corporation of all of B's stock will increase A's ownership of stock by 50 percentage points.

(2) An increase in percentage points may also be attributable to a decrease in the outstanding stock of a corporation owning, directly or indirectly, stock in the loss corporation. For example, if X Corporation owns 100 percent of the outstanding stock of Y Corporation, a loss corporation, and if A and B each owns 50 percent of the value of the outstanding stock of X Corporation, a redemption by X Corporation of all of B's stock will increase A's indirect ownership of the outstanding stock of Y Corporation by 50 percentage points.

(3) If a decrease in the amount of outstanding stock of a corporation (whether a loss corporation or a corporation owning, directly or indirectly, stock in a loss corporation) results from a redemption to

pay death taxes to which section 303 applies, such decrease shall not be taken into account in determining whether there has occurred an increase of at least 50 percentage points under paragraph (d) of this section. For purposes of the preceding sentence, a decrease in outstanding stock results from a redemption to which section 303 applies only to the extent that the amount distributed in redemption does not exceed the sum of the items described in paragraphs (1) and (2) of section 303(a). Thus, if the amount of $100,000 is distributed in redemption of 100 shares and if the sum of the items described in paragraphs (1) and (2) of section 303(a) is $60,000, a decrease in outstanding stock of only 60 shares will be considered to result from a redemption to which section 303 applies.

(h) *Change in trade or business.*—(1) The provisions of section 382(a) are applicable only if the loss corporation has not continued to carry on a trade or business substantially the same as that conducted before any increase in stock ownership which is taken into account in determining under paragraph (d) of this section whether a change of ownership has occurred. The change in trade or business may occur at any time on or after the date of the earliest such increase during the period beginning on the first day of the loss corporation's prior taxable year. For example, assume that on December 31, 1958 (the end of the corporation's taxable year), the following shareholders own a percentage of the fair market value of the outstanding stock which is greater than each owned at the beginning of the corporation's prior taxable year (January 1, 1957) and that all increases are attributable to purchases within the meaning of paragraph (e) of this section. The increase in percentage points and the date of purchase is shown for each such shareholder:

Shareholder	Increase	Date of purchase
	Percent	
A	20	September 15, 1958.
B	20	June 15, 1958.
C	10	March 15, 1958.
D	10	June 15, 1957.

Since there have been increases in stock ownership which aggregate at least 50 percentage points, section 382(a) is applicable if the corporation has not continued to carry on a trade or business substantially the same as that conducted immediately before June 15, 1957, the date on which the first purchase occurred during the 2-year period.

(2) Section 382(a) may apply as of the close of a taxable year even though neither a change of ownership nor a change in trade or business has occurred during such year. For example, if during 1958 there is a purchase of a least 50 percent of the fair market value of a corporation's outstanding stock followed by a change in the corporation's trade or business, section 382(a) will apply as of December 31, 1958, to eliminate any net operating loss carryovers from 1957 and prior taxable years to 1958 and subsequent taxable years, and, even though no changes in stock ownership occur during 1959, section 382(a) will also apply as of December 31, 1959, to eliminate any net operating loss carryover from 1958 to 1959 and subsequent taxable years.

(3) A change in the trade or business of a corporation made in contemplation of a change in stock ownership will be treated as if such change in trade or business had occurred after such change in stock ownership. For example, if a loss corporation changes its business as part of a plan initiated by, or on behalf of prospective buyers of the loss corporation's stock who wish to avoid the provisions of section 382(a), a subsequent sale of stock to such buyers will cause the change in business to be treated as if it had occurred after the sale.

(4) For purposes of this paragraph, the holding, purchase, or sale for investments purposes of stock, securities, or similar property shall not be considered a trade or business unless such activities historically have constituted the primary activities of the corporation.

(5) In determining whether a corporation has not continued to carry on a trade or business substantially the same as that conducted before any increase in the ownership of its stock, all the facts and circumstances of the particular case shall be taken into account. Among the relevant factors to be taken into account are changes in the corporation's employees, plant, equipment, product, location, customers, and other items which are significant in determining whether there is, or is not, a continuity of the same business enterprise. These factors shall be evaluated in the light of the general objective of section 382(a) to disallow net operating loss carryovers where there is a purchase of the stock of a corporation and its loss carryovers are used to offset gains of a business unrelated to that which produced the losses. However, the prohibited utilization of net operating loss carryovers to offset gains of a business unrelated to that which produced the losses is not dependent upon considerations of purpose, motive, or intent, but rather is established by the objective facts of the particular case. The principles set forth in this subparagraph shall be applied in accordance with the rules set forth in the following subparagraphs of this paragraph.

(6) A corporation has not continued to carry on a trade or business substantially the same as that conducted before any increase in the ownership of its stock if the corporation is not carrying on an active trade or business at the time of such increase in ownership. Thus, if the corporation is inactive at the time of such an increase and subsequently is reactivated in the same line of business as that originally conducted, the corporation has not continued to carry on a trade or business substantially the same as that conducted before such increase in stock ownership. This subparagraph may be illustrated by the following examples:

Example (1). X Corporation is engaged in the business of manufacturing and selling machinery. On January 1, 1958, the corporation suspends its manufacturing activities and begins to reduce its inventory of finished products because of general adverse business conditions and lack of profits. During the period between January 1 and September 1, 1958, the business of the corporation remains dormant. On September 1, 1958, A, an individual, purchases at least 50 percent in value of X Corporation's outstanding stock. On October 1, 1958, the corporation begins to manufacture the same type of machinery it manufactured before January 1, 1958. The reactivation of the corporation in the same line of business as that conducted

before January 1, 1958, does not constitute the carrying on of a trade or business substantially the same as that conducted before the increase in stock ownership.

Example (2). Y Corporation is engaged in the business of manufacturing machinery. On January 1, 1958, the corporation suspends its manufacturing activities because of a fire which disrupts the operation of its plant. During the period between January 1 and June 1, 1958, substantial efforts are made to reactivate the business of the corporation by reconstructing the damaged plant. On June 1, 1958, A, an individual, purchases at least 50 percent in value of Y Corporation's outstanding stock. On July 1, 1958, the corporation resumes its normal manufacturing activities. The fact that the corporation's normal activities are temporarily suspended at the time of the increase in ownership does not of itself constitute a failure to carry on a trade or business substantially the same as that conducted before the increase in stock ownership.

(7) A corporation has not continued to carry on a trade or business substantially the same as that conducted before an increase in the ownership of its stock if the corporation discontinues more than a minor portion of its business carried on before such increase. In determining whether the discontinued activities are more than "minor" for purposes of the preceding sentence, consideration shall be given to whether the discontinuance of the activities has the effect of utilizing loss carryovers to offset gains of a business unrelated to that which produced the losses. This subparagraph may be illustrated by the following examples:

Example 1. X Corporation, a calendar-year taxpayer, is engaged in three separate businesses, A, B, and C. Approximately one-half of X Corporation's total business activities (measured in terms of capital invested, gross income, size of payroll, and similar factors) relates to business A, 30 percent to business B, and the remaining 20 percent to business C. On December 31, 1957, X Corporation has substantial net operating loss carryovers all of which are attributable to the operation of business C. On June 1, 1958, Y Corporation purchases at least 50 percent in value of X Corporation's outstanding stock and during 1959 X Corporation discontinues business C. As of December 31, 1959, X Corporation has not continued to carry on substantially the same trade or business as that conducted prior to the increase in ownership.

Example (2). Assume the same facts as in example (1), except that all of X Corporation's net operating loss carryovers are attributable to business A and that the capital released by the discontinuance of business C is used to revitalize business A. Since the discontinuance of business C does not result in the utilization of net operating losses attributable to one business to offset gains of a business unrelated to that which produced the losses, the discontinuance of such business does not of itself constitute the failure to carry on substantially the same trade or business as that conducted prior to the increase in ownership.

(8) If, after an increase in ownership, the corporation continues to carry on its prior business activities substantially undiminished, the addition by the corporation of a new trade or business does not con-

stitute a failure to carry on substantially the same trade or business. This subparagraph may be illustrated by the following example:

Example. X Corporation, a calendar-year taxpayer, is engaged in the manufacture and sale of electrical appliances and has substained substantial net operating losses. On June 30, 1958, Y Corporation purchases 100 percent of X Corporation's outstanding stock. During 1959, X Corporation continues substantially undiminished its activities in the manufacture and sale of electrical appliances and also diversifies its activities by acquiring a cement manufacturing plant. The addition of the cement manufacturing business by X Corporation does not of itself constitute a failure to carry on substantially the same trade or business even though net operating loss carryovers attributable to the electrical appliance business are used to offset profits of the cement manufacturing business. See, however, section 269 and the regulations thereunder.

(9) A corporation has not continued to carry on a trade or business substantially the same as that conducted before any increase in the ownership of its stock if the corporation changes the location of a major portion of its activities and as a result of such change in location the business of the corporation is substantially altered. This subparagraph may be illustrated by the following examples:

Example (1). X Corporation, a calendar-year taxpayer, is engaged in the business of manufacturing in State A and has sustained substantial net operating losses. On June 30, 1958, Y Corporation purchases all of X Corporation's outstanding stock. During 1959, X Corporation transfers its operations to State B which is several hundred miles distant from State A. In order to effect the change in location, X Corporation disposes of its plant and a large portion of its machinery located in State A. The distance between State A and State B makes it necessary for the majority of the employees of X Corporation to terminate their employment with X Corporation. During 1959, X Corporation resumes its manufacturing activities in State B and continues to make the same product and to serve substantially the same group of customers. However, by reason of the changes in location, employees, plant, and equipment, X Corporation on December 31, 1959, is not carrying on substantially the same trade or business as that conducted prior to the increase in ownership.

Example (2). Y Corporation, a calendar-year taxpayer, is engaged in the operation of a department store in city A. On June 30, 1958, Z Corporation purchases all of the outstanding stock of Y Corporation. During 1959, Y Corporation transfers its operations to town B, a suburb of city A. By reason of the change in location, Y Corporation disposes of its interest in the building formerly occupied by it in city A and also substitutes new equipment for a major portion of the equipment formerly utilized by it in city A. After the change in location, Y Corporation continues to sell substantially the same products to substantially the same customers or to customers drawn from substantially the same area and retains substantially all of the employees formerly employed in city A. Under such circumstances, the change of location does not result in a failure to carry on substantially the same trade or business as that conducted before the increase in ownership.

Example (3). Z Corporation, a calendar-year taxpayer, operates a retail liquor store in town M, utilizing the services of 10 employees. On June 30, 1958, individual A purchases all of the stock of Z Corporation. During 1959, Z Corporation transfers its operations to town O, a distance of 5 miles from its former location. By reason of the change in location, Z Corporation disposes of its interest in the premises formerly occupied by it and also disposes of the license and franchise issued by town M. During 1959, Z Corporation transfers its inventory of liquor to its new location and resumes its retail liquor activities under a license and franchise issued by town O. Z Corporation continues to employ 5 of the 10 employees formerly employed in town M, but the corporation does not serve substantially the same customers or customers drawn from substantially the same area. Under these circumstances, the change of location results in a failure to carry on substantially the same trade or business as that conducted before the increase in ownership.

(10) A corporation has not continued to carry on a trade or business substantially the same as that conducted before any increase in the ownership of its stock if the corporation is primarily engaged in the rendition of services by a particular individual or individuals and, after the increase in ownership, the corporation is primarily engaged in the rendition of services by different individuals. This subparagraph may be illustrated by the following examples:

Example (1). X Corporation, a calendar-year taxpayer, is engaged in the business of selling real estate and insurance primarily through the services of individual A as broker. On June 30, 1958, individual B purchases all of the stock of X Corporation, and individual A retires from the business. During the latter part of 1958, X Corporation is engaged primarily in rendering the brokerage services of individual B in the sale of insurance and real estate. On December 31, 1958, the corporation has not continued to carry on a trade or business substantially the same as that conducted before the increase in ownership.

Example (2). Y Corporation, a calendar-year taxpayer, is engaged in the business of operating a beauty salon with 10 employees under the supervision of individual A, who owns all of the stock of Y Corporation and who is held out to the public as the corporation's principal beauty consultant. However, the quality of the services rendered by each of the 10 employees is primarily responsible for attracting the corporation's clientele. On June 30, 1958, individual B purchases all of the outstanding stock of Y Corporation and individual A retires from the business. During 1959, Y Corporation continues to operate the beauty salon in the same location and continues to serve substantially the same group of customers with substantially the same employees under the supervision of individual B, who is held out to the public as the corporation's principal beauty consultant. On December 31, 1959, Y Corporation has continued to carry on substantially the same trade or business as that conducted before the increase in ownership.

§ 1.382(b) Statutory Provisions; Special Limitations on Net Operating Loss Carryovers; Change of Ownership as the Result of a Reorganization.

SEC. 382. SPECIAL LIMITATIONS ON NET OPERATING LOSS CARRYOVERS. * * *

(b) CHANGE OF OWNERSHIP AS THE RESULT OF A REORGANIZATION.—(1) IN GENERAL.—If, in the case of a reorganization specified in paragraph (2) of section 381(a), the transferor corporation or the acquiring corporation—

(A) Has a net operating loss which is a net operating loss carryover to the first taxable year of the acquiring corporation ending after the date of transfer, and

(B) The stockholders (immediately before the reorganization) of such corporation (hereinafter in this subsection referred to as the "loss corporation"), as the result of owning stock of the loss corporation, own (immediately after the reorganization) less than 20 percent of the fair market value of the outstanding stock of the acquiring corporation, the total net operating loss carryover from prior taxable years of the loss corporation to the first taxable year of the acquiring corporation ending after the date of transfer shall be reduced by the percentage determined under paragraph (2).

(2) REDUCTION OF NET OPERATING LOSS CARRYOVER.—The reduction applicable under paragraph (1) shall be the percentage determined by subtracting from 100 percent—

(A) The percent of the fair market value of the outstanding stock of the acquiring corporation owned (immediately after the reorganization) by the stockholders (immediately before the reorganization) of the loss corporation, as the result of owning stock of the loss corporation, multiplied by

(B) Five.

(3) EXCEPTION TO LIMITATION IN THIS SUBSECTION.—The limitation in this subsection shall not apply if the transferor corporation and the acquiring corporation are owned substantially by the same persons in the same proportion.

(4) NET OPERATING LOSS CARRYOVERS TO SUBSEQUENT YEARS.—In computing the net operating loss carryovers to taxable years subsequent to a taxable year in which there was a limitation applicable to a net operating loss carryover by operation of this subsection, the income in such taxable year, as computed under section 172(b)(2), shall be increased by the amount of the reduction of the total net operating loss carryover determined under paragraph (2).

(5) ATTRIBUTION OF OWNERSHIP.—If the transferor corporation or the acquiring corporation owns (immediately before the reorganization) any of the outstanding stock of the loss corporation, such transferor corporation or acquiring corporation shall, for purposes of this subsection, be treated as owning (immediately after the reorganization) a percentage of the fair market value of the acquiring corporation's outstanding stock which bears the same ratio to the percentage of the fair market value of the outstanding stock of the loss corporation (immediately before the reorganization) owned by such transferor corporation or acquiring corporation as the fair market value of the total outstanding stock of the loss corporation (immediately before the reorganization) bears to the fair market value of the total outstanding stock of the acquiring corporation (immediately after the reorganization).

(6) STOCK OF CORPORATION CONTROLLING ACQUIRING CORPORATION.—If the stockholders of the loss corporation (immediately before the reorganization) own, as a result of the reorganization, stock in a corporation controlling the acquiring corporation, such stock of the controlling corporation shall, for purposes of this subsection, be treated as stock of the acquiring corporation in an amount valued at an equivalent fair market value.

§ 1.382(b)-1 CHANGE OF OWNERSHIP AS THE RESULT OF A REORGANIZATION.—(a) *In general.*—(1) Section 382(b)(1) provides that if, in the case of a reorganization described in section 381(a)(2), either

the transferor corporation or the acquiring corporation has a net operating loss carryover which is a carryover to the first taxable year of the acquiring corporation ending after the date of transfer, the amount of such carryover which may be used by the acquiring corporation is reduced unless the stockholders (immediately before the reorganization) of the corporation possessing the carryover (hereinafter called the "loss corporation") own, immediately after the reorganization, at least 20 percent of the fair market value of the outstanding stock of the acquiring corporation. See paragraph (b) of § 1.381(b)–1 for determination of the date of transfer, and paragraph (b) of this section for computation of the amount of the reduction.

(2) The ownership of at least 20 percent of the fair market value of the stock of the acquiring corporation after the reorganization must result from the ownership of stock in the loss corporation immediately before the reorganization. Thus, if stockholders of a transferor-loss corporation before the reorganization also own stock of the acquiring corporation at such time, such stock of the acquiring corporation is not considered as owned after the reorganization by such stockholders as a result of owning stock in the loss corporation in determining whether the 20-percent requirement is satisfied. Moreover, the stockholders (immediately before the reorganization) of a transferor-loss corporation shall not be regarded as owning, immediately after the reorganization, any stock of the acquiring corporation which is not distributed to such stockholders pursuant to the plan of reorganization.

(3) If the net operating loss carryovers of a loss corporation are reduced under section 382(b)(1), then in computing the net operating loss deduction of the acquiring corporation for its first taxable year ending after the date of transfer, that portion of such deduction which is attributable to the net operating loss carryovers of the loss corporation is limited to the amount of such carryovers minus the reduction. Thus, if the net operating loss carryovers of the loss corporation are $100,000 and if the amount of the reduction is $60,000, only $40,000 of such carryovers may be used by the acquiring corporation in computing its net operating loss deduction under section 172(a) for its first taxable year ending after the date of transfer. The reduction provided in section 382(b)(1) is applied to the aggregate of the allowable net operating loss carryovers of the loss corporation without regard to the taxable years in which the net operating losses were sustained.

(4) See paragraph (e) of this section for the effect of the reduction in subsequent taxable years of the acquiring corporation.

(5) The reduction provided by section 382(b)(1) may apply to the carryovers of more than one corporation a party to the reorganization. For example, assume that X Corporation acquires the assets of Y Corporation and of Z Corporation in a reorganization described in section 381(a)(2) and that both X Corporation and Y Corporation have net operating loss carryovers at the date of the reorganization. The reduction under section 382(b)(1) will apply to the net operating loss carryovers of X Corporation unless the stockholders (immediately before the reorganization) of X Corporation own, immediately after the reorganization, at least 20 percent of the fair market value

of the outstanding stock of X Corporation. Similarly, the reduction under section 382(b)(1) will apply to the net operating loss carryovers from Y Corporation unless the stockholders (immediately before the reorganization) of Y Corporation own, immediately after the reorganization, at least 20 percent of the fair market value of the outstanding stock of X Corporation.

(6) Section 382(b) applies only with respect to those reorganizations described in section 381(a)(2). However, a series of transactions which purport to be a reorganization qualifying under section 368(a)(1)(B) followed by a liquidation qualifying under section 332, but which in substance comprise a reorganization qualifying under section 368(a)(1)(C), will be considered as a reorganization of the last-described type for purposes of section 382(b) and this section.

(7) See § 1.382(c)–1 for definition of the term "stock" as used in this section.

(b) *Amount of reduction.*—(1) The amount of the reduction provided in section 382(b)(1) shall be determined as follows:

(i) Determine the percentage of the fair market value of the outstanding stock of the acquiring corporation owned, immediately after the reorganization, by the stockholders (immediately before the reorganization) of the loss corporation, which is attributable to their ownership of stock in the loss corporation immediately before the reorganization.

(ii) If the percentage determined under subdivision (i) is less than 20 percent, compute the difference between such percentage and 20 percent, and multiply such difference by five. The resulting product is the percentage by which the net operating loss carryovers are reduced.

(2) Subparagraph (1) of this paragraph may be illustrated by the following example:

Example. Assume that X Corporation acquires the assets of Y Corporation, a loss corporation, in a reorganization described in section 381(a)(2), and that immediately after the reorganization the former stockholders of Y Corporation, as the result of owning stock of Y Corporation, own 8 percent of the fair market value of X Corporation's outstanding stock. The difference between 8 percent and 20 percent is 12 percent, which when multiplied by five produces 60 percent. Therefore, the amount of the reduction is equal to 60 percent of the net operating loss carryovers from the loss corporation, so that if the net operating loss carryovers from Y Corporation amounted to $100,000, the amount of the reduction would be $60,000.

(c) *Acquisitions designed to avoid section 382(b).*—The purpose of the 20-percent requirement of section 382(b)(1) is to ensure that the net operating loss carryovers from a corporation a party to a reorganization will be allowed in full only when the shareholders of the loss corporation have a substantial continuing interest in the acquiring corporation, thereby ensuring that the carryovers will be utilized to some extent for the benefit of those persons who were owners of the loss corporation before the reorganization. Therefore, in applying section 382(b)(1), any acquisition of stock of a loss corporation will be disregarded if made for the purpose of avoiding the 20-percent continuity of interest requirement. Moreover, two or more

successive reorganizations will be treated as if they had occurred simultaneously in cases where they are undertaken with a view to avoiding the 20-percent continuity requirement. These rules may be illustrated by the following examples:

Example (1). Assume that X Corporation desires to merge into Y Corporation, a loss corporation, in a reorganization. A and B, who are the controlling stockholders of X Corporation, with a view to avoiding the 20-percent continuity of interest requirement of section 382(b)(1), acquire for cash 40 percent of the fair market value of the outstanding stock of Y Corporation (or acquire an option to purchase such stock, which option they exercise shortly after the merger). Thereafter, Y Corporation acquires the assets of X Corporation in a reorganization to which section 381(a) applies. In determining whether the 20-percent continuity requirement is satisfied (and, if not, the amount of the reduction under section 382(b)(2)), the stock of Y Corporation purchased by A and B (or acquired upon their exercise of the option) will be considered as outstanding immediately after the reorganization but will not be considered as owned by persons who were stockholders of Y Corporation immediately before the reorganization.

Example (2). Assume that X Corporation, which has a net worth of $2,000,000, desires to acquire the assets of Y Corporation, a loss corporation, which has a net worth of $100,000. X Corporation also desires to acquire the assets of Z Corporation, which has a net worth of $400,000. With a view to avoiding the 20-percent continuity requirement, Z Corporation acquires the assets of Y Corporation in a reorganization to which section 381(a) applies. Immediately after the reorganization, the former stockholders of Y Corporation own 20 percent of the fair market value of the outstanding stock of Z Corporation. Shortly thereafter, X Corporation acquires the assets of Z Corporation in a reorganization to which section 381(a) applies. Immediately after the reorganization, the former stockholders of Y Corporation own 4 percent of the fair market value of the outstanding stock of X Corporation. Under these circumstances, the application of section 382(b)(1) to the net operating loss carryovers of Y Corporation shall be determined by reference to the fair market value of the outstanding stock of X Corporation owned, immediately after the successive reorganizations, by the stockholders (immediately before the successive reorganizations) of Y Corporation. Therefore, the net operating loss carryovers from Y Corporation will be reduced by 80 percent.

(d) *Exception to application of section 382(b).*—(1) Section 382(b)(3) provides an exception to the application of the reduction provided in section 382(b)(1). Under this exception there is no reduction if, immediately before the reorganization, the transferor corporation and the acquiring corporation are owned substantially by the same persons in the same proportion. If the acquiring corporation is not in existence immediately before the reorganization (as in the case of a statutory consolidation), the requirements of section 382(b)(3) are not met unless the transferor corporations immediately before the

reorganization are owned substantially by the same persons in the same proportion.

(2) The transferor corporation and the acquiring corporation will be considered as owned substantially by the same persons in the same proportion only if the same persons own substantially all the stock of the corporations in substantially the same proportion. This rule may be illustrated by the following examples:

Example (1). A and B each owns 50 percent of the fair market value of the outstanding stock of X Corporation. A owns 52 percent and B owns 48 percent of the fair market value of the outstanding stock of Y Corporation. Y Corporation acquires the assets of X Corporation in a reorganization to which section 381(a) applies. The exception provided in section 382(b)(3) is applicable.

Example (2). A and B each owns 50 percent of the fair market value of the outstanding stock of X Corporation. A owns 60 percent and B owns 40 percent of the fair market value of the outstanding stock of Y Corporation. Y Corporation acquires the assets of X Corporation in a reorganization to which section 381(a) applies. The exception provided in section 382(b)(3) is not applicable.

Example (3). A and B each owns 48 percent of the fair market value of the outstanding stock of X Corporation and of Y Corporation. C owns the remaining 4 percent of X Corporation and D owns the remaining 4 percent of Y Corporation. Y Corporation acquires the assets of X Corporation in a reorganization to which section 381(a) applies. The exception provided in section 382(b)(3) is applicable.

Example (4). A and B each owns 40 percent of the fair market value of the outstanding stock of X Corporation and of Y Corporation. C owns the remaining 20 percent of X Corporation and D owns the remaining 20 percent of Y Corporation. Y Corporation acquires the assets of X Corporation in a reorganization to which section 381(a) applies. The exception provided in section 382(b)(3) is not applicable.

(3) If stock of the transferor or acquiring corporation is acquired or disposed of for the purpose of meeting the requirements of section 382(b)(3), then for purposes of such section such stock shall not be considered to be owned by the person who acquired it. For example, if A, owning 100 percent of the outstanding stock of X Corporation and 75 percent of the outstanding stock of Y Corporation, a loss corporation, acquires the remaining 25 percent of the outstanding stock of Y Corporation with a view to merging the two corporations, then for purposes of section 382(b)(3) such 25 percent shall not be considered to be owned by A.

(e) *Carryovers to subsequent years.*—(1) The reduction provided in section 382(b)(1) applies only to net operating loss carryovers to the first taxable year of the acquiring corporation ending after the date of transfer. However, section 382(b)(4) contains a rule to ensure that the portion of the carryovers equal to the amount of the reduction will not be available for deduction in subsequent taxable years of the acquiring corporation. This rule provides that if a re-

duction is applicable under section 382(b)(1), then in computing net operating loss carryovers from taxable years of the transferor and acquiring corporations ending on or before the date of transfer to taxable years of the acquiring corporation subsequent to the first taxable year ending after the date of transfer, the income of the acquiring corporation for such first taxable year, as computed under section 172(b)(2) (without regard to the fact that the deduction under section 172(a) is reduced by the amount computed under section 382(b)(2)), shall be increased by the amount of the reduction computed under section 382(b)(2) for that year. The preceding rule may be illustrated by the following example:

Example. X Corporation and Y Corporation are organized on January 1, 1957, and each makes its return on the basis of the calendar year. On December 31, 1958, Y Corporation acquires the assets of X Corporation in a reorganization to which section 381(a) applies. Immediately after the reorganization, those persons who were stockholders of X Corporation immediately before the reorganization own 10 percent of the fair market value of the outstanding stock of Y Corporation. The net operating losses and the taxable income (computed without any net operating loss deduction) of the two corporations are as follows:

Year	X corporation (transferor)	Y corporation (acquirer)
1957	($5,000)	($5,000)
1958	(15,000)	(1,000)
1959	----------	5,000

The computation of the carryovers to Y Corporation's calendar year 1960 may be illustrated as follows:

(i) *X Corporation's 1957 loss.*—The carryover to 1960 is $0, computed as follows:

Net operating loss			$5,000
Less:			
X's 1958 taxable income		$0	
Y's 1959 taxable income before adjustment under section 382(b)(4)	$5,000		
Plus amount of reduction computed under section 382(b)(2) (50% of $20,000)	10,000	15,000	15,000
Carryover to 1960			0

(ii) *Y Corporation's 1957 loss.*—The carryover to 1960 is $0, computed as follows:

Net operating loss			$5,000
Less:			
Y's 1958 taxable income		$0	
Y's 1959 taxable income before net operating loss deduction and adjustment under section 382(b)(4)	$5,000		
Minus Y's 1959 net operating loss deduction (i.e., X's 1957 carryover)	5,000		
Plus amount of reduction under section 382(b)(2)	10,000	10,000	10,000
Carryover to 1960			0

(iii) *X Corporation's 1958 loss.*—The carryover to 1960 is $10,000, computed as follows:

Net operating loss			$15,000
Less:			
X's 1957 taxable income		$0	
Y's 1959 taxable income before net operating loss deduction and adjustment under section 382(b)(4)	$5,000		
Minus Y's 1959 net operating loss deduction (i.e., X's 1957 carryover of $5,000 and Y's 1957 carryover of $5,000)	10,000		
Plus amount of reduction under section 382(b)(2)	10,000	5,000	5,000
Carryover to 1960			10,000

(iv) *Y Corporation's 1958 loss.*—The carryover to 1960, is $1,000, computed as follows:

Net operating loss			$1,000
Less:			
Y's 1957 taxable income		$0	
Y's 1959 taxable income before net operating loss deduction and adjustment under section 382(b)(4)	$5,000		
Minus Y's 1959 net operating loss deduction (i.e., X's 1957 carryover of $5,000, Y's 1957 carryover of $5,000, and X's 1958 carryover of $15,000)	25,000		
Plus amount of reduction under section 382(b)(2)	10,000	0	0
Carryover to 1960			1,000

(v) *Summary of carryovers to 1960.*—The aggregate of the net operating loss carryovers to 1960 is $11,000, computed as follows:

X's 1958 loss	$10,000
Y's 1958 loss	1,000
Total	11,000

(2) If the date of transfer is on a day other than the last day of a taxable year of the acquiring corporation, and if the reduction provided in section 382(b)(1) applies to net operating loss carryovers of the transferor corporation, then for purposes of section 381(c)(1)(C), the adjustment provided in section 382(b)(4) shall be considered as an increase in income of the "postacquisition part year" and no portion of such adjustment shall be considered as an increase in income of the "preacquisition part year".

(f) *Attribution of ownership.*—(1) Section 382(b)(5) provides a special rule for determining whether the reduction provided in section 382(b)(1) applies in cases where, immediately before the reorganization, either the transferor corporation or the acquiring corporation owns outstanding stock of the loss corporation. Under this rule, the transferor or acquiring corporation (whichever owns stock of the loss corporation) is treated as owning, immediately after the reorganization, a percentage, A, of the fair market value of the acquiring corporation's outstanding stock which bears the same ratio to B (the percentage of the fair market value of the stock of the loss corporation owned, immediately before the reorganization, by such transferor or acquiring corporation) as C (the fair market value of the outstanding stock of the loss corporation immediately before the reorganization) bears to D (the fair market value of the outstanding stock of the acquiring corporation immediately after the reorganization). Stated

algebraically, the percentage of the fair market value of the acquiring corporation's outstanding stock treated as owned by the transferor or acquiring corporation immediately after the reorganization, A, equals—

$$\frac{\text{Value of stock of loss corporation immediately before reorganization (C)}}{\text{Value of stock of acquiring corporation immediately after reorganization (D)}} \times \text{Percentage of stock of loss corporation owned by transferor or acquiring corporation immediately before reorganization (B)}$$

The preceding rule may be illustrated by the following examples:

Example (1). Assume that X Corporation owns 25 percent of the fair market value of the outstanding stock of Y Corporation, a loss corporation; that X Corporation acquired the assets of Y Corporation in a reorganization to which section 381(a) applies; that immediately before the reorganization the total outstanding stock of Y Corporation has a fair market value of $10,000; and that immediately after the reorganization the total outstanding stock of X Corporation has a fair market value of $50,000. For the purpose of determining whether the reduction provided in section 382(b)(1) is applicable (and, if so, the amount of the reduction computed under section 382(b)(2)), X Corporation is treated as owning (immediately after the reorganization) 5 percent of the fair market value of its outstanding stock, determined as follows:

$$\frac{\$10,000\ \text{(C)}}{\$50,000\ \text{(D)}} \times 25\%\ \text{(B)} = 5\%\ \text{(A)}$$

Thus, if the other former stockholders of Y Corporation own, after the reorganization, at least 15 percent of the fair market value of the outstanding stock of X Corporation as the result of owning stock in Y Corporation, there will be no reduction under section 382(b)(1).

Example (2). Assume the same facts as in example (1), except that Y Corporation acquires the assets of X Corporation in a reorganization to which section 381(a) applies and that immediately after the reorganization the total outstanding stock of Y Corporation has a fair market value of $50,000. The result is the same as that in example (1). X Corporation is treated as owning (immediately after the reorganization) 5 percent of the fair market value of the outstanding stock of Y Corporation. Thus, there will be no reduction under section 382(b)(1) if those persons (other than X Corporation) who were stockholders of Y Corporation immediately before the reorganization own at least 15 percent of the fair market value of the outstanding stock of Y Corporation immediately after the reorganization.

(2) The provisions of paragraph (5) of section 382(b) do not apply with respect to an interest in a loss corporation which is acquired for the purpose of avoiding the 20-percent continuity of interest requirement of section 382(b)(1). Thus, paragraph (5) of section 382(b) does not apply with respect to stock of a loss corporation which is acquired by another corporation with a view to causing a merger of the two corporations. For example, if X Corporation owns 15 percent of the fair market value of the outstanding stock of Y Corporation, a loss corporation, and if X Corporation purchases an additional 15 percent with a view to causing a merger of the two corporations, paragraph (5) of section 382(b) applies only with re-

spect to the stock previously held by X Corporation and not to the stock so purchased.

(g) *Stock of corporation controlling acquiring corporation.*—(1) Section 382(b)(6) provides a special rule for determining whether the reduction provided in section 382(b)(1) applies in cases where the transferor corporation is a loss corporation and the former stockholders of the loss corporation own, as a result of the reorganization, stock in a corporation which controls (within the meaning of section 368(c)) the acquiring corporation. In such cases, the former stockholders of the loss corporation are treated as owning, after the reorganization, stock of the acquiring corporation equal in value to the fair market value of their stock in the controlling corporation. This rule may be illustrated by the following example:

Example. X Corporation owns 100 percent of the stock of Y Corporation. In a reorganization to which section 381(a) applies, Y Corporation acquires the assets of Z Corporation, a loss corporation, in exchange for stock of X Corporation. Immediately after the reorganization the total outstanding stock of Y Corporation has a fair market value of $50,000, and the stockholders (immediately before the reorganization) of the loss corporation own, as a result of the reorganization, stock of X Corporation having a fair market value of $20,000. For the purpose of determining whether the reduction provided in section 382(b)(1) is applicable (and, if so, the amount of the reduction computed under section 382(b)(2)), the former stockholders of the loss corporation are treated as owning stock of Y Corporation worth $20,000 (the value of their stock in X Corporation), which is 40 percent ($20,000 divided by $50,000) of the fair market value of the outstanding stock of the acquiring corporation.

(2) The 20-percent continuity of interest requirement of section 382(b)(1) applies with respect to an interest in the corporation desiring to utilize the net operating loss carryovers from the loss corporation. Thus, the provisions of section 382(b)(6) and of subparagraph (1) of this paragraph apply only if, at the time of the reorganization, it is intended that the acquiring corporation itself, and not the corporation which controls the acquiring corporation, shall make use of the net operating loss carryovers from the loss corporation. Section 382(b)(6) and subparagraph (1) of this paragraph do not apply if the loss corporation is acquired by a controlled corporation with a view to the liquidation of the controlled corporation into its parent at a time when a substantial part of the net operating loss carryovers from the loss corporation remain to be utilized. (This requirement is satisfied in any case in which such action was contemplated at the time of the reorganization by those persons in a position to determine the policies of the controlled corporation.) In such case, it is the controlling corporation, instead of the controlled corporation, in which the former stockholders of the loss corporation must own a 20-percent interest. Thus, assume in the example appearing in subparagraph (1) of this paragraph, that the total fair market value of the outstanding stock of X Corporation immediately after the reorganization is $200,000 and that X Corporation causes Y Corporation to be liquidated at a time when a substantial part of the loss carryovers from Z Corporation remain to be utilized. Under these circumstances, the former stockholders of the loss corporation would own after the

reorganization only 10 percent ($20,000 divided by $200,000) of the fair market value of the outstanding stock of the controlling corporation and the net operating loss carryovers from Z Corporation to the first taxable year of Y Corporation ending after the date of transfer would accordingly be reduced by 50 percent.

§ 1.382(c) STATUTORY PROVISIONS; SPECIAL LIMITATIONS ON NET OPERATING LOSS CARRYOVERS; DEFINITION OF STOCK.

SEC. 382. SPECIAL LIMITATIONS ON NET OPERATING LOSS CARRYOVERS. * * *

(c) DEFINITION OF STOCK.—For purposes of this section, "stock" means all shares except nonvoting stock which is limited and preferred as to dividends.

§ 1.382(c)-1 DEFINITION OF STOCK.—Section 382(c) contains the definition of the term "stock" for purposes of section 382 (a) and (b). For these purposes, the term "stock" means all outstanding shares except nonvoting stock which is limited and preferred as to dividends.

§ 1.394 STATUTORY PROVISIONS; EFFECTIVE DATE OF PART V, SUBCHAPTER C, CHAPTER 1 OF THE CODE.

SEC. 394. EFFECTIVE DATE OF PART V.

(a) SECTION 381.—Except as otherwise provided in this subchapter, section 381 shall apply to liquidations and reorganizations, the tax treatment of which is determined under this Code.

(b) SECTION 382(a).—For purposes of applying the special limitation on net operating loss carryovers in section 382(a), the beginning of the taxable years specified in clauses (i) and (ii) of section 382(a)(1)(A) shall be considered to be the beginning of such taxable years or June 22, 1954, whichever occurs later.

(c) SECTION 382(b).—Section 382(b) shall apply to reorganizations, the tax treatment of which is determined under this Code.

§ 1.394–1 EFFECTIVE DATE OF PART V OF SUBCHAPTER C.—(a) *Section 381.*—Section 394(a) provides that, except as otherwise provided in subchapter C, chapter 1 of the Code, section 381 shall apply to liquidations and reorganizations, the tax treatment of which is determined under the Internal Revenue Code of 1954. For such liquidations, see section 392 and the regulations thereunder. For such reorganizations, see section 393 and the regulations thereunder.

(b) *Section 382(a).*—Section 394(b) provides that for purposes of applying the special limitation on net operating loss carryovers contained in section 382(a), the beginning of the taxable years specified in clauses (i) and (ii) of section 382(a)(1)(A) shall be considered to be the beginning of such taxable years or June 22, 1954, whichever occurs later. Thus, if X Corporation made its returns for 1954 and 1955 on the basis of the calendar year, then in determining whether the limitation contained in section 382(a) applies as of December 31, 1954, the beginning of the taxable years specified in clauses (i) and (ii) of section 382(a)(1)(A) would be June 22, 1954, and in determining whether section 382(a) applies as of December 31, 1955, the beginning of the taxable year specified in clause (i) of section 382(a)(1)(A) would be January 1, 1955, and the beginning of the taxable year specified in clause (ii) of section 382(a)(1)(A) would be June 22, 1954.

(c) *Section 382(b).*—Section 394(c) provides that section 382(b) shall apply to reorganizations, the tax treatment of which is de-

termined under the Internal Revenue Code of 1954. See section 393 and the regulations thereunder.

Authority: §§ 1.382(a) through 1.382(c)-1, incl., 1.394 and 1.394-1, issued under sec. 7805, I.R.C. 1954; 68A Stat. 917; 26 U.S.C. 7805.

MORTIMER M. CAPLIN,
Commissioner of Internal Revenue.

Approved October 30, 1962.

STANLEY S. SURREY,
Assistant Secretary of the Treasury.

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PART VI.—EFFECTIVE DATE OF SUBCHAPTER C

SECTION 394.—EFFECTIVE DATE OF PART V

26 CFR 1.394: Statutory provisions; effective date of part V, subchapter C, chapter 1 of the Code.

Effective date of regulations under sections 381 and 382 of the Internal Revenue Code of 1954, relating to carryovers in certain reorganizations. See T.D. 6616, page 98.

SUBCHAPTER D.—DEFERRED COMPENSATION, ETC.

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

SECTION 401.—QUALIFIED PENSION, PROFIT-SHARING, AND STOCK BONUS PLANS

26 CFR 1.401-1: Qualified pension, profit-sharing, and stock bonus plans. (Also Section 404; 1.404(a)-1.) Rev. Rul. 62-139

> Past service with specified former employers may be used for the purpose of determining eligibility to participate in a qualified employees' pension plan of a present employer and for determining benefits thereunder, provided (1) all employees having such past service are treated uniformly; (2) the use of such past service factor does not produce discrimination in favor of officers, shareholders, supervisors, or highly compensated employees, and (3) there is no duplication of benefits.
>
> However, it does not necessarily follow that, because a plan satisfies the nondiscrimination requirements of section 401(a) of the Internal Revenue Code of 1954, all employer contributions thereto are within the ordinary and necessary business expense and reasonable compensation deductions limitations imposed by section 162(a)(1) of the Code.

Advice has been requested as to the extent to which past service with a former employer may be recognized, under a present employer's qualified pension plan, for the purposes of making determinations

as to (1) eligibility and benefits thereunder and (2) determining deductibility of contributions to such plan by the present employer.

Section 401(a) of the Internal Revenue Code of 1954 provides, in part, that a trust created or organized in the United States and forming a part of a stock bonus, pension, or profit-sharing plan of an employer for the exclusive benefit of his employees or their beneficiaries shall constitute a qualified trust if the trust or plan does not discriminate in favor of employees who are officers, shareholders, persons whose principal duties consist in supervising the work of other employees, or highly compensated employees.

Pursuant to a pension plan adopted by one or more employers, the periods of past service of an employee with a former employer, irrespective of the degree of affiliation existing between the present employer and the former employer and notwithstanding the fact that the former employer is not a participant in a group plan with the present employer, may be used for purposes of determining eligibility and benefits thereunder, provided (1) such former employer, if not a participant in a group plan with the present employer, is specified in the plan or trust; (2) all employees of such former employer are treated uniformly; (3) the use of the past service factor does not produce discrimination in favor of officers, shareholders, persons whose principal duties consist in supervising the work of other employees, or highly compensated employees; and (2) such past service is not covered by any pension plan under which the rights accrued during such prior service are vested in the employee. It is considered immaterial that such former employer had no pension plan in effect during the period upon which the past service is based.

The allowance of credit for services rendered as an employee of a former employer in a pension plan of the present employer is not deemed compensation for such prior service but is considered a unit of measurement as to the reasonableness of the current compensation of the employee for services rendered to the present employer. Hence, the primary test for inclusion of credits pursuant to a qualified pension plan based on the employee's services with any former employer, whether for eligibility or benefit purposes, is whether the application of such past service credits results in discrimination in favor of employees in the prohibited group.

Section 404(a)(1) of the Code provides that contributions of an employer under an exempt employees' pension plan shall be deductible within the limitations specified therein, provided such contributions satisfy the conditions of section 162, relating to trade or business expense, or section 212, relating to expenses for the production of income. However, a conclusion that a plan is within the nondiscrimination requirements of the Code is not necessarily conclusive that all contributions made to the plan by the employer will be within the "ordinary and necessary business expense" and "reasonable compensation" limitations set forth in section 162(a)(1) of the Code.

Depositing trust funds in a savings account with the employer-grantor. See Rev. Rul. 62–183, page 143.

Rev. Rul. 62–195

A trust established by an employer for his employees which provides for mandatory lump-sum distributions which are not made in the form of stock of the employer and to which the employer's contributions are not contingent upon profits is neither a qualified profit-sharing trust, stock bonus trust, nor a pension trust within the meaning of section 401(a) of the Internal Revenue Code of 1954.

Advice has been requested whether a trust established by an employer for his employees will meet the requirements of section 401(a) of the Internal Revenue Code of 1954 if it provides that only lump-sum cash distributions may be made to participating employees upon their retirement or other separation from the service of the employer.

A corporation established a contributory retirement plan for its employees and arranged to fund the benefits thereunder through a trust established as a part thereof. Under the terms of the plan and trust, each participating employee contributes up to ten percent of his regular earnings to the trust fund and the employer, whether or not it has profits, contributes an amount equal to that contributed by each participating employee. The trust provides only for lump-sum cash distributions to participating employees upon their retirement or other separation from the employer's service. Neither the trustee nor a participant has an option to distribute, or to receive, the participant's account in the trust in any manner other than as a lump-sum cash settlement.

In order to qualify under section 401(a) of the Code, a trust must, among other things, form a part of a stock bonus, pension, or profit-sharing plan of an employer for his employees or their beneficiaries.

Section 1.401–1(b)(1) (i) to (iii), inclusive, of the Income Tax Regulations, defines pension, profit-sharing and stock bonus plans within the meaning of section 401(a) of the Code. A pension plan is defined as "a plan established and maintained by an employer primarily to provide systematically for the payment of definitely determinable benefits to his employees over a period of years, usually for life, after retirement." A profit sharing plan is defined as "a plan established and maintained by an employer to provide for the participation in his profits by his employees or their beneficiaries." To the extent here pertinent, a stock bonus plan is defined as "a plan established and maintained by an employer to provide benefits similar to those of a profit-sharing plan, except that the contributions by the employer are not necessarily dependent upon profits and the benefits are distributable in stock of the employer company."

The trust under consideration does not qualify under section 401(a) of the Code as a profit sharing trust since, under the plan, the employer's contributions are not contingent upon either current or accumulated profits. Neither does the trust qualify thereunder as a stock bonus trust because distributions from the trust are not made in stock of the employer company. Nor is the trust a pension trust within the meaning of section 401(a) of the Code because of the mandatory provision for a lump-sum distribution to each participant which precludes consideration of the plan as one primarily to provide for payments over a period of years, usually for life, after retirement of the employee.

It is accordingly held that an employees' trust such as here described fails to meet the requirements of section 401(a) of the Code.

Procedures are prescribed for requests with respect to the qualification of pension, annuity, profit-sharing and stock bonus plans and related trusts. See Rev. Proc. 62–31, page 517.

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26 CFR 1.401–3: Requirements as to coverage. Rev. Rul. 62–152

Guides for determining whether disability benefits in a pension or annuity plan are integrated with disability benefits provided by the Social Security Act.

The Internal Revenue Service has formulated the following guides for determining whether disability benefits under an employees' pension or annuity plan, intended to qualify under section 401(a) of the Internal Revenue Code of 1954, are properly integrated with disability benefits under the Social Security Act.

An employees' pension plan provides for a normal retirement benefit integrated with social security benefits in accordance with the guides set forth in Mimeograph 6641, C.B. 1951–1, 41, as modified by Revenue Ruling 61–75, C.B. 1961–1, 140. Besides the normal retirement benefit, the plan provides for a benefit payable upon "total and permanent disability."

1. *General rule.*—Such disability benefits will be considered properly integrated with disability benefits provided by the Social Security Act if the requirements set forth in paragraphs 2 and 3 below are satisfied.

2. *Limitation on amount of disability benefits.*—(a) Except as provided in (b) or (c) of this paragraph, the amount of the disability benefits payable for life or until recovery from disability, if that occurs before normal retirement age in an excess plan (see paragraph 4(d) of Mimeograph 6641) of either the fixed benefit or unit credit type, may not exceed 60 percent of the maximum normal retirement benefit which would be permitted, if the employee's service had continued to his normal retirement date, by the rules of paragraphs 5, 6, 7, and 8 of Mimeograph 6641, as modified by Revenue Ruling 61–75 (or paragraph 7 of Revenue Ruling 61–75, but without actuarial reduction by reason of disability benefits commencing before age 65). This amount should be based upon average compensation, determined upon retirement for disability, no greater than the average permitted by paragraph 2 of Revenue Ruling 61–75.

(b) In the case of a fixed benefit plan, if the ratio that the actual number of years of service of the employee upon retirement for disability bears to the total number of years of service he would have had if he had remained in service until normal retirement date exceeds 6/10, then such higher ratio may be used instead of the 60 percent factor mentioned in the first sentence of (a) above.

(c) In the case of a unit benefit plan, if the amount of the maximum uniform unit credits permitted by paragraph 12 (a), (b), or (c) (whichever is applicable) of Mimeograph 6641, as modified by Revenue Ruling 61–75, which have accrued to the time of the employee's retirement for disability, without actuarial reduction by reason of commencement of disability benefits before age 65, exceeds the amount determined in (a) above, then such larger amount may be used.

(d) In the case of plans with stepped-up benefit rates, the above limits are to be applied in a manner consistent with the method set forth in paragraph 16 of Mimeograph 6641.

(e) In the case of a pension plan of the offset type referred to in paragraph 15 of Mimeograph 6641, benefits payable to a disabled employee before age 65 will be considered properly integrated with disability benefits payable under the Social Security Act if such disability benefits are determined uniformly in accordance with compensation or service or both for all covered employees (with no employee or no portion of compensation excluded by reason of a minimum compensation requirement), and if reduced by no more than 64 percent of the actual disability benefit received by the employee under the Social Security Act in effect in 1961. After normal retirement age, when old-age benefits under the Social Security Act become payable, the offset may be that provided in paragraph 8 of Revenue Ruling 61–75.

(f) Minimum benefits and salary or wage brackets for disability benefits may be provided in accordance with the rules of paragraph 17 of Mimeograph 6641, as modified by paragraph 5 of Revenue Ruling 61–75.

3. *Conditions for payment of integrated disability benefits.*—If a pension plan is to provide total and permanent disability benefits which are integrated with the disability benefits payable under the Social Security Act, the plan benefits must not only be properly limited as to amount, as set forth above, but must also be payable under eligibility conditions which are as stringent as those required for payment of disability benefits under that Act. In order to be eligible for total and permanent disability benefits under the Social Security Act, an "insured" individual must have had the equivalent of five years of covered employment, must be totally and permanently disabled, and must have been so disabled for at least six months. Total and permanent disability is defined in the Act as the inability "to engage in any substantial gainful activity by reason of a medically determinable physical or mental impairment which can be expected to result in death or to be of long-continued and indefinite duration."

If the eligibility conditions for disability retirement in a pension plan are as stringent as those under the Social Security Act, an individual receiving disability benefits under the terms of the plan should also be entitled to disability benefits under the Act.

Therefore, the disability benefits under a pension plan will be properly integrated with the disability benefits under the Social Security Act if disability benefits are paid under the plan only when the employee is also entitled to disability benefits under the Social Security Act. This requirement does not apply in the case of a pension plan of the offset type, described in paragraph 2(e) above, if the plan provides for payment of the full disability benefits (without offset) when disability benefits are not payable under the Social Security Act.

4. *Advance determinations.*—Some employers are reluctant to tie the payment of disability benefits under a plan to adjudication of disability under the Social Security Act. There would be no objection, as far as integration is concerned, to a plan's requirement for disability benefits being more stringent than those in the Social Security Act.

On the other hand, benefits paid to a disabled employee under an excess plan will obviously not be integrated with *disability* benefits under the Social Security Act and will probably be discriminatory within the meaning of section 401(a) of the Code, if another employee, similarly disabled, who is excluded from the plan by a minimum compensation requirement, is not entitled to disability benefits under that Act. Therefore, if a pension plan provides that its "integrated" disability benefits will be payable only to employees entitled to disability benefits under the Act, and the plan is found to qualify in all other respects, a favorable advance determination under section 401(a) will be issued. In the absence of such a provision (except as permitted in the last sentence of paragraph 3 above and in paragraph 5 below), a favorable advance determination as to qualification of the plan will not be issued, since the actual operation of the plan's disability benefit provision will determine whether the plan's disability benefit is in operation properly integrated with disability benefits under the Social Security Act. In any event, the plan will be considered discriminatory if the disability benefits paid fail to satisfy paragraphs 2 and 3 above or paragraph 5 below.

5. *Integration with normal retirement benefits.*—If disability benefits may be paid under eligibility conditions which do not satisfy the provisions of paragraph 3 above, such benefits are not integrated with the *disability* benefits of the Social Security Act and must satisfy the integration requirements relating to early retirement benefits (set forth in paragraphs 9 and 12 of Mimeograph 6641, as modified by Revenue Ruling 61–75), if they are to be integrated at all under a plan qualified under section 401(a) of the Code. For the purpose of determining the amount of such "disability" benefits, it will not be acceptable to use a disabled life mortality table in the computation of equivalent actuarial values.

Disability experience depends to a large extent on the definition of disability, economic conditions, and the attitude of the employees and plan administrators regarding utilization of the disability provision. For this reason, particularly in the case of a plan with a liberal definition of disability, there is little likelihood that the actual value of the "disabled" life annuities provided by the plan, determined on the basis of an arbitrarily selected disabled life table, will be close to the value of the early retirement benefits determined in accordance with Mimeograph 6641 and Revenue Ruling 61–75. Any such plan requiring integration with Social Security benefits would be discriminatory within the meaning of section 401(a) of the Code if in operation the disability benefits involve additional employer costs not provided for by the reserves for normal retirement benefits. Whether the discrimination will occur, therefore, depends primarily on factors, other than the plan provisions themselves, which cannot be evaluated in advance. Accordingly, a favorable advance determination as to the qualification of the plan will not be issued if the plan provides disability benefits designed to integrate under the provisions relating to early retirement benefits but which uses a disabled life mortality table for the purpose of determining the amount of such "disability" benefits.

26 CFR 1.401–4: Discrimination as to contributions or benefits. Rev. Rul. 62–206

Employer contributions under a qualified employees' pension plan on behalf of certain uncompensated employees, who are also officers, may not be based on imputed compensation for such employees without adversely affecting the status of the plan under section 401(a) of the Internal Revenue Code of 1954.

Advice has been requested whether the qualification of an employees' pension plan will be adversely affected by contributions the amounts of which are based on compensation imputed to certain uncompensated employees.

A labor union established a money-purchase retirement plan and trust for the benefit of the employees of each local which elected to participate. The plan requires each participating local to contribute annually to a common trust an amount equal to ten percent of the annual salary of each of its employees. The plan has been held to meet the requirements of section 401(a) of the Internal Revenue Code of 1954 and the trust is exempt from tax under section 501(a).

One local with ten employees, consisting of five clerical workers and five business representatives of whom three are also officers of the local, elected to participate in the plan as of January 1, 1960. The local pays all but two of the business representatives a salary of approximately twice the salary it pays the clerical employees. Two of the business representatives, who are also officers of the local, do not receive a salary from the local for the performance of services in their respective capacities. Therefore, both of the uncompensated employees fall within the group with respect to which discrimination is prohibited by section 401(a)(4) of the Code.

Since contributions under the pension plan are based on the amount of the annual salaries of the employee participants, there is no basis on which to determine the amount of contribution to be made on behalf of these two uncompensated business representatives. Therefore, by the very terms of the plan, they are both ineligible for participation in the local's contribution to the common trust unless they may be included by imputing compensation to them.

Section 1.401–4(a)(2)(iii) of the Income Tax Regulations provides, in part, that variations in contributions or benefits may be provided so long as the plan, viewed as a whole for the benefit of employees in general, with all its attendant circumstances, does not discriminate in favor of the employees within the enumerations with respect to which discrimination is prohibited by section 401(a)(4) of the Code. Imputing income in the instant case for the purpose of allocating contributions will result in prohibited discrimination. This conclusion follows from the application of the tests set forth in Revenue Ruling 61–157, C.B. 1961–2, 67.

Part 5(k) of that Revenue Ruling, which discusses section 401(a)(5) of the Code, provides that total compensation, basic compensation, or regular rate of compensation may be used provided that whatever is used is consistently and uniformly applicable to all participants. In the instant circumstances this provision would preclude allowing benefits for uncompensated personnel to be based on imputed compensation.

Furthermore, as indicated in Parts 5 (a) and (g) of Revenue Ruling 61–157, the ratio of benefits to compensation is important in determining whether the application of the benefit formula results in discrimination in favor of employees who are officers, shareholders, highly compensated, or persons whose principal duties consist in supervising the work of other employees. Clearly, when examined in terms of this ratio, any benefits flowing from contributions which are based on imputed compensation are discriminatory in favor of the individuals who are to receive the benefits.

Accordingly, it is held that since the basis of compensation on which benefits are computed would not be consistently and uniformly applicable to all participants, and since the benefit formula would result in the prohibited discrimination, the local may not base contributions under the pension plan, for the benefit of the uncompensated employees, on imputed compensation without adversely affecting the qualified status of the plan under section 401(a) of the Code.

SECTION 402.—TAXABILITY OF BENEFICIARY OF EMPLOYEES' TRUST

26 CFR 1.402(a)–1: Taxability of beneficiary under a trust which meets the requirements of section 401(a). Rev. Rul. 62–190

An employee's qualified, contributory, profit-sharing trust provides that, upon retirement, a participating employee becomes entitled to an amount equal to his share in the trust as of the end of the calendar quarter last preceding the date of his retirement, plus a pro rata share of the employer's contribution for the year of retirement. The trustees make a lump-sum distribution of such total amount in the year following the year of an employee's retirement. *Held*, the participating employee may treat as a long-term capital gain, to the extent exceeding his own contributions, the amount to his credit in the trust at the date of separation from the service of the employer, plus his share of the employer's contribution, if any, for the year of retirement attributable to services performed prior to separation. Any increment, other than his pro rata share of the employer's contributions for the year of retirement credited to his account subsequent to the date of his termination of service, is taxable as ordinary income.

Advice has been requested whether a distribution of the total amount due a participant in a qualified employees' profit-sharing trust, in the year following the year of separation from service, will qualify for treatment as a long-term capital gain when the amount includes the employee-participant's pro rata share of the employer's contribution for the year of separation.

An employer established a contributory profit-sharing plan for the benefit of his employees. The plan meets the requirements of section 401(a) of the Internal Revenue Code of 1954 and the trust forming a part thereof is exempt from income tax under section 501(a) of the Code.

Under the terms of the plan, upon retirement, a participating employee becomes entitled to an amount equal to his share in the trust as

of the end of the calendar quarter last preceding the date of his retirement, plus any amounts he contributed since that time, together with a pro rata share of the employer's contribution for the year of retirement.

A governing committee which administers the plan may determine whether payment to the employee is to be made in a lump sum or by installments and the time at which the payments are to be made. Generally, the committee has been authorizing distributions in a lump sum at the time of retirement, with a supplemental distribution the following year with respect to the employee's share of the employer's contribution for the year of retirement.

In the instant case, however, the governing committee, acting within its authority, delayed payment of the total amount due the employee until the year following that of retirement. At that time the lump-sum payment included the employee's pro rata share of the employer's contribution for the year of retirement as well as the amount standing to the employee's credit at the date of retirement.

Section 402(a)(1) of the Code provides, in effect, that the amount actually distributed or made available to any distributee by any employees' trust described in section 401(a), which is exempt from tax under section 501(a), shall be taxable to him, in the year in which so distributed or made available, under section 72 (relating to annuities) except that section 72(e)(3) (relating to the tax limitation on certain lump sums) shall not apply.

Section 402(a)(2) of the Code provides in substance that if the total distributions payable, under an employees' trust exempt under section 501(a), are paid to the distributee within one taxable year of the distributee on account of the employee's death or other separation from the service, or on account of the employee's death after such separation from service, the amount of such distribution, to the extent exceeding the amount contributed by the employee, shall be considered a gain from the sale or exchange of a capital asset held for more than six months.

Section 402(a)(3)(C) of the Code defines the term "total distributions payable" to mean the balance to the credit of an employee which becomes payable to a distributee on account of the employee's death or other separation from the service, or on account of his death after separation from the service.

Based upon the above facts, it is held that the employee in the instant case may treat as a long-term capital gain, to the extent exceeding his own contribution, the amount to his credit in the trust at the date of separation from the service of the employer, plus his pro rata share of the employer's contributions, if any, for the year of retirement attributable to services performed prior to separation since the total amount thereof was paid in one taxable year of the distributee-employee.

Any increment, other than his pro rata share of the employer's contributions for the year of retirement, credited to his account subsequent to the date of the termination of his service is taxable as ordinary income in the year of distribution since it is not a part of the balance which becomes payable to a distributee on account of separation from service. See Rev. Rul. 60–292, C.B. 1960–2, 153.

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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)–1: Contributions of an employer to an employees' trust or annuity plan and compensation under a deferred payment plan; general rule.

Whether contributions are within the ordinary and necessary business expense and reasonable compensation deductions limitations imposed by section 162(a)(1) of the Internal Revenue Code. See Rev. Rul. 62–139, page 123.

PART II.—MISCELLANEOUS PROVISIONS

SECTION 421.—EMPLOYEE STOCK OPTIONS

26 CFR 1.421–2: Restricted stock option. Rev. Rul. 62–155
(Also Section 544; 1.544–2.)

In determining stock ownership for the purposes of section 421(d)(1)(C) and section 544(a)(1) of the Internal Revenue Code of 1954, an actuarial method may be used where stock is held in trust.

Revenue Ruling 58–325, C.B. 1958–1, 212, revoked.

In view of the decision of the United States Court of Appeals for the Fifth Circuit in the case of *Phinney* v. *Tuboscope Company*, 268 Fed. (2d) 233 (1959), further consideration has been given to the position taken in Revenue Ruling 58–325, C.B. 1958–1, 212.

That Revenue Ruling held, on the basis of the decision in the case of *Steuben Securities Corporation* v. *Commissioner*, 1 T.C. 395 (1943), that in determining stock ownership for the purposes of section 421(d)(1)(C) of the Internal Revenue Code of 1954, an optionee is considered to own proportionately the present interests of qualifying relatives in a trust holding shares of stock in the corporation by which he has been granted the option and is considered not to own remainder or other remote interests of such relatives, whether vested or contingent.

The question presented in the *Steuben* case was whether the corporation, most of the stock of which was held in trust, was a personal holding company.

The predecessor sections in the Revenue Acts of 1937 and 1938 to section 503(a)(1) of the Internal Revenue Code of 1939, all of which contain language identical to section 544(a)(1) of the 1954 Code, provided, for purposes of determining whether the stock ownership requirements of the personal holding company provisions were met, "Stock owned, directly or indirectly, by or for a * * * trust shall be considered as being owned proportionately by its * * * beneficiaries."

The taxpayer contended that it was not a personal holding company because, under those sections, certain remaindermen beneficiaries of the trusts were to be considered as owning a portion of its stock held by the trusts. In holding that the taxpayer was a personal holding

company, the court reasoned that to prevent tax avoidance in the personal holding company area, the word "beneficiaries" must be read to mean those who have a direct present interest in the shares and income in the taxable year and not those whose interest, whether vested or contingent, will or may become effective at a later time.

Subsequent to the publication of Revenue Ruling 58–325, the court was confronted in the *Tuboscope* case, with the problem of determining a method of computing constructive ownership between a trust and its beneficiaries for purposes of a provision of the Korean War excess profits tax statute. This determination, in turn, depended upon interpreting section 503(a)(1) of the 1939 Code. The court held that the benefits sought were not available to the taxpayer. In arriving at this conclusion it determined that the stock held in trust for a settlor's children, for whom the income was accumulated and who were also the remaindermen, was to be considered owned, under section 503(a)(1), by the children and, therefore, under another provision of section 503(a), by the settlor. The court pointed out that otherwise the purpose of the section to treat members of a family as a unit could be bypassed through the simple expedient of an inter vivos trust.

The considerations which led the court in the *Tuboscope* case to treat the remaindermen of the trusts as beneficiaries for purposes of section 503(a)(1) of the 1939 Code are applicable in determining the ownership of stock held in trust for purposes of sections 421(d)(1)(C) and 544(a)(1) of the 1954 Code.

Accordingly, it is held that in determining stock ownership for the purposes of section 421(d)(1)(C) and section 544(a)(1) of the Code, the shares held by a trust are considered to be owned by its present or future beneficiaries in proportion to their actuarial interests.

The Internal Revenue Service will continue to follow the holding in the *Steuben* case, but will not follow that part of the rationale which precluded computing ownership interests of beneficiaries of the trusts, including remaindermen, on an actuarial basis. See *Tuboscope*, *supra*.

Inasmuch as Revenue Ruling 58–325, C.B. 1958–1, 212, is contrary to this holding, that Revenue Ruling is hereby revoked.

Rev. Rul. 62–181

An employee stock purchase plan provides for payment of an employee's stock subscription through deductions from his salary and allows the employee to withdraw the amounts withheld at any time before such amounts equal the subscription price. The plan also provides that in the event the subscription price exceeds the market value of the stock at the date of full payment, the desired shares shall be purchased on the open market for the employee and any saving realized returned to him. *Held*, the provision calling for purchase on the open market in the circumstances does not disqualify stock options which otherwise constitute "restricted stock options" within the meaning of section 421 of the Internal Revenue Code of 1954.

A provision which permits the legal representative of a legally incompetent employee to exercise, within three months of termination of employment, an option granted the employee is not considered, in the circumstances, to be a transfer or exercise of such option by one other than the employee within the meaning of section 421 of the Code.

Advice has been requested concerning the income tax treatment of stock options which would otherwise qualify as "restricted stock options," within the purview of section 421 of the Internal Revenue Code of 1954, where such options are granted under an employees stock purchase plan which, in stated circumstances, calls for the purchase of the desired shares in the open market and which, in the event of legal disability, allows the exercise of the options by the legal representative of an employee.

A corporation has adopted a stock purchase plan providing for the sale of its stock to select employees. During a specified period, the company is to offer a limited number of shares to such employees at a percentage of market value. The number of shares purchasable by each employee is fixed by a formula set forth in the plan, but may be reduced depending on the subscriptions received.

If an employee is desirous of purchasing stock, he must file a stock subscription with the company. The employee can either pay the subscription price in a lump sum or in regular installments deducted from his salary and remitted to a local bank to be held on deposit in the employee's name. In either event, the shares are to be transferred to an employee only on the full payment of the purchase price.

If an employee elects to pay in installments, he has a right of complete or partial withdrawal of the deducted sums any time before the principal amount equals the subscription price. The exercise of this right completely or partially cancels, as the case may be, the employee's subscription. In addition, if, on the date that the principal sum equals the subscription price, the market price of the corporation's stock is lower than the subscription price by a stated amount, the subscription is deemed to be cancelled and the desired shares are to be purchased for the employee on the open market, with any saving realized to be returned to the employee.

In the event of the termination of his employment before the principal sum is paid or the market purchase is made, the employee or, in the event of death or legal disability, his legal representative has the right either to cancel the subscription and withdraw the amounts withheld, or to pay the remaining balance due within three months of such termination and have the desired shares issued.

In all other material respects, the options granted under the plan satisfy the requirements of section 421 of the Code.

Section 421 of the Code sets forth the tax treatment of "restricted stock options" granted by a corporation to its employees, in defining "restricted stock options," section 421(d)(1) provides, in part, as follows:

> (B) such option by its terms is not transferable by such individual otherwise than by will or the laws of descent and distribution, and is exercisable, during his lifetime, only by him; * * *

Section 1.421-2(a)(4) of the Income Tax regulations provides that an option which is transferable by the individual to whom it is granted, during his lifetime, or is exercisable during such individual's lifetime by another person, is not a restricted stock option.

Section 1.421-1(e) of the regulations provides that the term "exercise" means the act of acceptance by the optionee of the offer to sell

contained in the option. In general, exercise is deemed to occur when there is a sale or a contract of sale in existence. However, an agreement to make payments under a stock purchase plan does not constitute the exercise of an option so long as the payments made remain subject to withdrawal by the employee.

In the instant case, incorporation of a provision calling for the purchase of shares in the open market, in the circumstances described does not disqualify stock options which otherwise constitute "restricted stock options." Due to the right of withdrawal held by participating employees, the stock options would not be exercised until the principal sum deducted from an employee's salary equals the offer price, or, in other words, until the date of lapse of an employee's right of withdrawal. Under these circumstances, an employee could completely or partially withdraw the withheld sum before the date of exercise, thus foregoing exercise of the option, and make a market purchase himself if he so desires. This provision does not disqualify any option granted under the plan from treatment under section 421 of the Code. The option plan provision under consideration is designed merely to enable the employees to forego the formality of withdrawing their funds to make a market purchase, by providing that, in such circumstances, it will be done for them. Such a purchase of stock on behalf of the employee is not an exercise of his option.

The provision permitting the exercise of the option by an employee's legal representative in the event of legal disability does not in itself permit an exercise of the option by a person other than the employee nor permit a transfer of such option as meant by section 421 of the Code. This provision ordinarily would be merely declaratory of applicable state law. Normally, under the state law the legal representative, a court officer, would take custody of an employee's property interests on declaration of incompetency. However, he would do so subject to court supervision and a fiduciary duty to act in the incompetent's best interest. Legal title and all beneficial interest in the property rest in the incompetent. See 4 Corpus Juris Secundum 49, 78—112; and 25 American Jurist 60–72, 107–9. Furthermore, the custodial nature of the relationship is recognized for Federal income tax purposes. The estate of an incompetent, although administered by his legal representative, is not a taxable entity, separate and distinct from the incompetent. See I.T. 3996, C.B. 1950–1, 130; Rev. Rul. 58–267, C.B. 1958–1, 327. Therefore, where under applicable state law the legal representative is a mere custodian of an incompetent's property, standing in a fiduciary relationship to the incompetent and subject to court supervision, the passage of the right to exercise a stock option to such representative does not constitute a "transfer" of the option as meant by the statute and, if exercised by him, it is to be considered as an exercise by the employee within the meaning of the statute.

Accordingly, it is held that the market purchase provisions do not disqualify the stock options under consideration from being "restricted stock options" within the meaning of section 421 of the Code. Furthermore, the exercise of an option by a legal representative of a legally incompetent employee is not considered to be a transfer of the

stock option or an exercise of such option by one other than the employee within the meaning of section 421(d) of the Code.

Rev. Rul. 62–182

Under an employee stock option plan, stock options granted directly to specific employees are expressly nontransferable, either voluntarily or by operation of law, except by will or the laws of descent and distribution, but are not expressly stated to be exercisable only by the employee during his lifetime. *Held*, such options constitute stock options exercisable by their terms only by such employee, within the meaning of section 421(d)(1)(B) of the Internal Revenue Code of 1954, and qualify as "restricted stock options," provided the other requirements of section 421(d) of the Code are met.

Advice has been requested whether stock options, granted to specific employees under an employee stock option plan, which are expressly nontransferable, either voluntarily or by operation of law, except by will or the laws of descent and distribution, but are not expressly stated to be exercisable only by the employee during his lifetime, qualify as "restricted stock options" within the meaning of section 421(d) of the Internal Revenue Code of 1954.

A corporation adopted an employee stock option plan providing for the sale of stock to a limited number of its employees. An option committee, consisting of members of the board of directors of the corporation, selects the eligible employees and, upon such selection, the corporation enters into an option agreement with the employee concerned, offering its shares for sale to him at a specified price which represents a percentage of its fair market value at that date.

By the terms of the plan and the agreements, the options are not assignable or transferable by the grantee-employee, either voluntarily or by operation of law, except by will or the laws of descent and distribution. The grantee-employee is to exercise the option by execution of a form notice setting forth the shares desired to be purchased. In the event of termination of employment, the options automatically expire. However, if the termination of employment is due either to the death or mental or physical disability of the grantee-employee, his estate, or any committee or other representative authorized to act on his behalf, has the privilege of exercising the option within three months of such termination. In all other material respects, the options satisfy the requirements of section 421 of the Code.

Section 421 of the Code sets forth the income tax treatment of "restricted stock options" granted by a corporation to its employees. In defining "restricted stock options," section 421(d)(1) provides, in part, as follows:

> (B) such option by its terms is not transferable by such individual otherwise than by will or the laws of descent and distribution, and is exercisable, during his lifetime, only by him: * * *

Section 1.421–2(a)(4) of the Income Tax Regulations provides that an option which is transferable by the individual to whom it is granted, during his lifetime, or is exercisable during such individual's lifetime by another person, is not a restricted stock option.

In Revenue Ruling 62–181, page 133, this Bulletin, it is held that where, under applicable state law, the legal representative of a legally incompetent employee is a mere custodian of the employee's property, standing in a fiduciary relationship to the incompetent and acting subject to court supervision, passage to the representative of the right to exercise the employee's stock option does not constitute a "transfer" of such option within the meaning of section 421 of the Code and, if exercised by him, is to be considered as an exercise by the employee within the meaning of that section.

In the instant case, the options were granted by the corporation directly to the employees concerned. Under the plan and the various agreements, the employee alone possesses the right to purchase the corporation's stock and then only upon execution by him of a stock purchase form. Furthermore, these rights are expressly not transferable, either voluntarily or by operation of law. Therefore, any attempted exercise by any other person or an attempt to extend the privilege of exercise to any other person would be in violation of the agreement and would constitute an "assignment or transfer" prohibited by the terms of the options.

Since the options in question are granted directly to the employee, granting him alone the right to purchase, and since they are not transferable either voluntarily or by operation of law except by will or the laws of descent or distribution, they are, within the meaning of section 421(d)(1)(B) of the Code, by their terms exercisable only by such employee. The legal effect of the option provisions is to restrict the exercise of the option to the employee. Under these circumstances, it is held that the options constitute "restricted stock options" within the purview of section 421(d) of the Code.

SUBCHAPTER E.—ACCOUNTING PERIODS AND METHODS OF ACCOUNTING

PART I.—ACCOUNTING PERIODS

SECTION 442.—CHANGE OF ANNUAL ACCOUNTING PERIOD

26 CFR 1.442–1: Change of annual accounting period. T. D. 6614 [1]

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

Amendment of Income Tax Regulations under section 442 of the Internal Revenue Code of 1954, relating to change of annual accounting period.

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

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

On July 18, 1962, notice of proposed rulemaking with respect to the amendment of the Income Tax Regulations (26 CFR Part 1) under

[1] 27 F.R. 10098.

section 442 of the Internal Revenue Code of 1954 (relating to change of annual accounting period) to facilitate the processing of requests for change of annual accounting period was published in the Federal Register (27 F.R. 6786). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the amendment of paragraph (b)(1) of § 1.442–1 which reads as follows is hereby adopted.

§ 1.442–1 CHANGE OF ANNUAL ACCOUNTING PERIOD.

* * * * * * *

(b) *Prior approval of the Commissioner.*—(1) *In general.*—In order to secure prior approval of a change of a taxpayer's annual accounting period, the taxpayer must file an application on Form 1128 with the Commissioner of Internal Revenue, Washington 25, D.C., on or before the last day of the calendar month following the close of the short period for which a return is required to effect the change of accounting period. Approval will not be granted unless the taxpayer and the Commissioner agree to the terms, conditions, and adjustments under which the change will be effected. In general, a change of annual accounting period will be approved where the taxpayer establishes a substantial business purpose for making the change. In determining whether a taxpayer has established a substantial business purpose for making the change, consideration will be given to all the facts and circumstances relating to the change, including the tax consequences resulting therefrom. Among the nontax factors that will be considered in determining whether a substantial business purpose has been established is the effect of the change on the taxpayer's annual cycle of business activity. The agreement between the taxpayer and the Commissioner under which the change will be effected shall, in appropriate cases, provide terms, conditions, and adjustments necessary to prevent a substantial distortion of income which otherwise would result from the change. The following are examples of effects of the change which would substantially distort income: (i) deferral of a substantial portion of the taxpayer's income, or shifting of a substantial portion of deductions, from one year to another so as to substantially reduce the taxpayer's tax liability; (ii) causing a similar deferral or shifting in the case of any other person, such as a partner, a beneficiary, or a shareholder in an electing small business corporation as defined in section 1371(b); or (iii) creating a short period in which there is either (*a*) a substantial net operating loss, or (*b*) in the case of an electing small business corporation, a substantial portion of amounts treated as long-term capital gain. Even though a substantial business purpose is not established, the Commissioner in appropriate cases may permit a husband or wife to change his or her taxable year in order to secure the benefits of section 2 (relating to tax in the case of a joint return). See paragraph (e) of this section for special rule for newly married couples.

(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 October 10, 1962.

STANLEY S. SURREY,
Assistant Secretary of the Treasury.

(Filed by the Division of the Federal Register on October 12, 1962, 8:49 a.m., and published in the issue of the Federal Register for October 13, 1962, 27 F.R. 10098)

SECTION 451.—GENERAL RULE FOR TAXABLE YEAR OF INCLUSION

26 CFR 1.451–1: General rule for taxable year of inclusion. Rev. Rul. 62–128

(Also Section 351; 1.351–1.)

A taxpayer, engaged in a business as a sole proprietor, transferred all of the assets of his business, subject to its liabilities, to a corporation controlled by the transferor in a nontaxable exchange under the provisions of section 351 of the Internal Revenue Code of 1954. Prior to the transfer, the business had, on its books of account, a reserve for bad debts which had been accumulated by additions for which the taxpayer had derived full tax benefits in prior taxable years. *Held*, under these circumstances the reserve for bad debts is not transferable to any other entity. Accordingly, the reserve for bad debts represents ordinary income to the taxpayer for the taxable year during which the transfer of the accounts receivable was made since, during such time, his need for the reserve ceased. See *Geyer, Cornell & Newell, Inc.* v. *Commissioner*, 6 T.C. 96, acquiescence, C.B. 1946–1, 2; Rev. Rul. 57–482, C.B. 1957–2, 49; and *C. Standlee Martin, Inc.* v. *Riddell*, 56–2, U.S.T.C. 9989, 51 A.F.T.R. 1376. Under similar circumstances, a partnership must likewise include such reserve for bad debts in its final return as ordinary income. However, to the extent that the additions to the reserve for bad debts in prior years may not have resulted in tax benefits, they need not be included in the transferor's gross income. See *M. & E. Corporation* v. *Commissioner*, 7 T.C. 1276, acquiescence, C.B. 1947–1, 3.

Excess of the present value of annuity payments, to be paid by an organization other than a commercial insurance company under a contract received by the transferor in exchange for property, over the transferor's basis in the property exchanged. See Rev. Rul. 62–136, page 12.

Rev. Rul. 62–160

In the case of a taxpayer whose books are kept on the accrual method, interest on a refund or credit of tax must be accrued as income as of the date the right to receive the refund or credit is determined. This date is ordinarily that on which the District Director of Internal Revenue, the Director of the Regional Service Center, or an authorized certifying officer designated by either of them, first certifies the allowance of an overassessment in respect of the tax. An exception to this rule applies in a case where a refund is made after settlement and administrative closing of the case as mutually agreed upon by the taxpayer and the Internal Revenue Service. In such a case the date the agreement is executed by both parties, or the effective date of the agreement, whichever is later, is the date for accrual of interest on the overpayment as income. Further exceptions occur when a case is in litigation.

I.T. 2210, C.B. IV–2, 43 (1925), modified.

The Internal Revenue Service has re-examined the position taken in I.T. 2210, C.B. IV–2, 43 (1925), as to the year in which interest on a refund of tax constitutes taxable income to an accrual-method taxpayer.

In I.T. 2210, it is held that the interest on refunds of tax paid to a taxpayer whose books are kept on the cash receipts and disbursements method is taxable income to the taxpayer in the year in which received. In the case of the taxpayer whose books are kept on the accrual method, the receipt of the certificate of overassessment affords a basis for the accrual of such interest.

Section 1.451–1(a) of the Income Tax Regulations provides, in part, that under an accrual method of accounting, income is includible in gross income when all the events have occurred which fix the right to receive such income and the amount thereof can be determined with reasonable accuracy. Consequently, where the accrual method is used, the right to receive and not the actual receipt determines the year of inclusion of the amount in gross income. See *Spring City Foundry Co.* v. *Commissioner*, 292 U.S. 182, Ct. D. 829, C.B. XIII–1, 281 (1934).

In *Household Products, Inc.* v. *Commissioner*, 24 B.T.A. 594, nonacquiescence, C.B. XI–1, 9 (1932), the Board of Tax Appeals concluded that prior to the allowance of a tax refund there was no liability for interest running from the Government to a taxpayer. It accordingly held that the interest should be accrued at the time the refund was allowed, which time was found to be when the Commissioner of Internal Revenue first signed the schedule of overassessments. The same conclusion was reached in *Pacific Coast Biscuit Company* v. *Commissioner*, 32 B.T.A. 39. Also, compare *American Enka Corporation* v. *Commissioner*, 30 T.C. 684, acquiescence, C.B. 1959–2, 3.

Upon reconsideration, the Service has decided to withdraw its nonacquiescence in *Household Products, Inc.*, to acquiesce therein and to acquiesce in issue 4 of *Pacific Coast Biscuit Company*. See page 5 this Bulletin.

Accordingly, it is held that an accrual-method taxpayer should accrue interest on a refund or credit of tax upon the date of allowance of the refund or credit.

Section 6407 of the Internal Revenue Code of 1954 provides that the date on which the Secretary of the Treasury or his delegate first authorizes the scheduling of an overassessment in respect of any internal revenue tax shall be considered as the date of allowance of refund or credit in respect of such tax.

Section 301.6407–1 of the Regulations on Procedure and Administration provides further that the date on which the District Director, the Director of the Regional Service Center, or an authorized certifying officer designated by either of them, certifies the allowance of an overassessment in respect of any internal revenue tax shall be considered as the date of allowance of refund or credit in respect of such tax.

Hence, in the case of a taxpayer who keeps his books on the accrual method, interest on a refund or credit must be accrued when the refund or credit is allowed, namely, on the date on which the District Director, the Director of the Regional Service Center, or an authorized certifying officer designated by either of them, first certifies the allowance of an overassessment in respect of the tax.

Exceptions to this general rule will apply in those cases in which a right to receive a refund or credit is in fact duly established otherwise than by the certification of the overassessment. For example, in a case where a refund is made after settlement and administrative closing of the case as mutually agreed upon by the taxpayer and the Service, the date the agreement is duly executed by both parties, or the effective date of the agreement, whichever is the later, is the date for accrual of interest on the overpayment as income.

Additional exceptions to the general rule for accrual stated herein will apply in cases involving litigation. In such a case the date the court's decision, pursuant to which a refund is made, becomes final is the date for accrual. Where a suit for refund brought by the taxpayer is settled by the Department of Justice and a refund is made on acceptance of an offer of the taxpayer, the date of the letter from that Department advising the taxpayer of unconditional acceptance of the offer is the accrual date. In a case tried before the Tax Court of the United States, where the decision is entered and a refund is made pursuant to stipulation by the parties, the date for accrual is the date the decision is entered.

Under section 6611 of the Code interest on a refund runs to a date preceding the date of the refund check by not more than thirty days. In certain cases interest may, therefore, run on the overpayment to a date beyond the date on which the right to receive a refund and interest on the amount thereof was established. In such a case apportionment of interest income for accrual purposes may be applicable based on the facts of the particular case. See *Pacific Coast Biscuit Company*, *supra*.

The rule set forth in I.T. 2210, as to accrual-method taxpayers, is modified in accordance with the foregoing. The rule stated in I.T. 2210 will continue to be followed in the cases of taxpayers who maintain their books on the cash receipts and disbursements method.

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.

Accrual date of Oklahoma real estate and personal property taxes. See Rev. Rul. 62–107, page 63.

SUBCHAPTER F.—EXEMPT ORGANIZATIONS

PART I.—GENERAL RULE

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

26 CFR 1.501(a)–1: Exemption from taxation.

Procedures are prescribed for organizations requesting exemption from Federal income tax. See Rev. Proc. 62–30, page 512.

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26 CFR 1.501(c)(4)–1: Civic organizations and local associations of employees. Rev. Rul. 62–167

A nonprofit organization formed for the purpose of providing television reception for the community as a whole by the process of retransmitting television signals in an area not adaptable to ordinary reception is entitled to exemption from Federal income tax under section 501(c)(4) of the Internal Revenue Code of 1954 as an organization operated exclusively for the promotion of social welfare.

Revenue Ruling 54–394, C.B. 1954–2, 131, and Revenue Ruling 55–716, C.B. 1955–2, 263, distinguished.

Advice has been requested whether, under the circumstances described herein, an organization which provides television reception in an area not adaptable to ordinary reception is entitled to exemption from Federal income tax as an organization described in section 501(c)(4) of the Internal Revenue Code of 1954.

The organization in question was incorporated under state law, without capital stock, as a nonprofit corporation. Its purposes are to construct and maintain a translator, or reflector-type television station, capable of receiving signals of television stations and reproducing such signals so that satisfactory television reception may be available to the community in general.

Membership is available to all persons in the area. The income of the association is derived from membership fees and donations. Its disbursements are made for the maintenance and operation of the television relay station.

The reflector-type equipment operated by the station receives signals from three television stations and retransmits these signals into the community. This activity is distinguishable from that of a community-antenna-type system which operates upon a closed circuit, in which impulses are transmitted by cable. Users of a community antenna system are required to tap into a cable to receive the transmitted impulses. On the other hand, the signals retransmitted by the reflector-type apparatus are available to any television receiver in the community.

Section 501(c)(4) of the Code provides, in part, for the exemption of civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare.

An organization is operated exclusively for the promotion of social welfare if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community. See section 1.501(c)(4)–1 of the Income Tax Regulations.

In Revenue Ruling 54–394, C.B. 1954–2, 131, it is held that an organization would be denied exemption as a civic league if its only activity was to provide television reception on a cooperative basis to its members who paid for such services. Such an organization is held to be operating for the benefit of its members.

Revenue Ruling 55–716, C.B. 1955–2, 263, holds that an organization which furnishes television antenna service to its members in their homes, upon payment of a stipulated membership fee and a monthly charge for maintenance of the antenna, is not entitled to exemption from Federal income tax under section 501(c)(7) of the Code as a club organized exclusively for pleasure, recreation, and other nonprofitable purposes. The basis for denial in that ruling is that such an organization does not possess the elements of personal contact and fellowship which are characteristic of a club.

The circumstances in this case are distinguishable from those stated in Revenue Ruling 54–394 and Revenue Ruling 55–716. In both of those Revenue Rulings, the facts make it apparent that the television services are available only to members of the organization under consideration and then only pursuant to a contract requiring the payment of membership fees and monthly maintenance charges.

The instant organization operates its system for the benefit of all television owners in the community. It retransmits television signals for the benefit of the entire community. Memberships and contributions are obtained by the organization on a voluntary basis.

Therefore, the organization is held to be entitled to exemption from Federal income tax as an organization of the type described in section 501(c)(4) of the Code.

An organization which considers itself within the scope of this Revenue Ruling must, in order to establish exemption under section 501(c)(4) of the Code, file an application on Form 1024 Exemption Application, with the District Director of Internal Revenue for the Internal Revenue District in which is located the principal place of business or principal office of the organization. See section 1.501(a)–1 of the regulations.

SECTION 503.—REQUIREMENTS FOR EXEMPTION

26 CFR 1.503(c)–1: Prohibited transactions. Rev. Rul. 62–183
(Also Section 401; 1.401–1.)

An employees' trust, exempt from Federal income tax under section 501(a) of the Internal Revenue Code of 1954, maintains a savings account with the employer-grantor, a state bank. *Held*, the placing of funds by the exempt employees' trust in a savings account with the employer-grantor bank is a deposit and, as such is not a loan within the meaning of section 503(c)(1) of the Code. Therefore, the trust is not engaging in a prohibited transaction within the meaning of section 503(c) of the Code and the exempt status of the trust is not affected thereby. *Held further*, the above conclusion is applicable to national banks, state banks, savings and loan associations, or building and loan associations properly chartered and subjected to the usual Federal or state regulatory requirements, whose deposits are covered by insurance issued by the Federal Deposit Insurance Corporation or the Federal Savings and Loan Insurance Corporation, or their state equivalent.

Advice has been requested whether a qualified employees' profit-sharing trust, established by a state bank, will be engaging in a prohibited transaction, within the meaning of section 503(c) of the Internal Revenue Code of 1954, by depositing trust funds in a savings account with the employer-grantor.

A state bank established a profit-sharing trust for the benefit of its employees. The trust meets the requirements of section 401(a) of the Code and is held to be exempt from Federal income tax under section 501(a). Funds of the trust have been placed on deposit in a savings account with the employer-grantor bank in an amount in excess of the amount for which insurance is provided by the Federal Deposit Insurance Corporation. The bank pays a reasonable rate of interest on savings accounts. While withdrawals may generally be made at any time without prior notice, the bank reserves the right to require 30 days' notice.

Under the provisions of section 503(a)(1) of the Code, an organization described in section 401(a) is not exempt from taxation under section 501(a) if it has engaged in a prohibited transaction after March 1, 1954. Section 503(c) of the Code provides, in part, that where an exempt trust lends any part of its income or corpus to the creator of such trust without the receipt of adequate security and a reasonable rate of interest, or where it engages in any other transaction which results in a substantial diversion of its income or corpus to the creator, the trust shall be considered as engaging in a prohibited transaction.

When the "prohibited transaction" provisions of the Internal Revenue Code were first considered by the Congress of the United States, it was stated by the Senate Finance Committee, in dealing with section 331 of the Revenue Act of 1950, that there is no objection to engaging in transactions with donors if these transactions are carried out at arm's length. It was also stated that the only type of loan that would not be at arm's length is one in which the organization lends any part of its income or corpus without adequate security or at an unreasonable rate of interest to donors, etc. Section 331 of the Revenue Act of 1950 added section 3813(b)(1) to the 1939 Code which was the predecessor of section 503(c)(1) of the 1954 Code. See Senate Report No. 2375, 81st Cong., C.B. 1950–2, 483, at 510 and 569. Thus, the situation presented by the facts in the instant case is not one of the type intended to be covered by the legislation enacted in 1950.

Having determined that the instant situation does not violate the spirit of the statute, the question arises whether this type of "loan" is actually a loan within the meaning of the statute. Generally speaking, the judicial view tends to support treating a deposit as not being a loan to the financial institution, whether the deposit be a savings deposit bearing interest and requiring 30 to 60 days' notice for withdrawal or some other form of deposit, such as a checking account requiring no withdrawal notice. Although it is well established that such a transaction does create a debtor-creditor relationship (*Schumacher* v. *Eastern Bank & Trust Company*, 52 Fed. (2d) 925 (1931)), this fact alone is not determinative that a deposit in a savings account

is a loan. However, a time deposit, that is, a deposit made for a fixed period of time is considered to be a loan. Thus, a deposit of this kind is distinguishable from deposits in ordinary checking and savings accounts of the type described above and for the purposes of section 503(c)(1) the Service would treat such a deposit as being a loan.

The concept of what constitutes a deposit and the basic distinction between a deposit and a loan can be found in the decision of the Supreme Court of the United States in *Texas & Pacific Railway Company* v. *Pottorff*, 291 U.S. 245 (1933), and, among others, in the decision of the Circuit Court of Appeals for the Fourth Circuit in the *Eastern Bank & Trust Company* case. The courts there stated that the modern deposit grew out of the older form of deposit in which the fund was held separate and intact and the sole purpose of the deposit was safekeeping. Safekeeping is still a very important function of deposit banking and, from the viewpoint of most depositors, the chief one. A loan is primarily for the benefit of the bank while a deposit is primarily for the benefit of the depositor.

In the instant case, the deposit is made primarily for the benefit of the depositor, that is, safekeeping of the funds and the return of interest thereon. It may or may not be for the bank's benefit depending on whether the deposited funds could, at the time, be placed in loans or suitable investments yielding a sufficient return to the bank. Even if the bank can so place the funds and is benefited thereby, the basic motive of the depositor is the overriding factor in denominating the transaction as a deposit rather than as a loan.

In view of the above, it is held, in the instant case, that the placing of funds by the exempt employees' trust in a savings account with the employer-grantor bank is a deposit and, as such, it does not represent a loan within the meaning of section 503(c)(1) of the Code. Therefore, the trust is not engaging in a prohibited transaction within the meaning of section 503(c) of the Code.

The above conclusion is applicable to national banks, state banks, savings and loan associations, or building and loan associations, properly chartered and subjected to the usual Federal or state regulatory requirements, whose deposits are covered by insurance issued by the Federal Deposit Insurance Corporation or the Federal Savings and Loan Insurance Corporation, or their state equivalents. This is true even though the amount on deposit is in excess of the amount for which insurance is provided.

The provisions of Part 2(r) of Revenue Ruling 61–157, C.B. 1961–2, 67, govern the manner in which the savings account is to be conducted in order to be consistent with the exemption requirements under section 401(a) of the Code. It is there pointed out that the primary purpose of benefiting employees or their beneficiaries must be maintained with respect to the investment of trust funds as well as in other activities of the trust.

See Revenue Ruling 59–29, C.B. 1959–1, 123, with respect to the deposit of funds of an exempt employees' trust in a checking account with the employer-grantor bank.

SECTION 511.—IMPOSITION OF TAX ON UNRELATED BUSINESS INCOME OF CHARITABLE, ETC., ORGANIZATIONS

26 CFR 1.511–2: Organizations subject to tax. Rev. Rul. 62–191

A labor organization, otherwise exempt from Federal income tax under section 501(c)(5) of the Internal Revenue Code of 1954, is subject to the unrelated business income tax imposed by section 511 of the Code with respect to income derived from the performance of accounting and tax services for certain of its members.

Advice has been requested whether an exempt labor organization is subject to the tax, imposed by section 511 of the Internal Revenue Code of 1954 on unrelated business taxable income, with respect to income derived from the performance of accounting and tax services for certain of its members.

The instant organization is a local chapter of a labor union and is exempt from Federal income taxation under section 501(a) of the Code as an organization described in section 501(c)(5) of the Code. Certain members of the local are engaged in activities of an itinerant nature and are considered employers for Federal employment tax purposes. The employees of such members are also members of the local.

Due to the conditions under which such individuals perform their services, the employer members find it impracticable to maintain separate offices solely for the purpose of keeping employment records and filing the necessary tax returns. Accordingly, they have made arrangements with the local to handle all of their accounting and tax work. The local is paid an agreed percentage of the weekly remuneration of the members involved which it credits to a "Tax fund." The local then pays all unemployment and social security taxes, industrial insurance premiums for such members, and its incurred operating expenses from such fund. After paying these items, the amount remaining in the fund is transferred annually to the general operating funds of the local.

The labor and other organizations contemplated by section 501(c)(5) of the Code have as their objects the betterment of 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.

Section 511 of the Code imposes a tax on the unrelated business taxable income, as computed under section 512 of the Code, of organizations otherwise exempt from tax under section 501(c)(5) of the Code. The term "unrelated business taxable income" as defined in section 512 of the Code means, with certain exceptions, additions, and limitations, the gross income derived by any subject organization from any unrelated trade or business regularly carried on by it, less allowable deductions directly connected with the carrying on of such trade or

business. Section 513 of the Code defines the term "unrelated trade or business," in the case of any organization subject to the tax imposed by section 511 of the Code, as any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its exempt functions.

The providing of an accounting and tax service is a business of a kind regularly carried on for profit. The performance of such services is not substantially related to the purposes forming the basis for exemption of the instant organization.

Accordingly, it is held that the accounting and tax services performed by the instant organization for certain of its members constitute the conduct of an unrelated trade or business within the meaning of section 513 of the Code, and the organization is subject to the tax imposed by section 511 of the Code on unrelated business taxable income with respect to the income derived from such activity.

PART III.—FARMERS' COOPERATIVES

SECTION 521.—EXEMPTION OF FARMERS' COOPERATIVES FROM TAX

26 CFR 1.521–1: Farmers' cooperative marketing and purchasing associations; requirements for exemption under section 521.

Procedures are prescribed for farmers' cooperatives requesting exemption from Federal income tax. See Rev. Proc. 62–30, page 512.

SUBCHAPTER G.—CORPORATIONS USED TO AVOID INCOME TAX ON SHAREHOLDERS

PART II.—PERSONAL HOLDING COMPANIES

SECTION 544.—RULES FOR DETERMINING STOCK OWNERSHIP

26 CFR 1.544–2: Constructive ownership by reason of indirect ownership.

Use of an actuarial method in determining the ownership of stock held in trust. See Rev. Rul. 62–155, page 132.

SUBCHAPTER J.—ESTATES, TRUSTS, BENEFICIARIES, AND DECEDENTS

PART I.—ESTATES, TRUSTS, AND BENEFICIARIES

Subpart A.—General Rules for Taxation of Estates and Trusts

SECTION 641.—IMPOSITION OF TAX

26 CFR 1.641(a)-2: Gross income of estates and trusts.
(Also Section 871; 1.871-2.)

Rev. Rul. 62-154 [1]

Whether the estate of a nonresident alien decedent, which is subject to domiciliary administration in a foreign country and ancillary administration in the United States, is a resident or nonresident alien entity for Federal income tax purposes depends upon all of the facts involved, including the appointment of an ancillary administrator who is a citizen or resident of the United States and the extent and duration of the activities of such ancillary administrator in the United States.

Revenue Ruling 57-245, C.B. 1957-1, 286, modified; and Revenue Ruling 58-232, C.B. 1958-1, 261, superseded.

Advice has been requested whether the Internal Revenue Service adheres to the positions taken in Revenue Ruling 57-245, C.B. 1957-1, 286, and Revenue Ruling 58-232, C.B. 1958-1, 261.

These Revenue Rulings involve the income taxation of estates of nonresident alien decedents which were subject to domiciliary administration in a foreign country and to ancillary administration in the United States. The question was asked because I.T. 1885, C.B. II-2, 164 (1923), which was referred to in Revenue Ruling 57-245 in support of the Service position, was modified by Revenue Ruling 60-181, C.B. 1960-1, 257, and because the result reached in Revenue Ruling 58-232 appears inconsistent with such modification of I.T. 1885.

The underlying question presented in Revenue Ruling 57-245 is whether the estate of a citizen of a foreign country domiciled in a foreign country at the date of his death is classified as a nonresident alien entity, even though the will of the decedent was admitted to original probate by a court in the United States because over 90 percent of his property was physically located in the United States at the date of his death. The ruling holds that ancillary administration in the United States of the estate of a nonresident alien decedent which is subject to domiciliary administration in a foreign country does not change the status of the estate for Federal income tax purposes from that of a nonresident alien entity; that the original probate of the estate in the United States was an ancillary proceeding in the technical sense; and that the estate is a nonresident alien entity.

Revenue Ruling 57-245 makes reference to I.T. 1885 to support its holding that the status of an executor as a resident or a nonresident alien is not controlling in determining the tax status of an estate as a resident or a nonresident entity.

In Revenue Ruling 58-232 the question is whether the estate of a nonresident alien, domiciled abroad at the time of his death, is taxable on capital gains to the extent provided in section 871(a)(2) of the

[1] Also released as Technical Information Release No. 395, dated August 29, 1962.

Internal Revenue Code of 1954, where the ancillary and the domiciliary representative of such estate were present in the United States for more than 90 days during the taxable year in which such gains were realized. Neither the decedent nor the domiciliary administratrix, who was also a nonresident alien, was engaged in trade or business in the United States. The ancillary representative was a citizen and resident of the United States appointed by a state court to dispose of stock in United States corporations held in the estate.

The Revenue Ruling holds that appointment of an ancillary administrator within the United States for the estate of a nonresident alien decedent subject to domiciliary administration in a foreign country does not create a new taxable entity which may be treated as a domestic estate. Therefore, gains from the sale or exchange of the capital assets of such estate were held not to be subject to the tax imposed by section 871(a)(2) of the Code, irrespective of the presence in the United States of the ancillary and the domiciliary representative during the year in which such gains were realized.

The main question in I.T. 1885 is whether a trustee should be classed as a resident or nonresident fiduciary under the facts of the case. The fiduciary, a nonresident alien, was trustee of a trust created under the will of a nonresident alien who owned property in the foreign country and in the United States. The trustee maintained an office in the United States for the purpose of collecting the income from property located in the United States and appointed a resident agent in the United States whom he visited several times a week.

This ruling holds that the status of the fiduciary as a citizen or an alien, a resident or a nonresident, has nothing to do with the status of the trust. In the case of a trust which is treated as a taxable entity, the tax is imposed upon the income of the trust, not of the trustee. The ruling holds that the status of such a trust depends upon where it was created and that the trust under discussion is, therefore, a nonresident alien entity because it owes its existence to the laws of a foreign jurisdiction.

Reconsideration was given to this portion of I.T. 1885 in Revenue Ruling 60–181, because it appeared to be inconsistent with the decision in the case of *B. W. Jones Trust* v. *Commissioner*, 46 B.T.A. 531 (1942), affirmed, 132 Fed. (2d) 914 (1943).

The *Jones* case involved trusts created in England by a citizen and resident of that country for the benefit of English beneficiaries. The trusts had both English trustees and an American trustee, and 90 percent of the corpora of the trusts consisted of securities of corporations organized and doing business in the United States. During the taxable year in question, the trusts maintained an office in the United States and the trustee made several sales of securities in this country resulting in capital gains.

The Court of Appeals for the Fourth Circuit rejected the argument of the taxpayer's representatives that the status of the taxpayer as a resident or nonresident depended solely on where it was created. Recognizing the difficulty of determining the residence of a trust in some instances, the court stated, in part, as follows:

> What is nonresidence on the part of a trust, within the statutory meaning, is a question which in some instances may be difficult of determination; but we feel no hesitation in saying that it cannot be predicated of a trust 90% of

whose property consists of stocks and bonds of domestic corporations, held in this country in the possession of a trustee who is a citizen of the country, traded in by that trustee on the exchange of the country, and returning income which is collected by such trustee in the country and handled from an office maintained in the country for that purpose. No individual who was present and operating within the country as were these trusts could claim to be a nonresident, and no corporation whose affairs were so handled could deny that it was present within the country on a permanent basis so as to subject it to service of process and other exercise of governmental power.

Revenue Ruling 60–181 involves a testamentary trust created by an alien domiciliary under the laws of a foreign country for the benefit of nonresident aliens. During the tax years in question, the trustees were citizens and residents of the United States and the trust property consisted of securities of United States corporations which were traded in on a domestic exchange. Based on the *Jones* decision, the ruling holds that such a trust is a resident alien entity of the United States for Federal income tax purposes. It modifies I.T. 1885 "to the extent that it holds that the status of the fiduciary has nothing to do with the status of the trust and that the status of the trust depends upon where it was created."

Section 641(a) of the Code does not make a distinction between the fiduciary of a trust and the fiduciary of an estate in imposing a tax on the income of estates and of trusts. No distinction is made between such fiduciaries in the provisions of section 1.871–2 of the Income Tax Regulations which includes a nonresident alien fiduciary in the term "nonresident alien individual." It follows, therefore, that the criteria drawn from the *Jones* case and from Revenue Ruling 60–181 for determining whether a trust is domestic or foreign, resident or nonresident, have equal application to questions concerning alienage and residence of estates.

In view of the foregoing, it is held that the estate of a nonresident alien decedent which is subject to domiciliary administration abroad is not *ipso facto* a nonresident alien estate. In each case consideration should be given to all of the facts involved, including the appointment of an ancillary administrator who is a citizen or resident of the United States and the extent and duration of the activities of such ancillary administrator in the United States, in connection with the estate before determining whether the estate of a nonresident alien decedent is a resident or nonresident alien entity.

Presence in the United States means something less than residence. In the case of an individual, mere physical presence is the test for determining whether such individual is present in the United States at any time during the taxable year. It follows that where an ancillary administrator is appointed in the United States to dispose of stock in United States corporations held by a nonresident alien and does dispose of such stock, the estate of such decedent is present in the United States within the meaning of section 871(a)(2) of the Code during the year in which such gains are realized.

Revenue Ruling 57–245 is modified to remove therefrom the implication that the residence status of the estate of a nonresident alien decedent depends solely on the state in which it is subject to domiciliary administration and that such estate which is subject to domiciliary administration in a foreign country is in every case a nonresident alien estate. Revenue Ruling 58–232 is hereby superseded.

SECTION 651.—DEDUCTION FOR TRUSTS DISTRIBUTING CURRENT INCOME ONLY

26 CFR 1.651(2)–2: Income required to be distributed currently. Rev. Rul. 62–147

(Also Section 652; 1.652(a)–1.)

Where the terms of a trust instrument require that trust income is to be distributed currently, suspension of distribution by the trustee pending termination of a legal dispute as to the amounts properly distributable does not shift the liability for the tax from the beneficiary to the trust. Whether trust income is required to be distributed currently depends upon the terms of the trust instrument and not on any action of the trustee.

I.T. 1733, C.B. II–2, 169 (1923), revoked.

Advice has been requested whether income of a trust is considered to be distributable currently within the meaning of sections 651 and 652 of the Internal Revenue Code of 1954 where, despite the fact that the terms of the trust require current distribution of income of the trust, it is withheld and not distributed by the trustee pending termination of litigation respecting the proper distribution to be made.

A similar question arose under the 1939 Code and prior income taxing statutes. In I.T. 1733, C.B. II–2, 169 (1923), this question was considered in a case in which distribution of income was withheld by the trustee contrary to the terms of the trust because of a legal dispute between two beneficiaries as to the share of each. In that case, the portion withheld by the trustee was regarded as being in fact not distributable currently to either beneficiary.

On the other hand, in *Mary Clark DeBrabant* v. *Commissioner*, 90 Fed. (2d) 433 (1937), the trustee, pending termination of litigation in a local court whether certain dividends received by the trust in 1930 were allocable to corpus, refrained from making distribution to the beneficiary to whom income of the trust was currently distributable. The local court, in 1933, held that the dividends were wholly distributable income. In a separate action to determine when this income was taxable, the Circuit Court of Appeals for the Second Circuit affirmed the Board of Tax Appeals decision that the distribution made by the trustee to the beneficiary in 1933 was taxable income to the beneficiary for 1930, the year when distributable, whether or not it was then distributed.

In the case of *United States* v. *Francis L. Higginson et al., Trustees*, 238 Fed. (2d) 439 (1956), the court, citing with approval the *DeBrabant* decision, held that the beneficiaries of an inter vivos trust which, by its terms, required net income to be paid semiannually to them, were taxable upon net income received by the trustee but withheld from distribution for approximately four years pending resolution by state courts of an unsuccessful claim that the trust was invalid. The court stated that a decision by the trustees to withhold income, even though in good faith, cannot amend the plain terms of the trust deed.

Whether the issue arises under the 1954 Code or under prior income taxing statutes, the rule applied in the court decisions mentioned above

will be followed by the Internal Revenue Service. Accordingly, it is held that where the terms of a trust instrument require that trust income is to be distributed currently, suspension of distribution by the trustee pending termination of a legal dispute as to the amounts properly distributable does not shift the liability for the tax from the beneficiary to the trust.

As stated in the Income Tax Regulations under the 1954 Code, the determination of whether trust income (as defined in section 643(b) of the Code) is required to be distributed currently depends upon the terms of the trust instrument and the applicable local law. See section 1.651(a)-2 of the regulations. The fact that the trustee does not comply with such terms, therefore, is not decisive of the question whether trust income is distributable currently.

However, extraordinary dividends received by the trust, which the fiduciary acting in good faith, after consideration of the terms of the governing instrument and applicable provisions of local law, determines to be allocable to corpus, would not constitute income required to be distributed currently to an income beneficiary. See section 643(b) of the Code and sections 1.651(a)-2, 1.643(b)-1, and 1.643(b)-2 of the regulations. Also, those dividends would be excludable in computing distributable net income of the trust. See section 643(a)(4) of the Code and the regulations thereunder. Compare section 1.665(d)-1(b) of the regulations for a description of the tax consequences when an extraordinary dividend or taxable stock dividend is later distributed to the income beneficiary.

I.T. 1733, C.B. II-2, 169 (1923), which is in conflict with the result reached herein, is hereby revoked.

SECTION 652.—INCLUSION OF AMOUNTS IN GROSS INCOME OF BENEFICIARIES OF TRUSTS DISTRIBUTING CURRENT INCOME ONLY

26 CFR 1.652(a)-1: Simple trusts; inclusion of amounts in income of beneficiaries

Distribution of capital gain attributable to sale of corporate stock forming the corpus of an irrevocable inter vivos trust the income from which is required to be distributed currently. See Rev. Rul. 62-147, page 151.

Subpart E.—Grantors and Others Treated as Substantial Owners

SECTION 671.—TRUST INCOME, DEDUCTIONS, AND CREDITS ATTRIBUTABLE TO GRANTORS AND OTHERS AS SUBSTANTIAL OWNERS

26 CFR 1.671-2: Applicable principles.

Income of savings account in the State of New York where the deposit is made of the depositor's own funds and in his own name "as trustee" for another person. See Rev. Rul. 62-148, page 143.

SECTION 676.—POWER TO REVOKE

26 CFR 1.676(a)–1: Power to revest title to portion of trust property in grantor; general rule. (Also Section 671; 1.671–2.) Rev. Rul. 62–148

A depositor who places his own funds in a savings account in the State of New York, in his own name "as trustee" for another person, is deemed, in the absence of evidence of a different intention on his part, to have created a revocable trust. The depositor is treated as the owner of the trust under the provisions of section 676 of the Internal Revenue Code of 1954 and is required, by section 671 of the Code, to include the income of the trust in his gross income.

Advice has been requested as to the person who is required to report, for Federal income tax purposes, the income from a savings account in a bank or other savings organization in the State of New York when the deposit consists of the depositor's own funds and is made in his own name "as trustee" for another person.

The taxpayer in the instant case deposited his own funds in a New York savings bank in his own name "as trustee" for his minor son. There was no other evidence as to his intention in making the deposit.

Section 676(a) of the Internal Revenue Code of 1954 provides, in part, that the grantor shall be treated as the owner of any portion of a trust where at any time the power to revest in the grantor title to such portion is exercisable by the grantor.

Section 671 of the Code provides the general rule that in cases where the grantor or another person is regarded as the owner of any portion of a trust, there shall be included in computing his taxable income and credits those items of income, deductions, and credits against the tax of the trust which are attributable to that portion of the trust to the extent that such items would be taken into account in computing the taxable income or credits against the tax of an individual.

One of the essential elements of a trust is an intention on the part of the owner of property to create a trust. A trust is created only if the settler properly manifests an intention to create a trust. Section 23, Restatement of Trusts, Second Edition.

Under New York law, the absence of evidence of a different intention of the depositor, the fact that a deposit is made in a savings bank in the name of the depositor "as trustee" for another person is sufficient to show only an intention to create a revocable trust. See *In re Totten*, 179 N.Y. 112, 71 N.E. 748 (1904); also section 58 Restatement of Trusts, Second Edition. Such trusts have been variously referred to as Totten trusts, tentative trusts, pass book trusts, parol trusts, and savings bank trusts.

The depositor, in such cases, is held to have intended to reserve a power to withdraw the whole or any part of the deposit at any time during his lifetime or otherwise to revoke the trust. Thus, tentative trusts of savings bank deposits in New York are valid, although revocable; and the grantor of such a trust may revest, in himself, title to all or any portion of the trust by merely withdrawing all or any part of the account.

Accordingly, it is held that the depositor in the instant case is treated as the owner of the trust under the provisions of section 676 of the Code and is required, by section 671 of the Code, to include the income of the trust in his gross income for Federal income tax purposes.

SUBCHAPTER L.—INSURANCE COMPANIES

PART I.—LIFE INSURANCE COMPANIES

Subpart A.—Definition; Tax Imposed

SECTION 801.—DEFINITION OF LIFE INSURANCE COMPANY

26 CFR 1.801–7: Variable annuities. T. D. 6610[1]
(Also Sections 11, 809, 821, 822, 823, 1016, 1201; 1.11, 1.809–4, 1.821, 1.822, 1.823–3, 1.1016, 1.1201.)

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 sections 801, 809, 821, 822, 823, 832, 841, 842, 843, 891, 1016, and 1201 of the Internal Revenue Code of 1954, relating to insurance companies.

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 May 12, 1961, notice of proposed rulemaking regarding amendment of the Income Tax Regulations under sections 821, 822, 823, 832, and 843 of the Internal Revenue Code of 1954 to conform to the Life Insurance Company Tax Act for 1955 (70 Stat. 47, 48) [Public Law 429, 84th Congress, C.B. 1956–1, 858], and under sections 801, 809, 841, 842, 891, 1016, and 1201 of the Internal Revenue Code of 1954 to conform to the Life Insurance Company Income Tax Act of 1959 (73 Stat. 112, 121, 139, 140), [Public Law 86–69, C.B. 1959–2, 654] relating to insurance companies, was published in the Federal Register (26 F.R. 4102). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the following regulations are hereby adopted. The amendments adopted by this Treasury Decision do not include the amendment of paragraph (c)(2)(ii) of section 1.822–5, relating to deduction of investment expenses from gross income, set forth in paragraph 7 of the notice of proposed rulemaking. Further consideration is being given to the rules contained therein and revised rules will be republished in a subsequent notice of proposed rule making. In addition,

[1] The publication of this Treasury Decision in 27 F.R. 8717, dated August 31, 1962, contains (1) instructions for modifying the notice of proposed rulemaking in 26 F.R. 4102, dated May 12, 1961, and (2) the full content 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.

there is contained herein an amendment of the Income Tax Regulations under section 11 of the Internal Revenue Code of 1954 to conform to the Tax Rate Extension Act of 1962 (76 Stat. 114) [Public Law 87–508, C.B. 1962–3, 58].

PARAGRAPH 1. Section 1.801–7 is amended to read as follows:

§1.801–7 VARIABLE ANNUITIES.—(a) *In general.*—(1) Section 801(g)(1) provides that for purposes of part I, subchapter L, chapter 1 of the Code, an annuity contract includes a contract which provides for the payment of a variable annuity computed on the basis of recognized mortality tables and the investment experience of the company issuing such a contract. A variable annuity differs from the ordinary or fixed dollar annuity in that the annuity benefits payable under a variable annuity contract vary with the insurance company's investment experience with respect to such contracts while the annuity benefits paid under a fixed dollar annuity contract are guaranteed irrespective of the company's actual investment earnings.

(2) The reserves held with respect to the annuity contracts described in section 801(g)(1) and subparagraph (1) of this paragraph shall qualify as life insurance reserves within the meaning of section 801(b)(1) and paragraph (a) of § 1.801–4 provided such reserves are required by law (as defined in paragraph (b) of § 1.801–5) and are set aside to mature or liquidate, either by payment or reinsurance, future unaccrued claims arising from such contracts involving, at the time with respect to which the reserve is computed, life, health, or accident contingencies. Accordingly, a company issuing variable annuity contracts shall qualify as a life insurance company for Federal income tax purposes if it satisfies the requirements of section 801(a) (relating to the definition of a life insurance company) and paragraph (b) of § 1.801–3.

(b) *Special rules for variable annuities.*—(1) *Adjusted reserves rate; assumed rate.*—The adjusted reserves rate for any taxable year with respect to the annuity contracts described in section 801(g)(1) and paragraph (a)(1) of this section, and the rate of interest assumed by the taxpayer for any taxable year in calculating the reserve on any such contract, shall be a rate equal to the current earnings rate determined under section 801(g)(3) and subparagraph (2) of this paragraph. However, any change in the rate of interest assumed by the taxpayer in calculating the reserve on a variable annuity contract for any taxable year which is attributable to an increase or decrease in the current earnings rate, shall not be treated as a change of basis in computing reserves for purposes of section 806(b) (relating to certain changes in reserves) or section 810(d)(1) (relating to adjustment for change in computing reserves).

(2) *Current earnings rate.*—(i) The current earnings rate for any taxable year with respect to the annuity contracts described in section 801(g)(1) and paragraph (a)(1) of this section shall be the current earnings rate determined under section 805(b)(2) and paragraph (a)(2) of § 1.805–5 with respect to such contracts, reduced by the percentage obtained by dividing (*a*) the amount of the actuarial margin charge on all such variable annuity contracts issued by the taxpayer, by (*b*) the mean of the reserves for such contracts.

(ii) For purposes of section 801(g)(3) and subdivision (i) of this subparagraph, the term "actuarial margin charge" means any amount retained by the company from gross investment income pursuant to the terms of the variable annuity contract in excess of any portion of the investment expenses which is attributable to such contract and which is deductible under section 804(c) and paragraph (b) of § 1.804–4.

(3) *Increases and decreases in reserves.*—(i) Section 801(g)(4) provides that for purposes of section 810 (a) and (b) (relating to adjustments for increases or decreases in certain reserves), the sum of the items described in section 810(c) and paragraph (b) of § 1.810–2 taken into account as of the close of the taxable year shall be adjusted—

(*a*) By subtracting therefrom the sum of any amounts added from time to time (for the taxable year) to the reserves for variable annuity contracts described in section 801(g)(1) and paragraph (a)(1) of this section by reason of realized or unrealized appreciation in the value of the assets held in relation thereto, and

(*b*) By adding thereto the sum of any amounts subtracted from time to time (for the taxable year) from such reserves by reason of realized or unrealized depreciation in the value of such assets.

(ii) The application of section 801(g)(4) and subdivision (i) of this subparagraph may be illustrated by the following example:

Example. Company M, a life insurance company issuing only variable annuity contracts of the type described in section 801(g)(1) and paragraph (a)(1) of this section, increased its life insurance reserves held with respect to such contracts during the taxable year 1959 by $275,000. Of the total increase in the reserves, $100,000 was attributable to premium receipts, $50,000 to dividends and interest, $100,000 to unrealized appreciation in the value of the assets held in relation to such reserves, and $25,000 to realized capital gains on the sale of such assets. As of the close of the taxable year 1959, the reserves held by company M with respect to all variable annuity contracts amounted to $1,275,000. However, under section 801(g)(4) and subdivision (i) of this subparagraph, this amount must be reduced by the $100,000 unrealized asset value appreciation and the $25,000 of realized capital gains. Accordingly, for purposes of section 810 (a) and (b), the amount of these reserves which is to be taken into account as of the close of the taxable year 1959 under section 810(c) is $1,150,000 ($1,275,000 less $125,000).

(c) *Companies issuing variable annuities and other contracts.*—(1) In the case of a life insurance company which issues both annuity contracts described in section 801(g)(1) and paragraph (a)(1) of this section and other contracts, the policy and other contract liability requirements (as defined in section 805(a) and paragraph (b) of § 1.805–4) of such a company for any taxable year shall be considered to be the sum of—

(i) The policy and other contract liability requirements computed with respect to the items which relate to such variable annuity contracts, and

(ii) The policy and other contract liability requirements computed by excluding the items taken into account under subdivision (i) of this subparagraph.

(2) [Reserved for regulations to be issued under section 801(g)(5)(B).]

(d) *Termination.*—Paragraphs (1), (2), (3), (4), and (5) of section 801(g) and paragraphs (a), (b), (c), (d), and (e) of § 1.801–7 shall not apply with respect to any taxable year beginning after December 31, 1962.

PAR. 2. Paragraph (a)(1)(i) of § 1.809–4 is amended to read as follows:

§ 1.809–4 GROSS AMOUNT.—(a) *Items taken into account.* * * *

(1) *Premiums.*—(i) The gross amount of all premiums and other consideration on insurance and annuity contracts (including contracts supplementary thereto); less return premiums and premiums and other consideration arising out of reinsurance ceded. The term "gross amount of all premiums" means the premiums and other consideration provided in the insurance or annuity contract. Thus, the amount to be taken into account shall be the total of the premiums and other consideration provided in the insurance or annuity contract without any deduction for commissions, return premiums, reinsurance, dividends to policyholders, dividends left on deposit with the company, discounts on premiums paid in advance, interest applied in reduction of premiums (whether or not required to be credited in reduction of premiums under the terms of the contract), or any other item of similar nature. Such term includes advance premiums, premiums deferred and uncollected and premiums due and unpaid, deposits, fees, assessments, and consideration in respect of assuming liabilities under contracts not issued by the taxpayer (such as a payment or transfer of property in an assumption reinsurance transaction as defined in paragraph (a)(7)(ii) of § 1.809–5). The term also includes amounts a life insurance company charges itself representing premiums with respect to liability for insurance and annuity benefits for its employees (including full-time life insurance salesmen within the meaning of section 7701(a)(20)).

PAR. 3. Paragraph (a)(12) of section 1.809–5 is amended to read as follows:

§ 1.809–5 DEDUCTIONS.—(a) *Deductions allowed.* * * *

(12) *Other deductions.*—Except as modified by section 809(e) and § 1.809–6, all other deductions allowed under subtitle A of the Code for purposes of computing taxable income to the extent not allowed as a deduction in computing investment yield. For example, a life insurance company shall be allowed a deduction under section 809(d)(12) and this subparagraph for amounts representing premiums charged itself with respect to liability for insurance and

annuity benefits for its employees (including full-time life insurance salesmen within the meaning of section 7701(a)(20)) in accordance with the rules prescribed in sections 162 and 404 and the regulations thereunder, to the extent that a deduction for such amounts is not allowed under section 804(c)(1) and paragraph (b)(1) of § 1.804–4 or section 809(d)(9) and subparagraph (9) of this paragraph.

PAR. 4. Section 1.821 is amended by revising subdivision (i) of subsection (a)(1)(A), by adding subdivision (ii) of subsection (a)(1)(A), by revising paragraph (2) of subsection (a), by revising subparagraph (A) of subsection (b)(1), by revising subsection (c), and by adding a historical note. These amended and added provisions and added historical note read as follows:

§ 1.821 STATUTORY PROVISIONS; TAX ON MUTUAL INSURANCE COMPANIES (OTHER THAN LIFE OR MARINE OR FIRE INSURANCE COMPANIES ISSUING PERPETUAL POLICIES).

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

(a) IMPOSITION OF TAX ON MUTUAL COMPANIES OTHER THAN INTERINSURERS. * * *

(1) * * *

(A) NORMAL TAX.—

(i) TAXABLE YEARS BEGINNING BEFORE JULY 1, 1963.—In the case of taxable years beginning before July 1, 1963, a normal tax of 30 percent of the mutual insurance company taxable income, or 60 percent of the amount by which such taxable income exceeds $3,000, whichever is the lesser;

(ii) TAXABLE YEARS BEGINNING AFTER JUNE 30, 1963.—In the case of taxable years beginning after June 30, 1963, a normal tax of 25 percent of the mutual insurance company taxable income, or 50 percent of the amount by which such taxable income exceeds $3,000, whichever is the lesser; plus

* * * * * * *

(2) If for the taxable year the gross amount of income from the items described in section 822(b) (other than paragraph (1)(D) thereof) and net premiums, minus dividends to policyholders, minus the interest which under section 103 is excluded from gross income, exceeds $75,000, a tax equal to 1 percent of the amount so computed, or 2 percent of the excess of the amount so computed over $75,000, whichever is the lesser.

(b) IMPOSITION OF TAX ON INTERINSURERS. * * *

(1) NORMAL TAX.—

(A) TAXABLE YEARS BEGINNING BEFORE JULY 1, 1963.—In the case of taxable years beginning before July 1, 1963, a normal tax of 30 percent of the mutual insurance company taxable income, or 60 percent of the amount by which such taxable income exceeds $50,000, whichever is the lesser;

(B) TAXABLE YEARS BEGINNING AFTER JUNE 30, 1963.—In the case of a taxable year beginning after June 30, 1963, a normal tax of 25 percent of the mutual insurance company taxable income, or 50 percent of the amount by which such taxable income exceeds $50,000, whichever is the lesser; plus

* * * * * * *

(c) GROSS AMOUNT RECEIVED, OVER $75,000 BUT LESS THAN $125,000.—If the gross amount received during the taxable year from the items described in section 822(b) (other than paragraph (1)(D) thereof) and premiums (including deposits and assessments) is over $75,000 but less than $125,000, the tax imposed by subsection (a) or subsection (b), whichever applies, shall be reduced to an amount which bears the same proportion to the amount of the tax determined under such subsection as the excess over $75,000 of such gross amount received bears to $50,000.

* * * * * * *

[Sec. 821 as amended by sec. 2, Tax Rate Extension Act 1955 (69 Stat. 14) [P.L. 18, C.B. 1955–1, 619]; sec. 3(a) (1) and (2), Life Insurance Company Tax Act 1955 (70 Stat. 47) [Public Law 429, 84th Congress, C.B. 1956–1, 858]; sec. 2, Tax Rate Extension Act 1956 (70 Stat. 66) [Public Law 458, 84th Congress, C.B. 1956–1, 869]; sec. 2, Tax Rate Extension Act 1957 (71 Stat. 9) [Public Law 85–12, C.B. 1957–1, 666]; sec. 2, Tax Rate Extension Act 1958 (72 Stat. 259) [Public Law 85–475, C.B. 1958–3, 73]; sec. 2, Tax Rate Extension Act 1959 (73 Stat. 157) [Public Law 86–75, C.B. 1959–2, 676]; sec. 201, Public Debt and Tax Rate Extension Act 1960 (74 Stat. 290) [Public Law 86–564, C.B. 1960–2, 681]; sec. 2, Tax Rate Extension Act 1961 (75 Stat. 193) [Public Law 87–72, C.B. 1961–2, 317]; sec. 2, Tax Rate Extension Act 1962 (76 Stat. 114) [Public Law 87–508, C.B. 1962–3, 58].

PAR. 5. There are inserted immediately after § 1.821–1 the following new sections:

§ 1.821–2 TAXABLE YEARS AFFECTED.—Section 1.821–1 is applicable only to taxable years beginning after December 31, 1953, but before January 1, 1955, and ending after August 16, 1954, and all references to sections of part II, subchapter L, chapter 1 of the Code are to the Internal Revenue Code of 1954, before amendments. Section 1.821–3 is applicable only to taxable years beginning after December 31, 1954, and all references to sections of part II, subchapter L, chapter 1 of the Code are to the Internal Revenue Code of 1954, as amended by the Life Insurance Company Tax Act for 1955 (70 Stat. 36).

§ 1.821–3 TAX ON MUTUAL INSURANCE COMPANIES OTHER THAN LIFE OR MARINE OR FIRE INSURANCE COMPANIES SUBJECT TO THE TAX IMPOSED BY SECTION 831.—(a) *In general.*—(1) For taxable years beginning after December 31, 1954, all mutual insurance companies, including foreign insurance companies carrying on an insurance business within the United States, not taxable under section 802 or 831 and not specifically exempt under the provisions of section 501(c)(15), are subject to the tax imposed by section 821 on their investment income or on their gross income, whichever tax is the greater, except interinsurers and reciprocal underwriters which are taxed only on their investment income. For the alternative tax, in lieu of the tax imposed by section 821 (a) or (b), where the net long-term capital gain for any taxable year exceeds the net short-term capital loss, see section 1201(a) and the regulations thereunder.

(2) The taxable income of mutual insurance companies subject to the tax imposed by section 821 differs from the taxable income of other corporations. See section 821(a)(2) and section 822. Such companies are entitled, in computing mutual insurance company taxable income, to the deductions provided in part VIII (section 241 and following, except section 248), subchapter B, chapter 1 of the Code. The gross amount of income during the taxable year from interest, the deduction under section 822(c)(1) for wholly tax-exempt interest, and the deduction under section 242 for partially tax-exempt interest, are decreased by the appropriate amortization of premium and increased by the appropriate accrual of discount attributable to the taxable year on bonds, notes, debentures or other evidences of indebtedness held by a mutual insurance company subject to the tax imposed by section 821. See section 822(d)(2) and § 1.822–7. However, for taxable years beginning after May 31, 1960, only the accrual of discount relating to issue discount will increase the deduction for wholly tax-exempt interest. See section 103. In the case of any such evidence of indebtedness, adjustment shall be made to basis in the same manner as that made by life insurance companies under section 1016(a)(17) and the regulations thereunder.

(3) All provisions of the Internal Revenue Code and of the regulations in this part not inconsistent with the specific provisions of section 821 are applicable to the assessment and collection of the tax imposed by section 821 (a) or (b) and mutual insurance companies subject to the tax imposed by section 821 are subject to the same penalties as are provided in the case of returns and payment of income tax by other corporations. The return shall be on Form 1120M.

(4) Foreign mutual insurance companies not carrying on an insurance business within the United States are not taxable under section 821 (a) or (b), but are taxable as other foreign corporations. See section 881.

(5) Mutual insurance companies subject to the tax imposed by section 821, except interinsurers or reciprocal underwriters, with mutual insurance company

taxable income (computed without regard to the deduction provided in section 242 for partially tax-exempt interest) of over $3,000 or with gross amounts of income during the taxable year from the items described in section 822(b) (other than paragraph (1)(D) thereof) and net premiums (minus dividends to policyholders and wholly tax-exempt interest) in excess of $75,000, are subject to a tax computed under section 821(a)(1) or section 821(a)(2) whichever is the greater. Interinsurers and reciprocal underwriters with mutual insurance company taxable income (computed without regard to the deduction provided in section 242 for partially tax-exempt interest) of over $50,000 are subject to a tax computed under section 821(b).

(b) *Rates of tax.*—(1) For taxable years beginning before July 1, 1963, the normal tax under section 821(a)(1)(A) and 821(b)(1), except as hereinafter indicated, is computed upon mutual insurance company taxable income for purposes of the normal tax at the rate of 30 percent.

(2) The surtax under section 821(a)(1)(B) and 821(b)(2), except as hereinafter indicated, is computed on that portion of the mutual insurance company taxable income for the purposes of the surtax in excess of $25,000 at the rate of 22 percent. The tax under section 821(a)(2), except as hereinafter indicated, is 1 percent of the gross amount of income during the taxable year from the items described in section 822(b) (other than paragraph (1)(D) thereof) and net premiums, minus dividends to policyholders and minus wholly tax-exempt interest.

(3) For taxable years beginning before July 1, 1963, under section 821(a)(1)(A) companies with mutual insurance company taxable income for purposes of the normal tax of over $3,000 and not over $6,000 pay a normal tax, at a specified rate, on that portion of such income in excess of $3,000. The rate applicable in computing the normal tax of such companies is 60 percent. Under section 821(a)(2) companies with gross amounts of income during the taxable year from the items described in section 822(b) (other than paragraph (1)(D) thereof) and net premiums, minus dividends to policyholders and minus wholly tax-exempt interest, of over $75,000 and not over $150,000 pay a tax equal to 2 percent of that portion in excess of $75,000.

(4) For taxable years beginning before July 1, 1963, under section 821(b)(1) interinsurers and reciprocal underwriters with mutual insurance company taxable income for purposes of the normal tax of over $50,000 and not over $100,000 pay a normal tax computed on that portion of such income in excess of $50,000 at the rate of 60 percent. Under section 821(b)(2) interinsurers and reciprocal underwriters with mutual insurance company taxable income for purposes of the surtax of over $50,000 and not over $100,000 pay a surtax, at the rate of 33 percent, on that portion of such income in excess of $50,000.

(5) Section 821(c) provides for an adjustment of the amount computed under section 821(a)(1), section 821(a)(2), and section 821(b) where the gross amount received during the taxable year from the items described in section 822(b) (other than paragraph (1)(D) thereof) and premiums (including deposits and assessments) is over $75,000 and less than $125,000. The adjustment reduces the tax otherwise computed under those sections to an amount which bears the same proportion to such tax as the excess over $75,000 bears to $50,000.

(c) *Application.*—The application of sections 821 (a) to (c) inclusive, may be illustrated by the following examples:

Example (1). The W Company, a mutual casualty insurance company, for the calendar year 1958, has mutual insurance company taxable income for purposes of the surtax of $5,500 and, due to partially tax-exempt interest of $800, has income for purposes of the normal tax of $4,700. The gross amount of income of the W Company from the items described in section 822(b) (other than paragraph (1)(D) thereof) and net premiums, minus dividends to policyholders and wholly tax-exempt interest, is $150,000. Its normal tax under section 821(a)(1) for the calendar year 1958 is 60 percent of $1,700 ($4,700 minus $3,000) or $1,020, since its income subject to normal tax is not over $6,000. It is not liable for surtax for the calendar year 1958 as its mutual insurance company taxable income for purposes of the surtax does not exceed $25,000. It has no surtax and, therefore, its total tax under section 821(a)(1)(A) is the normal tax of $1,020. The tax under section 821(a)(2) is 2 percent of $75,000 ($150,000–$75,000), or $1,500. Since the tax under section 821(a)(2) exceeds the tax under section 821(a)(1), the tax under section 821 is $1,500, namely, that imposed by section 821(a)(2).

Example (2). If in the above example the income for purposes of the normal tax were not over $3,000, the income for purposes of the surtax were not over $25,000, the gross amount received from interest, dividends, rents, and premiums (including deposits and assessments) were $90,000, and the gross amount of income from the items described in section 822(b) (other than paragraph (1)(D) thereof) and net premiums, minus dividends to policyholders and wholly tax-exempt interest, were $70,000, the W Company would be required to file an income tax return but due to section 821(a) no income tax would be imposed.

Example (3). The X Company, a mutual casualty insurance company, for the calendar year 1958, has mutual insurance company taxable income for surtax purposes of $28,000 and, due to partially tax-exempt interest of $5,000, has income for normal tax purposes of $23,000. The gross amount of income of the X Company received during the taxable year from the items described in section 822(b) (other than paragraph (1)(D) thereof) and net premiums, minus dividends to policyholders and wholly tax-exempt interest, is $1,200,000. Under section 821(a)(1) its normal tax for the calendar year 1958 is 30 percent of $23,000, or $6,900, and the surtax is 22 percent of $3,000 ($28,000–$25,000), or $660. The combined tax under section 821(a)(1) is $7,560 ($6,900 plus $660). The tax under section 821(a)(2) is 1 percent of $1,200,000 or $12,000. Since the tax under section 821(a)(2) exceeds the tax under section 821(a)(1), the tax under section 821(a) is $12,000, namely, that imposed by section 821(a)(2).

Example (4). The Y Company, a mutual fire insurance company subject to the tax imposed by section 821 for the calendar year 1958, has mutual insurance company taxable income for purposes of the surtax of $35,000 and, due to partially tax-exempt interest of $5,000, has income for purposes of the normal tax of $30,000. The gross amount received during the taxable year from the items described in section 822(b) (other than paragraph (1)(D) thereof) and premiums (including deposits and assessments) is $120,000, and the gross amount of income from interest, dividends, rents, and net premiums, minus dividends to policyholders and wholly tax-exempt interest, is $100,000. Under section 821(a)(1), without application of section 821(c), the normal tax would be 30 percent of $30,000, or $9,000, since this is less than $16,200, 60 percent of $27,000 (excess of $30,000 over $3,000) ; and the surtax would be 22 percent of $10,000 (excess of $35,000 over $25,000), or $2,200. The combined tax of $11,200 ($9,000 plus $2,200) would then be reduced by applying section 821(c), since the gross receipts are between $75,000 and $125,000. The tax under section 821(a)(1), as thus adjusted, would be 90 percent of $11,200, or $10,080, since $45,000 (excess of $120,000 over $75,000) is 9 percent of $50,000. Under section 821(a)(2), without reference to section 821(c), the tax is 2 percent of $25,000 (excess of $100,000 over $75,000), or $500, since this is less than $1,000, 1 percent of $100,000. Applying section 821(c) reduces this to $450, or 90 percent of $500 Since $10,080, the tax under section 821(a)(1), as adjusted, exceeds $450, the tax under section 821(a)(2), as adjusted, the tax under section 821(a)(1), as adjusted, is applicable. The Y Company would accordingly pay a combined normal tax and surtax of $10,080.

Example (5). The Z Exchange, an interinsurer, for the calendar year 1958 has mutual insurance company taxable income for purposes of the surtax of $60,000 and, due to partially tax-exempt interest of $12,000, has income for purposes of the normal tax of $48,000. The gross amount received during the taxable year from the items described in section 822(b) (other than paragraph (1)(D) thereof) and premiums (including deposits and assessments) is $2,700,000. The Z Exchange is not liable for normal tax under section 821(b)(1) for the calendar year 1958 as its mutual insurance company taxable income for purposes of the normal tax does not exceed $50,000. Its surtax is 33 percent of $10,000 ($60,000 minus $50,000), or $3,300, since that amount is less than $7,700, 22 percent of $35,000 (excess of $60,000 over $25,000). Since the Z Exchange has no normal tax, is not subject to the tax imposed by section 821(a)(2), and is not entitled to the adjustment provided in section 821(c), its total tax under section 821(b) is $3,300.

PAR. 6. Section 1.822 is amended by revising section 822(b), by revising paragraphs (3) and (6) of section 822(c), by adding paragraphs (8) and (9) to paragraph 822(c), by revising paragraph (1) of section 822(d), by revising section 822(e), and by adding a histori-

cal note. These amended and added provisions and added historical note read as follows:

§ 1.822 STATUTORY PROVISIONS; DETERMINATION OF MUTUAL INSURANCE COMPANY TAXABLE INCOME.

SEC. 822. DETERMINATION OF MUTUAL INSURANCE COMPANY TAXABLE INCOME.

(a) DEFINITION. * * *

(b) GROSS INVESTMENT INCOME.—For purposes of subsection (a), the term "gross investment income" means the sum of the following:

(1) The gross amount of income during the taxable year from—

(A) Interest, dividends, rents, and royalties,

(B) The entering into of any lease, mortgage, or other instrument or agreement from which the insurance company derives interest, rents, or royalties,

(C) The alteration or termination of any instrument or agreement described in subparagraph (B), and

(D) Gains from sales or exchanges of capital assets to the extent provided in subchapter P (sec. 1201 and following, relating to capital gains and losses).

(2) The gross income during the taxable year from any trade or business (other than an insurance business) carried on by the insurance company, or by a partnership of which the insurance company is a partner. In computing gross income under this paragraph, there shall be excluded any item described in paragraph (1).

(c) DEDUCTIONS. * * *

(3) REAL ESTATE EXPENSES.—Taxes (as provided in section 164,) and other expenses, paid or accrued during the taxable year exclusively on or with respect to the real estate owned by the company. No deduction shall be allowed under this paragraph for any amount paid out for new buildings, or for permanent improvements or betterments made to increase the value of any property.

* * * * * * *

(6) CAPITAL LOSSES.—Capital losses to the extent provided in subchapter P (sec. 1201 and following) plus losses from capital assets sold or exchanged in order to obtain funds to meet abnormal insurance losses and to provide for the payment of dividends and similar distributions to policyholders. Capital assets shall be considered as sold or exchanged in order to obtain funds to meet abnormal insurance losses and provide for the payments of dividends and similar distributions to policyholders to the extent that the gross receipts from their sale or exchange are not greater than the excess, if any, for the taxable year of the sum of dividends and similar distributions paid to policyholders, losses paid, and expenses paid over the sum of the items described in subsection (b) (other than paragraph (1)(D) thereof) and net premiums received. In the application of section 1212 for purposes of this section, the net capital loss for the taxable year shall be the amount by which losses for such year from sales or exchanges of capital assets exceeds the sum of the gains from such sales or exchanges and whichever of the following amounts is the lesser:

(A) The mutual insurance company taxable income (computed without regard to gains or losses from sales or exchanges of capital assets or to the deduction provided in section 242 for partially tax-exempt interest); or

(B) Losses from the sale or exchange of capital assets sold or exchanged to obtain funds to meet abnormal insurance losses and to provide for the payment of dividends and similar distributions to policyholders.

* * * * * * *

(8) TRADE OR BUSINESS DEDUCTIONS.—The deductions allowed by this subtitle (without regard to this part) which are attributable to any trade or business (other than an insurance business) carried

on by the insurance company, or by a partnership of which the insurance company is a partner; except that for purposes of this paragraph—

(A) Any item, to the extent attributable to the carrying on of the insurance business, shall not be taken into account, and

(B) The deduction for net operating losses provided in section 172 shall not be allowed.

(9) DEPLETION. The deduction allowed by section 611 (relating to depletion).

(d) OTHER APPLICABLE RULES.—

(1) RENTAL VALUE OF REAL ESTATE.—The deduction under subsection (c) (3) or (4) on account of any real estate owned and occupied in whole or in part by a mutual insurance company subject to the tax imposed by section 821 shall be limited to an amount which bears the same ratio to such deduction (computed without regard to this paragraph) as the rental value of the space not so occupied bears to the rental value of the entire property.

* * * * * * *

(e) FOREIGN MUTUAL INSURANCE COMPANIES OTHER THAN LIFE OR MARINE.—In the case of a foreign mutual insurance company (other than a life or marine insurance company or a fire insurance company subject to the tax imposed by section 831), the mutual insurance company taxable income shall be the taxable income from sources within the United States (computed without regard to the deductions allowed by subsection (c)(7)), and the gross amount of income from the items described in subsection (b) (other than paragraph (1)(D) thereof) and net premiums shall be the amount of such income from sources within the United States. In the case of a company to which the preceding sentence applies, the deductions allowed in this section shall be allowed to the extent provided in subpart B of part II of subchapter N (sec. 881 and following) in the case of a foreign corporation engaged in trade or business within the United States.

[Sec. 822 as amended by sec. 3(a) (3), (4), (5), (6), (7), and (8), Life Insurance Company Tax Act 1955 (70 Stat. 47)]

PAR. 7. There are inserted immediately after § 1.822–3 the following new sections:

§ 1.822–4 TAXABLE YEARS AFFECTED.—Sections 1.822–1 through 1.822–3 are applicable only to taxable years beginning after December 31, 1953, but before January 1, 1955, and ending after August 16, 1954, and all references to sections of part II, subchapter L, chapter 1 of the Code are to the Internal Revenue Code of 1954, before amendments. Sections 1.822–5 through 1.822–7 are applicable only to taxable years beginning after December 31, 1954, and all references to sections of part II, subchapter L, chapter 1 of the Code are to the Internal Revenue Code of 1954, as amended by the Life Insurance Company Tax Act for 1955 (70 Stat. 36).

§ 1.822–5 MUTUAL INSURANCE COMPANY TAXABLE INCOME.—(a) *Mutual insurance company taxable income defined.*—Section 822(a) defines the term "mutual insurance company taxable income" for purposes of part II, subchapter L, chapter 1 of the Code. Mutual insurance company taxable income means gross investment income (as defined in section 822(b) and paragraph (b) of this section), less the deductions provided in section 822(c) and paragraph (c) of this section for wholly tax-exempt interest, investment expenses, real estate expenses, depreciation, interest paid or accrued, capital losses, special deductions, trade or business (other than an insurance business) expenses, and depletion. However, such expenses are deductible only to the extent that they relate to investment income and the deduction of such expenses is not disallowed by any other provision of subtitle A of the Code. For example, investment expenses are not allowable unless they are ordinary and necessary expenses within the meaning of section 162. In addition to the limitations on deductions relating to real estate owned and occupied by a mutual insurance company subject to the tax imposed by section 821 provided in section 822(d)(1), the adjustment for amortization of premium and accrual of discount provided in section 822(d)(2), and the limitation on the deduction for investment expenses where general

expenses are allocated to investment income provided in section 822(c)(2), mutual insurance companies subject to the tax imposed by section 821 are subject to the limitation on deductions relating to wholly tax-exempt income provided in section 265. Such companies are not entitled to the net operating loss deduction provided in section 172, and a deduction shall not be permitted with respect to the same item more than once.

(b) *Gross investment income defined.*—For purposes of part II, subchapter L, chapter 1 of the Code, section 822(b) defines the term "gross investment income" of a mutual insurance company subject to the tax imposed by section 821 as the sum of the following:

(1) The gross amount of income during the taxable year from—

(i) Interest (including tax-exempt interest and partially tax-exempt interest), as described in § 1.61–7. Interest shall be adjusted for amortization of premium and accrual of discount in accordance with the rules prescribed in section 822(d)(2) and § 1.822–7.

(ii) Dividends, as described in § 1.61–9.

(iii) Rents and royalties, as described in § 1.61–8.

(iv) The entering into of any lease, mortgage or other instrument or agreement from which the company may derive interest, rents, or royalties.

(v) The alteration or termination of any instrument or agreement described in subdivision (iv) of this subparagraph.

(vi) Gains from sales or exchanges of capital assets to the extent provided in subchapter P (section 1201 and following, relating to capital gains and losses), chapter 1 of the Code.

(2) The gross income from any trade or business (other than an insurance business) carried on by a mutual insurance company subject to the tax imposed by section 821, or by a partnership of which the insurance company is a partner.

For example, gross investment income includes amounts received as commitment fees, or as a bonus for the entering into of a lease, or as a penalty for the early payment of a mortgage. In computing the gross income from any trade or business (other than an insurance business) carried on by the insurance company, or by a partnership of which the insurance company is a partner, any item described in section 822(b)(1) and paragraph (a)(1) of this section shall not be considered as gross income arising from the conduct of such trade or business, but shall be taken into account under section 822(c)(1) and paragraph (a)(1) of this section.

(c) *Deductions from gross investment income.*—(1) *Wholly tax-exempt interest.*—Interest which in case of other taxpayers is excluded from gross income by section 103 but included in the gross investment income by section 822(b) is allowed as a deduction from gross investment income by section 822(c)(1).

(2) *Investment expenses.*—(i) The deduction for investment expenses under section 822(c)(2) includes only those expenses of the taxable year which are fairly chargeable against gross investment income. For example, investment expenses include salaries and expenses paid exclusively for work in looking after investments, and amounts expended for printing, stationery, postage, and stenographic work incident to the collection of interest. An itemized schedule of such expenses shall be attached to the return.

(ii) [Reserved]

(iii) If any general expenses are in part assigned to or included in investment expenses, the total deduction under section 822(c)(2) shall not exceed the sum of—

(*a*) One-fourth of 1 percent of the mean of the book value of the invested assets held at the beginning and end of the taxable year, plus

(*b*) One-fourth of the amount by which mutual insurance company taxable income (computed without any deduction for investment expenses, tax-free interest, partially tax-exempt interest, or dividends received) exceeds 3¾ percent of the book value of the mean of the invested assets held at the beginning and end of the taxable year.

For the purposes of section 822(c)(2) and this paragraph, the term "invested assets" means only those assets which are owned and used, and to the extent used, for the purpose of producing the income specified in section 822(b). See paragraph (b) of this section. The term does not include real estate owned and occupied, and to the extent owned and occupied, by the company.

(3) *Real estate expenses and taxes.*—The deduction for real estate expenses and taxes under section 822(c)(3) includes taxes (as defined in section 164) and other expenses for the taxable year exclusively on or with respect to real estate owned by the company. For example, no deduction shall be allowed under section 822(c)(3) for amounts allowed as a deduction under section 164(e) (relating to taxes of shareholders paid by a corporation). No deduction shall be allowed under section 822(c)(3) for any amount paid out for new buildings, or for permanent improvements or betterments made to increase the value of any property. An itemized schedule of such taxes and expenses shall be attached to the return. See § 1.822–6 for limitation of such deduction.

(4) *Depreciation.*—The deduction allowed by section 822(c)(4) for depreciation is, except as provided in section 822(d)(1) and § 1.822–6, identical to that allowed other corporations by section 167. Such amount allowed as a deduction from gross investment income in determining mutual insurance company taxable income is limited to depreciation sustained on the property used, and to the extent used, for the purpose of producing the income specified in section 822(b).

(5) *Interest paid or accrued.*—The deduction allowed by section 822(c)(5) for interest on indebtedness is the same as that allowed other corporations by section 163. See § 1.163–1.

(6) *Capital losses.*—(i) The deduction for capital losses under section 822(c)(6) includes not only capital losses to the extent provided in subchapter P, chapter 1 of the Code but in addition thereto losses from capital assets sold or exchanged to provide funds to meet abnormal insurance losses and to provide for the payment of dividends and similar distributions to policyholders. Losses in the latter case may be deducted from ordinary income while the deduction for losses under subchapter P is limited to the gains. See section 1211.

(ii) Capital assets are considered as sold or exchanged to provide for the funds or payments specified in section 822(c)(6), to the extent that the gross receipts from the sale or exchange of such assets are not greater than the excess, if any, for the taxable year of the sum of dividends and similar distributions paid to policyholders, and losses and expenses paid over the sum of the items described in section 822(b) (other than paragraph (1)(D) thereof) and net premiums received. If, by reason of a particular sale or exchange of a capital asset, gross receipts are greater than such excess, the gross receipts and the resulting loss should be apportioned and the excess included in capital losses subject to the provisions of subchapter P. Capital losses actually used to reduce net income in any taxable year may not again be used in a succeeding taxable year as an offset against capital gains in that year and for that purpose a special rule is set forth for the application of section 1212.

(iii) The application of section 822(c)(6) may be illustrated by the following examples:

Example (1). The X Company, a mutual fire insurance company subject to the tax imposed by section 821, in the taxable year 1958 sells capital assets in order to obtain funds to meet abnormal insurance losses and to provide for the payment of dividends and similar distributions to policyholders. The gross receipts from the sale are $60,000, resulting in losses of $20,000. It pays dividends to policyholders of $150,000. It sustains losses of $25,000, and pays expenses of $25,000. It receives interest of $50,000, dividends of $5,000, royalties of $4,000, and net premiums of $66,000. The excess of the sum of dividends, losses, and expenses paid ($200,000) over the sum of the items described in section 822(b) (other than paragraph (1)(D) thereof) and net premiums received ($125,000) is $75,000. As the gross receipts from the sale of capital assets ($60,000) do not exceed such excess ($75,000), the losses of $20,000 are allowable as a deduction from gross investment income.

Example (2). If in example (1) the gross receipts were $76,000 and the last capital asset sold, for the purpose therein specified, resulted in gross receipts of $2,000 and a loss of $500, the losses allowable as a deduction from gross investment income would be $19,750. The last sale made the gross receipts of $76,000 exceed by $1,000 the excess ($75,000) of the sum of dividends, losses, and expenses paid ($200,000) over the sum of the items described in section 822(b) (other than paragraph (1)(D) thereof) and net premiums received ($125,000). The gross receipts and the resulting loss from the last sale are apportioned on the basis of the ratio of the excess of $1,000 to the gross receipts of $2,000, or 50 percent. Fifty percent of the loss of $500 is deducted from the total loss of $20,000. The remaining gross receipts of $1,000 and the proportionate loss of $250 should be reported as capital losses under subchapter P.

Example (3). If in example (1) the X Company had mutual insurance company taxable income for purposes of the surtax of $9,750 and, under the provisions of subchapter P, chapter 1 of the Code, had capital losses of $18,000 and capital gains of $10,000, the net capital loss for the taxable year 1958, in applying section 1212 for the purposes of section 822(c)(6), would be $8,000. This is determined by subtracting from total losses of $38,000 ($18,000 capital losses under subchapter P plus $20,000 other capital losses under section 822(c)(6)) the sum of capital gains of $10,000 and losses from the sale or exchange of capital assets sold or exchanged to obtain funds to meet abnormal insurance losses and to provide for the payment of dividends and similar distributions to policyholders of $20,000. Such losses of $20,000 are added to capital gains of $10,000, since they are less than taxable income for purposes of the surtax, computed without regard to gains or losses from sales or exchanges of capital assets, of $29,750 ($9,750 taxable income for purposes of the surtax plus $20,000 other capital losses under section 822(c)(6) plus the portion of capital losses allowable under subchapter P of $10,000 minus capital gains under subchapter P of $10,000).

(7) *Special deductions.*—Section 822(c)(7) allows a mutual insurance company the special deductions provided by part VIII (section 241 and following), except section 248, subchapter B, chapter 1 of the Code, relating to partially tax-exempt interest and to dividends received.

(8) *Trade or business deductions.*—(i) Under section 822(c)(8), the deductions allowed by subtitle A of the Code (without regard to this part) which are attributable to any trade or business (other than an insurance business) carried on by the insurance company, or by a partnership of which the company is a partner are, subject to the limitations in subdivision (ii) of this subparagraph, allowable as deductions from gross investment income in computing mutual insurance company taxable income. Such deductions are allowable, however, only to the extent that they relate to income which is included in the company's gross investment income by reason of section 822(b)(2). Thus, a deduction shall not be allowed under section 822(c)(8) with respect to any item described in section 822(b)(1). The allowable deductions may exceed the gross income from such business.

(ii) In computing the deductions under section 822(c)(8)—

(*a*) Any item, to the extent attributable to the carrying on of the insurance business, shall not be taken into account. For example, if the company operates a radio station primarily to advertise its own insurance services, a portion of the expenses of the radio station shall not be allowed as a deduction. The portion disallowed shall be an amount which bears the same ratio to the total expenses of the station as the value of advertising furnished to the insurance company bears to the total value of services rendered by the station.

(*b*) The deduction for net operating losses provided in section 172 shall not be allowed.

(9) *Depletion.*—The deduction allowed by section 822(c)(9) for depletion is the same as that allowed life insurance companies under section 804(c)(4). See paragraph (b)(5) of § 1.804–4.

§ 1.822–6 Real Estate Owned and Occupied.—Section 822(d)(1) provides that the amount allowable as a deduction for taxes, expenses, and depreciation on or with respect to any real estate owned and occupied in whole or in part by a mutual insurance company subject to the tax imposed by section 821 shall be limited to an amount which bears the same ratio to such deduction (computed without regard to this limitation) as the rental value of the space not so occupied bears to the rental value of the entire property. For example, if the rental value of the space not occupied by the company is equal to one-half of the rental value of the entire property, the deduction for taxes, expenses, and depreciation is one-half of the taxes, expenses, and depreciation on account of the entire property. Where a deduction is claimed as provided in this section, the parts of the property occupied and the parts not occupied by the company, together with the respective rental values thereof, must be shown in a statement accompanying the return.

§ 1.822–7 Amortization of Premium and Accrual of Discount.—Section 822(d)(2) makes provision for the appropriate amortization of premium and the appropriate accrual of discount, attributable to the taxable year, on bonds, notes, debentures, or other evidences of indebtedness held by a mutual insurance company subject to the tax imposed by section 821. Such amortization and accrual

is the same as that provided for life insurance companies by section 818(b)(1), as amended by the Life Insurance Company Income Tax Act of 1959 (73 Stat. 133), and shall be determined in accordance with paragraphs (a) and (b) of § 1.818–3, except in the case of a mutual insurance company subject to the tax imposed by section 821, paragraph (b) of § 1.818–3 shall apply without regard to the date of acquisition and the basis provided in section 1012 shall be used in lieu of the acquisition value.

PAR. 8. There are inserted immediately after § 1.823–2 the following new sections:

§ 1.823–3. TAXABLE YEARS AFFECTED.—Sections 1.823–1 and 1.823–2 are applicable only to taxable years beginning after December 31, 1953, but before January 1, 1955, and ending after August 16, 1954, and all references to sections of part II, subchapter L, chapter 1 of the Code are to the Internal Revenue Code of 1954, before amendments. Sections 1.823–4 and 1.823–5 are applicable only to taxable years beginning after December 31, 1954, and all references to sections of part II, subchapter L, chapter 1 of the Code are to the Internal Revenue Code of 1954, as amended by the Life Insurance Company Tax Act for 1955 (70 Stat. 36).

§ 1.823–4 NET PREMIUMS.—Net premiums are one of the items used, together with the gross amount of income during the taxable year from the items described in section 822(b) (other than paragraph (1)(D) thereof), less dividends to policyholders and wholly tax-exempt interest, in determining tax liability under section 821(a)(2). They are also used in section 822(c)(6) in determining the limitation on certain capital losses and in the application of section 1212. The term "net premiums" is defined in section 823(1) and includes deposits and assessments, but excludes amounts returned to policyholders which are treated as dividends under section 823(2).

§ 1.823–5 DIVIDENDS TO POLICYHOLDERS.

(a) Dividends to policyholders is one of the deductions used, together with wholly tax-exempt interest, in determining tax liability under section 821(a)(2). They are also used in section 822(c)(6) in determining the limitation on certain capital losses and in the application of section 1212. The term "dividends to policyholders" is defined in section 823(2) as dividends and similar distributions paid or declared to policyholders. It includes amounts returned to policyholders where the amount is not fixed in the insurance contract but depends upon the experience of the company or the discretion of the management. Such amounts are not to be treated as return premiums under section 823(1). Similar distributions include such payments as the so-called unabsorbed premium deposits returned to policyholders by factory mutual fire insurance companies. The term "paid or declared" is to be construed according to the method of accounting regularly employed in keeping the books of the insurance company, and such method shall be consistently followed with respect to all deductions (including dividends and similar distributions to policyholders) and all items of income.

(b) If the method of accounting so employed is the cash receipts and disbursements method, the deduction is limited to the dividends and similar distributions actually paid to policyholders in the taxable year. If, on the other hand, the method of accounting so employed is the accrual method, the deduction, or a reasonably accurate estimate thereof, for dividends and similar distributions declared to policyholders for any taxable year will, in general, be computed as follows:

> To dividends and similar distributions paid during the taxable year add the amount of dividends and similar distributions declared but unpaid at the end of the taxable year and deduct dividends and similar distributions declared but unpaid at the beginning of the taxable year.

If an insurance company using the accrual method does not compute the deduction for dividends and similar distributions declared to policyholders in the manner stated, it must submit with its return a full and complete explanation of the manner in which the deduction is computed. For the rule as to when dividends are considered paid, see the regulations under section 561.

PAR. 9. Section 1.832 is amended by revising paragraph (4) of section 832(b), by revising paragraphs (5) and (8) of section 832(c), and by adding a historical note. These amended provisions and added historical note read as follows:

§ 1.832 STATUTORY PROVISIONS; INSURANCE COMPANY TAXABLE INCOME.

SEC. 832. INSURANCE COMPANY TAXABLE INCOME.

(a) DEFINITION OF TAXABLE INCOME. * * *

(b) DEFINITIONS. * * *

(4) PREMIUMS EARNED.—The term "premiums earned on insurance contracts during the taxable year" means an amount computed as follows:

(A) From the amount of gross premiums written on insurance contracts during the taxable year, deduct return premiums and premiums paid for reinsurance.

(B) To the result so obtained, add unearned premiums on outstanding business at the end of the preceding taxable year and deduct unearned premiums on outstanding business at the end of the taxable year.

For purposes of this subsection, unearned premiums shall include life insurance reserves, as defined in section 801(b), pertaining to the life, burial, or funeral insurance or annuity business of an insurance company subject to the tax imposed by section 831 and not qualifying as a life insurance company under section 801.

* * * * * * *

(c) DEDUCTIONS ALLOWED. * * *

(5) Capital losses to the extent provided in subchapter P (sec. 1201 and following, relating to capital gains and losses) plus losses from capital assets sold or exchanged in order to obtain funds to meet abnormal insurance losses and to provide for the payment of dividends and similar distributions to policyholders. Capital assets shall be considered as sold or exchanged in order to obtain funds to meet abnormal insurance losses and to provide for the payment of dividends and similar distributions to policyholders to the extent that the gross receipts from their sale or exchange are not greater than the excess, if any, for the taxable year of the sum of dividends and similar distributions paid to policyholders in their capacity as such, losses paid, and expenses paid over the sum of the items described in section 822(b) (other than paragraph (1) (D) thereof) and net premiums received. In the application of section 1212 for purposes of this section, the net capital loss for the taxable year shall be the amount by which losses for such year from sales or exchanges of capital assets exceeds the sum of the gains from such sales or exchanges and whichever of the following amounts is the lesser:

(A) The taxable income (computed without regard to gains or losses from sales or exchanges of capital assets or to the deductions provided in section 242 for partially tax-exempt interest); or

(B) Losses from the sale or exchange of capital assets sold or exchanged to obtain funds to meet abnormal insurance losses and to provide for the payment of dividends and similar distributions to policyholders;

* * * * * * *

(8) The depreciation deduction allowed by section 167 and the deduction allowed by section 611 (relating to depletion);

* * * * * * *

[Sec. 832 as amended by sec. 3(b) (1), (2), and (3), Life Insurance Company Tax Act 1955 (70 Stat. 48)]

PAR. 10. Section 1.841 is amended by revising section 841(1) and adding a historical note. This amended provision and added historical note read as follows:

§ 1.841 STATUTORY PROVISIONS; CREDIT FOR FOREIGN TAXES.

SEC. 841. CREDIT FOR FOREIGN TAXES. * * *

(1) In the case of the tax imposed by section 802, the life insurance company taxable income (as defined in section 802(b)), and

* * * * * * *

[Sec. 841 as amended by sec. 5(4), Life Insurance Company Tax Act 1955 (70 Stat. 49); sec. 3(b), Life Insurance Company Income Tax Act 1959 (73 Stat. 139)]

PAR. 11. Section 1.842 is amended by adding a historical note at the end thereof. This added historical note reads as follows:

§ 1.842 STATUTORY PROVISIONS; COMPUTATION OF GROSS INCOME.

SEC. 842. COMPUTATION OF GROSS INCOME. * * *

[Sec. 842 as amended by sec. 5(5), Life Insurance Company Tax Act 1955 (70 Stat. 49); sec. 3(f)(1), Life Insurance Company Income Tax Act 1959 (73 Stat. 140)]

PAR. 12. There is inserted immediately after § 1.842 the following new section:

§ 1.843 STATUTORY PROVISIONS; ANNUAL ACCOUNTING PERIOD.

SEC. 843. ANNUAL ACCOUNTING PERIOD.

For purposes of this subtitle, the annual accounting period for each insurance company subject to a tax imposed by this subchapter shall be the calendar year.

[Sec. 843 as added by sec. 4(a), Life Insurance Company Tax Act 1955 (70 Stat. 48)]

PAR. 13. Section 1.891 is amended by revising section 891 and the historical note. This amended provision and historical note read as follows:

§ 1.891 STATUTORY PROVISIONS; DOUBLING OF RATES OF TAX ON CITIZENS AND CORPORATIONS OF CERTAIN FOREIGN COUNTRIES.

SEC. 891. DOUBLING OF RATES OF TAX ON CITIZENS AND CORPORATIONS OF CERTAIN FOREIGN COUNTRIES.

Whenever the President finds that, under the laws of any foreign country, citizens or corporations of the United States are being subjected to discriminatory or extraterritorial taxes, the President shall so proclaim and the rates of tax imposed by sections 1, 3, 11, 802, 821, 831, 852, 871, and 881 shall, for the taxable year during which such proclamation is made and for each taxable year thereafter, be doubled in the case of each citizen and corporation of such foreign country; but the tax at such doubled rate shall be considered as imposed by such sections as the case may be. In no case shall this section operate to increase the taxes imposed by such sections (computed without regard to this section) to an amount in excess of 80 percent of the taxable income of the taxpayer (computed without regard to the deductions allowable under section 151 and under part VIII of subchapter B.) Whenever the President finds that the laws of any foreign country with respect to which the President has made a proclamation under the preceding provisions of this section have been modified so that discriminatory and extraterritorial taxes applicable to citizens and corporations of the United States have been removed, he shall so proclaim, and the provisions of this section providing for doubled rates of tax shall not apply to any citizen or corporation of such foreign country with respect to any taxable year beginning after such proclamation is made.

[Sec. 891 as amended by sec. 5(6), Life Insurance Company Tax Act 1955 (70 Stat. 49); sec. 3(f)(1), Life Insurance Company Income Tax Act 1959 (73 Stat. 140)]

PAR. 14. Section 1.1016 is amended by revising paragraphs (3)(A) and (B) of section 1016(a), by adding paragraphs (3)(C) and (17) to section 1016(a), and by revising the historical note. These amended and added provisions and amended historical note read as follows:

§ 1.1016 STATUTORY PROVISIONS; ADJUSTMENT TO BASIS.

SEC. 1016. ADJUSTMENT TO BASIS.

(a) GENERAL RULE. * * *

(3) * * *

(A) Before March 1, 1913,

(B) Since February 28, 1913, during which such property was held by a person or an organization not subject to income taxation under this chapter or prior income tax laws, and

(C) Since February 28, 1913, and before January 1, 1958, during which such property was held by a person subject to tax under part I of subchapter L (or the corresponding provisions of prior income tax laws), to the extent that paragraph (2) does not apply,

* * * * * * *

(17) In the case of any evidence of indebtedness referred to in section 818(b) (relating to amortization of premium and accrual of discount in the case of life insurance companies), to the extent of the adjustments required under section 818(b) (or the corresponding provisions of prior income tax laws) for the taxable year and all prior taxable years;

* * * * * * *

[Sec. 1016 as amended by sec. 4(c), Act of June 29, 1956 (Pub. Law 629, 84th Cong., 70 Stat. 407 [C.B. 1956–2, 1165]); sec. 3 (d) (1) and (2), Life Insurance Company Income Tax Act 1959 (73 Stat. 139)]

PAR. 15. Section 1.1016–4 is amended to read as follows:

§ 1.1016–4 EXHAUSTION, WEAR AND TEAR, OBSOLESCENE, AMORTIZATION, AND DEPLETION; PERIODS DURING WHICH INCOME WAS NOT SUBJECT TO TAX.—(a) Adjustments to basis must be made for exhaustion, wear and tear, obsolescence, amortization, and depletion to the extent actually sustained in respect of:

(1) Any period before March 1, 1913,

(2) Any period since February 28, 1913, during which the property was held by a person or organization not subject to income taxation under chapter 1 of the Code or prior income tax laws, and

(3) Any period since February 28, 1913, and before January 1, 1958, during which the property was held by a person subject to tax under part I, subchapter L, chapter 1 of the Code, or prior income tax law, to the extent that section 1016(a)(2) does not apply.

(b) The amount of the adjustments described in paragraph (a) of this section actually sustained is that amount charged off on the books of the taxpayer where such amount is considered by the Commissioner to be reasonable. Otherwise, the amount actually sustained will be the amount that would have been allowable as a deduction:

(1) During the periods described in paragraph (a) (1) or (2) of this section, had the taxpayer been subject to income tax during those periods, or

(2) During the period described in paragraph (a)(3) of this section, with respect to property held by a taxpayer described in that paragraph, to the extent that section 1016(a)(2) was inapplicable to such property during that period.

In the case of a taxpayer subject to the adjustment required by subparagraph (1) or (2) of this paragraph, depreciation shall be determined by using the straight line method.

PAR. 16. Section 1.1016–5 is amended by adding a new paragraph (n) at the end thereof. This added provision reads as follows:

§ 1.1016–5 MISCELLANEOUS ADJUSTMENTS TO BASIS.

* * * * * * *

(n) *Life insurance companies.*—In the case of any evidence of indebtedness referred to in section 818(b), the basis shall be adjusted to the extent of the adjustments required under section 818(b) (or the corresponding provisions of prior income tax laws) for the taxable year and all prior taxable years.

The basis of any such evidence of indebtedness shall be reduced by the amount of the adjustment required under section 818(b) (or the corresponding provision of prior income tax laws) on account of amortizable premium and shall be increased by the amount of the adjustment required under section 818(b) on account of accruable discounts.

PAR. 17. Section 1.1201 is amended by revising the portion of section 1201(a) which precedes paragraph (1), by adding subsection (c), and by revising the historical note. These amended and added provisions and amended historical note read as follows:

§ 1.1201 STATUTORY PROVISIONS; ALTERNATIVE TAX.

SEC. 1201. ALTERNATIVE TAX.

(a) CORPORATIONS.—If for any taxable year the net long-term capital gain of any corporation exceeds the net short-term capital loss, then, in lieu of the tax imposed by sections 11, 511, 821 (a)(1) or (b), and 831(a), there is hereby imposed a tax (if such tax is less than the tax imposed by such sections) which shall consist of the sum of—

* * * * * * *

(c) LIFE INSURANCE COMPANIES.—For alternative tax in case of life insurance companies, see section 802(a)(2).

[Sec. 1201 as amended by sec. 5(7), Life Insurance Company Tax Act 1955 (70 Stat. 49); sec. 3(f)(2), Life Insurance Company Income Tax Act 1959 (73 Stat. 140)]

PAR. 18. Paragraph (a) of § 1.1201–1 is amended to read as follows:

§ 1.1201–1 ALTERNATIVE TAX.—(a) *Corporation.*—In case the net long-term capital gain of any corporation exceeds the net short-term capital loss, section 1201(a) imposes an alternative tax in lieu of the tax imposed by sections 11, 511, 821 (a)(1) or (b), and 831(a), if and only if such alternative tax is less than the tax imposed by such sections. For taxable years beginning after December 31, 1954, and before January 1, 1958, the alternative tax shall also be in lieu of the tax imposed by section 802(a), as amended by the Life Insurance Company Tax Act for 1955 (70 Stat. 38), if such alternative tax is less than the tax imposed by such section. See section 802(e), as added by the Life Insurance Company Tax Act for 1955 (70 Stat. 39). However, for taxable years beginning after December 31, 1958, section 802(a)(2), as amended by the Life Insurance Company Income Tax Act of 1959 (73 Stat. 115), imposes a separate tax equal to 25 percent of the amount by which the net long-term capital gain of any life insurance company (as defined in section 801(a) and paragraph (b) of § 1.801–3) exceeds its net short-term capital loss. See paragraph (f) of § 1.802–3. The alternative tax is not in lieu of the personal holding company tax imposed by section 541, or of any other tax not specifically set forth in section 1201(a). The alternative tax is the sum of (1) a partial tax computed at the rates provided in sections 11, 511, 802 (a) (for taxable years beginning after December 31, 1954, and before January 1, 1958), 821 (a) or (b), and 831(a) on the taxable income of the taxpayer decreased by the amount of the excess of the net long-term capital gain over the net short-term capital loss, and (2) an amount equal to 25 percent of such excess or, in the case of a taxable year beginning before April 1, 1954, an amount equal to 26 percent of such excess. In the computation of the partial tax the special deductions provided for in sections 243, 244, 245, 247, 922, and 941 shall not be recomputed as the result of the reduction of taxable income by the excess of net long-term capital gain over net short-term capital loss.

PAR. 19. Section 1.11 is amended by revising section 11(b) and the historical note. This amended provision and historical note read as follows:

§ 1.11 STATUTORY PROVISIONS; TAX IMPOSED.

SEC. 11. TAX IMPOSED.

(a) CORPORATIONS IN GENERAL. * * *

(b) NORMAL TAX.—

(1) TAXABLE YEARS BEGINNING BEFORE JULY 1, 1963.—In the case of a taxable year beginning before July 1, 1963, the normal tax is equal to 30 percent of the taxable income.

(2) TAXABLE YEARS BEGINNING AFTER JUNE 30, 1963.—In the case of a taxable year beginning after June 30, 1963, the normal tax is equal to 25 percent of the taxable income.

* * * * * * *

[Sec. 11 as amended by sec. 2, Tax Rate Extension Act 1955 (69 Stat. 114); sec. 2, Tax Rate Extension Act 1956 (70 Stat. 66); sec. 2, Tax Rate Extension Act 1957 (71 Stat. 9); sec. 2, Tax Rate Extension Act 1958 (72 Stat. 259); sec. 2, Tax Rate Extension Act 1959 (73 Stat. 157); sec. 201, Public Debt and Tax Rate Extension Act 1960 (74 Stat. 290); sec. 2, Tax Rate Extension Act 1961 (75 Stat. 193); sec. 2, Tax Rate Extension Act 1962 (76 Stat. 114)]

PAR. 20. Paragraph (c) of § 1.11–1 is amended to read as follows:

§ 1.11–1 TAX ON CORPORATIONS.

* * * * * * *

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

	Percent
For taxable years beginning before July 1, 1963	30
For taxable years beginning after June 30, 1963	25

PAR. 21. Section 1.803 is amended by revising the historical note. This revised historical note reads as follows:

§ 1.803 STATUTORY PROVISIONS; LIFE INSURANCE COMPANIES; INCOME AND DEDUCTIONS.

SEC. 803. INCOME AND DEDUCTIONS.

(a) APPLICATION OF SECTION. * * *

[Sec. 803 as amended by sec. 2, Life Insurance Company Tax Act 1955 (70 Stat. 39). Sec. 803, as set forth herein, is applicable only for taxable years beginning after December 31, 1954, and before January 1, 1958; however, the regulations set forth below do not reflect amendment of sec. 803 by sec. 2, Life Insurance Company Tax Act 1955. See § 1.803–7. For taxable years beginning after December 31, 1957, see subch. L as amended by sec. 2, Life Insurance Company Income Tax Act 1959 (73 Stat. 112)]

PAR. 22. Section 1.807 is amended by adding a historical note at the end thereof. This added historical note reads as follows:

§ 1.807 STATUTORY PROVISIONS; LIFE INSURANCE COMPANIES; FOREIGN LIFE INSURANCE COMPANIES.

SEC. 807. FOREIGN LIFE INSURANCE COMPANIES.

(a) CARRYING ON UNITED STATES INSURANCE BUSINESS. * * *

[Sec. 807 is applicable only for taxable years beginning after December 31, 1953, and before January 1, 1955. For taxable years beginning after December 31, 1954, and before January 1, 1958, see sec. 816 as added by sec. 2, Life Insurance Company Tax Act 1955 (70 Stat. 36). For taxable years beginning after December 31, 1957, see sec. 819 as added by sec. 2, Life Insurance Company Income Tax Act 1959 (73 Stat. 112)]

PAR. 23. Section 1.809 is amended by revising paragraph (11) of section 809(d) and the historical note. These amended provisions read as follows:

§ 1.809 STATUTORY PROVISIONS; LIFE INSURANCE COMPANIES: IN GENERAL.

SEC. 809. IN GENERAL. * * *

(d) DEDUCTIONS. * * *

(11) CERTAIN MUTUALIZATION DISTRIBUTIONS.—The amount of distributions to shareholders made in 1958, 1959, 1960, and 1961 in acquisition of stock pursuant to a plan of mutualization adopted before January 1, 1958.

* * * * * * *

[Sec. 809 as added by sec. 2, Life Insurance Company Income Tax Act 1959 (73 Stat. 121); amended by sec. 2, Act of June 27, 1961 (Pub. Law 87–59, 75 Stat. 120 [C. B. 1961–2, 295])]

PAR. 24. Paragraph (a)(11) of § 1.809–5 is amended to read as follows:

§ 1.809–5 DEDUCTIONS.—(a) DEDUCTIONS ALLOWED. * * *

(11) CERTAIN MUTUALIZATION DISTRIBUTIONS.—The amount of distributions to shareholders actually made by the life insurance company in 1958, 1959, 1960, and 1961 in acquisition of stock pursuant to a plan of mutualization adopted by the company before January 1, 1958. If such deduction is claimed, there must be attached to the return of the company claiming such deduction a certified copy of the plan of mutualization and proof that such plan was adopted prior to January 1, 1958. See section 809(g) and § 1.809–8 for limitation of such deduction.

PAR. 25. Section 1.813 is amended by revising the historical note. This revised historical note reads as follows:

§ 1.813 STATUTORY PROVISIONS; LIFE INSURANCE COMPANIES; ADJUSTMENT FOR CERTAIN RESERVES.

SEC. 813. ADJUSTMENT FOR CERTAIN RESERVES. * * *

[Sec. 813 as added by sec. 2, Life Insurance Company Tax Act 1955 (70 Stat. 46). Sec. 813 is applicable only for taxable years beginning after December 31, 1954, and before January 1, 1958. For taxable years beginning after December 31, 1957, see subch. L as amended by sec. 2, Life Insurance Company Income Tax Act 1959 (73 Stat. 112)]

PAR. 26. Section 1.816 is amended by revising the historical note. This revised historical note reads as follows:

§ 1.816 STATUTORY PROVISIONS; LIFE INSURANCE COMPANIES; FOREIGN LIFE INSURANCE COMPANIES.

SEC. 816. FOREIGN LIFE INSURANCE COMPANIES.

(a) CARRYING ON UNITED STATES INSURANCE BUSINESS. * * *

[Sec. 816 as added by sec. 2, Life Insurance Company Tax Act 1955 (70 Stat. 46). Sec. 816 is applicable only for taxable years beginning after December 31, 1954, and before January 1, 1958. For taxable years beginning after December 31, 1953, and before January 1, 1955, see sec. 807. For taxable years beginning after December 31, 1957, see sec. 819 as added by sec. 2, Life Insurance Company Income Tax Act 1959 (73 Stat. 112)]

(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 August 27, 1962.

STANLEY S. SURREY,
Assistant Secretary of the Treasury.

(Filed by the Division of the Federal Register on August 30, 1962, 8:51 a.m., and published in the issue of the Federal Register for August 31, 1962, 27 F.R. 8717)

Subpart C.—Gain and Loss from Operations

SECTION 809.—IN GENERAL

26 CFR 1.809–4: Gross amount.

Amounts a life insurance company charges itself representing premiums with respect to liability for insurance and annuity benefits for its employees. See T.D. 6610, page 154.

PART II.—MUTUAL INSURANCE COMPANIES (OTHER THAN LIFE AND CERTAIN MARINE INSURANCE COMPANIES AND OTHER THAN FIRE OR FLOOD INSURANCE COMPANIES WHICH OPERATE ON BASIS OF PERPETUAL POLICIES OR PREMIUM DEPOSITS)

SECTION 821.—TAX ON MUTUAL INSURANCE COMPANIES TO WHICH PART II APPLIES

26 CFR 1.821: Statutory provisions; tax on mutual insurance companies (other than life or marine or fire insurance companies issuing perpetual policies).

Extension of existing 30 percent normal-tax rate to July 1, 1963. See T.D. 6610, page 154.

SECTION 822.—DETERMINATION OF TAXABLE INVESTMENT INCOME

26 CFR 1.822: Statutory provisions; determination of mutual insurance company taxable income.

Determination of gross investment income and allowable deductions for purposes of computing mutual insurance company taxable income. See T.D. 6610, page 154.

SECTION 823.—DETERMINATION OF STATUTORY UNDERWRITING INCOME OR LOSS

26 CFR 1.823–3: Taxable years affected.

Meaning of "net premiums" and "dividends to policyholders" for purposes of determining mutual insurance company taxable income for taxable years beginning after December 31, 1954. See T.D. 6610, page 154.

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

SECTION 852.—TAXATION OF REGULATED INVESTMENT COMPANIES AND THEIR SHAREHOLDERS

26 CFR 1.852–3: Investment company taxable income.

Deduction by a regulated investment company for dividends received. See Rev. Rul. 62–196, page 179.

SUBCHAPTER N.—TAX BASED ON INCOME FROM SOURCES WITHIN OR WITHOUT THE UNITED STATES

PART II.—NONRESIDENT ALIENS AND FOREIGN CORPORATIONS

Subpart A.—Nonresident Alien Individuals

SECTION 871.—TAX ON NONRESIDENT ALIEN INDIVIDUALS

26 CFR 1.871–2: Determining residence of alien individuals.

Taxation of an estate of a nonresident alien decedent which is subject to domiciliary administration in a foreign country and ancillary administration in the United States. See Rev. Rul. 62–154, page 148.

SUBCHAPTER O.—GAIN OR LOSS ON DISPOSITION OF PROPERTY

PART I.—DETERMINATION OF AMOUNT OF AND RECOGNITION OF GAIN OR LOSS

SECTION 1001.—DETERMINATION OF AMOUNT OF AND RECOGNITION OF GAIN OR LOSS

26 CFR 1.1001–1: Computation of gain or loss.

Transfer of appreciated stock to divorced wife in return for release of her marital rights. See Ct. D. 1873, page 15.

SECTION 1002.—RECOGNITION OF GAIN OR LOSS

26 CFR 1.1002–1: Sales or exchanges.

Transfer of appreciated stock to divorced wife in return for release of her marital rights. See Ct. D. 1873, page 15.

PART II.—BASIS RULES OF GENERAL APPLICATION

SECTION 1016.—ADJUSTMENTS TO BASIS

26 CFR 1.1016: Statutory provisions; adjustments to basis.

Rules for adjustments to basis in the case of life insurance companies. See T.D. 6610, page 154.

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. Rul. 62–211, page 177.

SECTION 1032.—EXCHANGE OF STOCK FOR PROPERTY

26 CFR 1.1032–1: Disposition by a corporation of its own capital stock.

Compensation payments by a corporation to its employees in the form of the corporation's treasury stock. See Rev. Rul. 62–217, page 59.

SECTION 1033.—INVOLUNTARY CONVERSIONS

26 CFR 1.1033(a)–1: Involuntary conversions; nonrecognition of gains. Rev. Rul. 62–161

The purchase of uncultivated land and young apple trees and expenses incurred in planting the trees on the land, immediately following the requisition of a taxpayer's apple orchard by a state agency, represents the purchase of property similar or related in service or use, for the purposes of section 1033(a)(3) of the Internal Revenue Code of 1954, relating to the nonrecognition of gain in certain involuntary conversions.

Costs of bringing the young apple trees to a productive state do not constitute replacement costs for purposes of section 1033 of the Code.

Revenue Ruling 59–8, C.B. 1959–1, 202, distinguished.

Advice has been requested whether the purchase of uncultivated land and the planting of apple trees thereon, following the requisition of the taxpayer's apple orchards by a state agency in the exercise of the state's power of eminent domain, represents a purchase of property similar or related in service or use for purposes of the nonrecognition of gain provisions of section 1033(a)(3) of the Internal Revenue Code of 1954.

The taxpayer's apple orchards were taken by an agency of a state government as part of the land affected by the construction of a dam. He received an award covering both the value of the land and the apple trees. Because of the scarcity of apple orchard property in the area, the taxpayer proceeded to purchase uncultivated land and to plant nursery stock apple trees ranging from one to two years of age. In addition to the cost of the nursery stock, the taxpayer incurred other expenditures incident to the planting of these trees.

Section 1033 of the Code provides, in part, as follows:

(a) GENERAL RULE.—If property (as a result of its destruction in whole or in part, theft, seizure, or requisition or condemnation or threat or imminence thereof) is compulsorily or involuntarily converted—

* * * * * * *

(3) CONVERSION INTO MONEY WHERE DISPOSITION OCCURRED AFTER 1950.—Into Money * * * the gain (if any) shall be recognized except to the extent hereinafter provided in this paragraph:

(A) NONRECOGNITION OF GAIN.—If the taxpayer during the period specified in subparagraph (B), for the purpose of replacing the property so converted, purchases other property similar or related in service or use to the property so converted * * * at the election of the taxpayer the gain shall be recognized only to the extent that the amount realized upon such conversion (regardless of whether such amount is received in one or more taxable years) exceeds the cost of such other property * * *. Such election shall be made at such time and in such manner as the Secretary or his delegate may by regulations prescribe.

Subparagraph (B), above referred to, requires that the replacement property be acquired within the period beginning with the date of the threat or imminence of condemnation and ending one year after the first taxable year in which any gain is realized, or, as provided in section 1.1033(a)-2(c)(3) of the Income Tax Regulations, at such later date as may be designated by the district director of internal revenue in the taxpayer's district at the request of the taxpayer.

It is essential to the application of section 1033(a)(3) of the Code that the acquired property be "similar or related in service or use" to the property involuntarily converted. The new property, however, need not be identical with the old, since precise duplication is often impossible. It is sufficient for the purposes of section 1033(a)(3) of the Code that the taxpayer, whose orchard property has been involuntarily converted by the state agency, acquires land and plants young fruit trees. In doing so, the cost of land, young trees, and all the expenses incurred in connection with the planting of such trees qualify as replacement costs, provided they are incurred during the replacement period.

However, any costs attributable to the young trees beyond the planting stage would not qualify as replacement costs because this would extend the replacement period beyond a reasonable period as contemplated by law.

In Revenue Ruling 59-8, C.B. 1959-1, 202, a taxpayer's wheat crop, ready for harvesting, was destroyed by hail. It was held that (1) expenditure of the insurance proceeds in the purchase of another standing crop qualified as a replacement with property similar or related in use but (2) expenditure of the proceeds in the planting of a new crop did not so qualify. The planting of a new crop was a course of action which the farmer would undertake in the regular course of business, wholly without regard to whether the prior crop had been

destroyed by hail or had been harvested at maturity. It could not, therefore, be said to have been done "for the purpose of replacing the property * * * converted," the qualifying condition set forth in section 1033(a)(3)(A) of the Code. The purchase of another standing crop, however, by one engaged in the business of growing crops, was clearly "for the purpose of replacing" the previously destroyed crop, since there was no other reason for such a purchase. Similarly, in the subject case, there was no reason for the taxpayer, who had owned a productive orchard subsequently lost through condemnation, to purchase unproductive land and to plant young trees thereon except "for the purpose of replacing" the condemned orchard. The treatment outlined herein is, therefore, consistent with that prescribed in Revenue Ruling 59–8.

Accordingly, it is held that the purchase of uncultivated land and the planting of young apple trees thereon, following the requisition of the taxpayer's apple orchards by a state agency in the exercise of the state's power of eminent domain during the taxable year, represents a purchase of property similar or related in service or use for purposes of section 1033 of the Code.

It is further held that the costs of bringing the young apple trees to a productive state do not constitute replacement costs for purposes of section 1033(a)(3) of the Code.

Pursuant to the authority contained in section 7805(b) of the Code, the provisions of this Revenue Ruling pertaining to the costs of bringing the young apple trees to a productive state will not be applied to involuntary conversions which occurred prior to January 1, 1962.

Revenue Ruling 59–8, *supra*, distinguished.

SECTION 1037.—CERTAIN EXCHANGES OF UNITED STATES OBLIGATIONS

(Also Section 1031; 26 CFR 1.1031(b)–1.) Rev. Rul. 62–211

Under section 1037(a) of the Internal Revenue Code of 1954, no gain or loss will be recognized upon the exchange of the 3½ percent Treasury Certificates of Indebtedness of Series A–1963; 2⅝ percent Treasury Notes of Series A–1963; 3¼ percent Treasury Notes of Series E–1963; 3¼ percent Treasury Certificates of Indebtedness of Series B–1963; 3¼ percent Treasury Notes of Series D–1963; or the 4 percent Treasury Notes of Series B–1963, as offered by Treasury Department Circulars, Public Debt Series Nos. 15–62 and 16–62, dated September 10, 1962.

In the Treasury Department circulars listed below, the Secretary of the Treasury offered the Treasury Bonds and Notes specified in exchange for other Treasury securities as follows:

Treasury Department Circular, Public Debt Series No. 15–62, Dated September 10, 1962, 27 F.R. 9183

Notes offered	*Exchange accepted*
3¾ percent Treasury Notes of Series A–1967 at 99.50 percent of their face value.	3½ percent Treasury Certificates of Indebtedness of Series A–1963, dated February 15, 1962, due February 15, 1963.

Notes offered	*Exchange accepted*
3¾ percent Treasury Notes of Series A–1967 at 99.90 percent of their face value.	2⅝ percent Treasury Notes of Series A–1963, dated April 15, 1958, due February 15, 1963.
3¾ percent Treasury Notes of Series A–1967 at 99.60 percent of their face value.	3¼ percent Treasury Notes of Series E–1963, dated November 15, 1961, due February 15, 1963.
3¾ percent Treasury Notes of Series A–1967 at 99.60 percent of their face value.	3¼ percent Treasury Certificates of Indebtedness of Series B–1963, dated May 15, 1962, due May 15, 1963.
3¾ percent Treasury Notes of Series A–1967 at 99.60 percent of their face value.	3¼ percent Treasury Notes of Series D–1963, dated May 15, 1961, due May 15, 1963.
3¾ percent Treasury Notes of Series A–1967 at 99.00 percent of their face value.	4 percent Treasury Notes of Series B–1963, dated April 1, 1959, due May 15, 1963.

Treasury Department Circular, Public Debt Series No. 16–62, Dated September 10, 1962, 27 F.R. 9182, As Corrected in 27 F.R. 9417

Bonds offered	*Exchanges accepted*
4 percent Treasury Bonds of 1972 at 99.30 percent of their face value.	3½ percent Treasury Certificates of Indebtedness of Series A–1963, dated February 15, 1962, due February 15, 1963.
4 percent Treasury Bonds of 1972 at 99.70 percent of their face value.	2⅝ percent Treasury Notes of Series A–1963, dated April 15, 1958, due February 15, 1963.
4 percent Treasury Bonds of 1972 at 99.40 percent of their face value.	3¼ percent Treasury Notes of Series E–1963, dated November 15, 1961, due February 15, 1963.
4 percent Treasury Bonds of 1972 at 99.40 percent of their face value.	3¼ percent Treasury Certificates of Indebtedness of Series B–1963, dated May 15, 1962, due May 15, 1963.
4 percent Treasury Bonds of 1972 at 99.40 percent of their face value.	3¼ percent Treasury Notes of Series D–1963, dated May 15, 1961, due May 15, 1963.
4 percent Treasury Bonds of 1972 at 98.80 percent of their face value.	4 percent Treasury Notes of Series B–1963, dated April 1, 1959, due May 15, 1963.

The income derived from the bonds and notes issued in exchange is subject to all taxes imposed under the Internal Revenue Code of 1954. The bonds and notes 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 and notes will be acceptable to secure deposits of public moneys. 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 the eligible securities enumerated herein solely for the 4 percent Treasury Bonds of 1972 or the 3¾ percent Treasury Notes of Series A–1967 as offered by the Department Circulars, Public Debt Series Nos. 15–62 and 16–62.

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 security holder in connection with the exchange. The payment due to the subscriber on account of the issue price of the notes and bonds to be issued 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.

PART IX.—DISTRIBUTIONS PURSUANT TO ORDERS ENFORCING THE ANTITRUST LAWS

SECTION 1111.—DISTRIBUTION OF STOCK PURSUANT TO ORDER ENFORCING THE ANTITRUST LAWS

(Also Section 852; 26 CFR 1.852–3.) Rev. Rul. 62–196

An investment trust is a "qualifying shareholder," for purposes of section 1111 of the Internal Revenue Code of 1954, for any year in which it is taxable as a regulated investment company under subchapter M, chapter 1, subtitle A of the Code.

Advice has been requested whether the trust described below is a "qualifying shareholder" within the meaning of section 1111 of the Internal Revenue Code of 1954.

The *T* trust is an association taxable as a corporation, and, for many years, it has been taxed as a regulated investment company under subchapter M, chapter 1, subtitle A, of the Code.

It owns stock in the *X* corporation. In 1962, *T* received a distribution from *X* of stock which *X* owned in the *Y* corporation. This distribution was made pursuant to a court order enforcing the antitrust laws and constituted a distribution of divested stock as defined in section 1111(e) of the Code.

Section 1111(a) of the Code provides, in pertinent part, that a distribution of divested stock (as defined in section 1111(e) of the Code) to a qualifying shareholder, to which section 301(c)(1) of the Code would otherwise apply, shall be a distribution which is not out of the earnings and profits of the distributing corporation.

Section 1111(b) of the Code defines the term "qualifying shareholder" as any shareholder other than a corporation which may be allowed a deduction under section 243, 244 or 245 of the Code with respect to dividends received.

Section 852(b)(2) of the Code requires certain adjustments to be made in order to convert the taxable income of a regulated investment

company into investment company taxable income. One of the adjustments required is that the deductions for dividends received provided by sections 243, 244, and 245 of the Code shall not be allowed. See section 1.852–3(c) of the Income Tax Regulations.

In view of the foregoing, it is clear that *T* will not be allowed a deduction for dividends received, under section 243, 244 or 245 of the Code, for any taxable year in which it is taxable as a regulated investment company. Accordingly, it is held that *T* is a "qualifying shareholder," for purposes of section 1111 of the Code, in any taxable year (including its taxable year 1962) in which it is taxable as a regulated investment company.

Therefore, the *Y* stock received by *T* from the *X* corporation during such years will be treated by *T* as a return of capital and the basis of the *X* corporation stock in the hands of *T* will be reduced by the amount of the distribution, that is, the lesser of the fair market value of the *Y* stock received or its adjusted basis in the hands of *X* immediately before the distribution. If, however, the amount of the distribution so determined exceeds the basis of the *X* stock, the excess will be treated as gain from the sale or exchange of property under section 301(c)(3) of the Code.

If the amount of the distribution is determined to be the adjusted basis of the *Y* stock in the hands of *X* immediately before the distribution, the holding period of the *Y* stock in the hands of the taxpayer will include the period during which the *Y* stock was held by *X*. See section 1223(2) of the Code.

SUBCHAPTER P.—CAPITAL GAINS AND LOSSES

PART I.—TREATMENT OF CAPITAL GAINS

SECTION 1201.—ALTERNATIVE TAX

26 CFR 1.1201: Statutory provisions; alternative tax.

Treatment of capital gains by life insurance companies for taxable years beginning after December 31, 1958. See T.D. 6610, page 154.

PART III.—GENERAL RULES FOR DETERMINING CAPITAL GAINS AND LOSSES

SECTION 1221.—CAPITAL ASSET DEFINED

26 CFR 1.1221–1: Meaning of terms.

Goodwill in the sale of a professional practice. See Rev. Rul. 62–114, page 15.

SECTION 1223.—HOLDING PERIOD OF PROPERTY

26 CFR 1.1223–1: Determination of period for which capital assets are held. Rev. Rul. 62–140

In November 1960, a taxpayer purchased, for $1 each, rights issued by a corporation entitling him, upon payment of $99, to subscribe to a debenture to be issued by such corporation. On December 1, 1960, the taxpayer subscribed for such debenture which was issued on December 10, 1960. The debenture contained a clause providing that its holder might receive one share of common stock of the issuing corporation upon surrender of the debenture, accompanied by payment of $50. The taxpayer presented the debenture, accompanied by payment of $50 and received one share of common stock. *Held*, (a) No gain or loss was realized upon the surrender of the debenture and payment of $50 for a share of common stock in accordance with the terms contained in the debenture. (b) Each share of stock acquired has a split holding period for purposes of determining long-term or short-term capital gain or loss, that part of the taxpayer's property in each share of stock which is attributable to his ownership of the debenture to be treated as held beginning with and including the date on which the right to acquire the debenture was exercised, in accordance with section 1223(6) of the Internal Revenue Code of 1954 and section 1.1223–1(f) of the Income Tax Regulations, and that part of the taxpayer's property in each share of stock which is attributable to the additional cash investment required for the acquisition of the stock to be treated as held beginning with the date following the date of acquisition. See I.T. 3287, C.B. 1939–1 (Part 1), 138, and I.T. 3705, C.B. 1945, 174.

It will be necessary to determine the portion of the taxpayer's property in the stock which is attributable to each component of the investment where the stock is disposed of at a time when, in accordance with holding (b) above, there may be both long-term and short-term capital gain or loss from disposition. For example, assume that the fair market value of one share of stock on the date of conversion is $200. Of the taxpayer's $150 basis for each share of stock, $100 is his basis for that portion attributable to his ownership of the debenture and $50 is his basis for that portion attributable to the additional cash investment. Since the market value of the stock was $200 on the date of conversion, it may fairly be said that the portion of such value attributable to his ownership of the debenture was $150. ($200, the fair market value of the stock at the date of conversion less $50, the amount of cash required to effect the conversion.) Thus, 150/200 of the taxpayer's property in the stock is attributable to his ownership of the debenture and 50/200 of the taxpayer's property in the stock is attributable to his additional cash investment. If the stock is disposed of at a time when the split holding period is relevant in determining his tax liability, these fractions will be applied to the amount realized to determine the portions of the amount realized attributable to the above components of his investment, which have a basis of $150 and $50 respectively. The following table illustrates the manner of computing the gain or loss

attributable to the taxpayer's ownership of the debenture (long-term) and his gain or loss attributable to the additional cash investment (short-term), assuming the amounts realized shown on line one from the disposition of the stock:

1. Total amount realized from disposition of stock	200	240	180	150	120	80
2. Portion of amount realized attributable to taxpayer's ownership of debenture. [150/200 of amount shown on line 1]	150	180	135	112. 50	90	60
3. Gain (or loss) attributable to debenture, *i.e.*, long-term gain (or loss) realized from disposition. [Amount shown on line 2 less $100, the portion of the taxpayer's basis in stock attributable to the debenture]	50	80	35	12. 50	(10)	(40)
4. Portion of amount realized attributable to taxpayer's additional cash investment. [50/200 of amount shown on line 1]	50	60	45	37. 50	30	20
5. Gain (or loss) attributable to additional cash investment, *i.e.*, short-term gain (or loss) realized from disposition. [Amount shown on line 4 less $50, the portion of taxpayer's basis for the stock attributable to additional cash investment]	0	10	(5)	(12. 50)	(20)	(30)

Common stock obtained from the conversion of preferred stock in the same corporation. See Rev. Rul. 62–153, page 186.

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. (Also Section 167; 1.167(a)–1.)

Rev. Rul. 62–141

Television films and tapes produced by a taxpayer and later sold for television exhibition will ordinarily constitute property held primarily for sale to customers in the ordinary course of the taxpayer's trade or business within the meaning of section 1231(b)(1)(B) of the Internal Revenue Code of 1954, although they have been leased by the taxpayer prior to sale. Therefore, gains or losses resulting from the sales of such films and tapes will be treated as ordinary gains or losses.

Similarly, gains or losses resulting from the sales of films by motion picture producers after initial theater showings will also be treated as ordinary gains or losses where, at the time of the sale, the films were property held primarily for sale to customers in the ordinary course of the trade or business. In determining whether such films were held primarily for sale to customers in the ordinary

course of the trade or business, the Internal Revenue Service will take cognizance of the fact that by August 1, 1948, the motion picture industry recognized the distinct possibility that its films might be sold for exhibition on television after being leased for theater showings.

Revenue Ruling 55-706, C.B. 1955-2, 300, superseded, as it applies to sales made on or after August 27, 1962.

Advice has been requested as to the proper treatment for Federal income tax purposes of the proceeds from sales by the producer of television films (including "live" shows taped for reproduction). A similar question has been raised as to motion picture films that are sold by the producers after initial theater showings.

Producers of films for television exhibition often lease their product rather than sell it initially. In some instances, after the films had been rented for various periods, ranging from several months to several years, they are then sold by the producers to television distributors or exhibitors.

Section 1231(a) of the Internal Revenue Code of 1954 provides, in effect, for capital-gains treatment in specified circumstances for gains from the sale or exchange of property used in the trade or business.

Section 1231(b)(1) of the Code provides, in part, as follows:

(1) GENERAL RULE.—The term "property used in the trade or business" means property used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 167, held for more than 6 months * * * which is not—

* * * * * * *

(B) property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business * * *.

The Internal Revenue Service has previously concluded that television films are subject to depreciation under section 167 of the Code. See Rev. Rul. 60-358, C.B. 1960-2, 68.

Therefore, the question arises whether the films in question are excepted from the definition of "property used in the trade or business" by section 1231(b)(1)(B) of the Code, although they have been leased prior to sale and are subject to the allowance for depreciation provided in section 167 of the Code. If the television films are held by producers for sale to customers in the ordinary course of the trade or business within the meaning of section 1231(b)(1)(B) of the Code, gains and losses from the sales of such films by them will be treated as ordinary gains and losses.

In *Rollingwood Corp.* v. *Commissioner*, 190 Fed. (2d) 263 (1951), the taxpayer had arranged for the construction of houses for war workers under the condition imposed by the United States Government that each of the houses would be rented by the taxpayer with an option to the tenant to purchase. The houses were rented for an average time of 22 months and all but four of the houses were sold. The United States Court of Appeals for the Ninth Circuit affirmed the decision of the Tax Court of the United States that the houses were property held primarily for sale to customers in the ordinary course of the taxpayer's trade or business and that the proceeds from their sales should be taxed as ordinary income. The court stated as follows:

Although the requirements of the statute are to some extent overlapping, the emphasis in this case is whether the houses were held primarily for sale or primarily for rent. Petitioners contend that the word "primarily" means "prin-

cipal" or "chief," while the Commissioner contends it means "essential" or "substantial." For reasons hereinafter stated we think the latter view is more consonant with the legislative policy.

Suppose the taxpayer in the instant case intended to rent the houses for as long as he was required to do so under existing regulations and then to sell them. Or suppose his intention was to pursue whichever of these activities proved to be the most profitable, that is, if the *rental market* were good he would continue to rent but if the *sales market* were high he would sell. In either of these suppositions we think it is fair to say that one of the essential purposes (in acquiring or holding the houses) is the purpose of sale. Under such circumstances, if the taxpayer does dispose of the houses by sale, is it within the legislative *purpose* to allow him to treat the proceeds of these sales as a capital gain? We think not.

Other cases in which courts have held that the word "primarily" in the statute is to be interpreted as meaning "essential or substantial" rather than "principal" or "chief" and accordingly have denied capital gains treatment for the proceeds of sale from property that the taxpayers had rented are *S.E.C. Corp.* v. *United States*, 140 Fed. Supp. 717 (1956), affirmed *per curiam*, 241 Fed. (2d) 416 (1957), certiorari denied, 354 U.S. 909 (1957), involving electric water and food coolers, and *Greene-Haldeman* v. *Commissioner*, 282 Fed. (2d) 884 (1960), rehearing denied December 9, 1960, which concerned the sale of rental cars by dealers. In the latter decision the court pointed out that—

* * * In Corn Products Refining Co. v. Commissioner, 1955, 350 U.S. 46, at page 52 * * * the Court indicated that a narrow construction should be given to provisions of the Code which authorize capital gain treatment. If we were to accept the taxpayer's contention we would of necessity be expanding the types of transactions which are entitled to capital gain treatment.

In view of the fact that television film producers are aware of the market that exists for sales of television films after initial leasing periods, it is reasonable to assume that generally, from the time of their production, a producer's intention is either to sell, to rent, or to rent and then sell, whichever method proves most profitable in its business. Under the rationale of the cases referred to above, the fact that the films were leased prior to sale would not prevent their being held "primarily" for the purpose of sale, within the meaning of section 1231 (b) (1) (B) of the Code.

Moreover, even if the producer originally has no intention to sell, he may develop a substantial intent to sell by the time of sale. In *Joseph A. Harrah* v. *Commissioner*, 30 T.C. 1236 (1958), a corporation had constructed a saw mill, which it originally used for experimental purposes, but later leased, subject to an option in the lessee to buy. In holding that the corporation's gain upon sale of the mill pursuant to the option constituted ordinary income, the court commented, at page 1241, that under the applicable decisions—

* * * While the underlying purpose of the original acquisition of property is to be given consideration, it is clear that such purpose may change over a given period of time. Where this has been the case, the original purpose necessarily must give way to the purpose for which the property is held at the time of its sale. * * *

Therefore, regardless of the purpose for which television films were originally held, if at the time of sale they are then being held with a substantial purpose of selling to customers in the ordinary course of trade or business, gain or loss realized upon the sale will be within

the exception to capital-gains treatment provided by section 1231 (b) (1) (B) of the Code.

Some television film producers have made few or no past sales of films. These situations differ from most of the cases cited above, in which the sellers had made numerous sales of properties previously leased. On the other hand, unlike many such cases, the producers have in each instance produced the property in question. In an analogous situation involving a sale by a playwright of the movie rights to his first play, a majority of the court in an opinion by Judge Learned Hand in *Clifford Goldsmith et al.* v. *Commissioner*, 143 Fed. (2d) 466, 467 (1944), certiorari denied, 323 U.S. 774 (1944), in upholding ordinary-income treatment of the sales proceeds, concluded that the taxpayer's business was both the production of that play and exploiting it for profit and that as a consequence the movie rights constituted property held for sale to customers in the ordinary course of his trade or business. See also *Joseph A. Fields* v. *Commissioner*, 189 Fed. (2d) 950 (1951). Similarly, the business of television film producers also embraces exploiting of the films through whatever methods are within their reasonable contemplation at the time of production or at a later time.

In accordance with the above, it is held that television films sold by the producers ordinarily will be considered to be property held primarily for sale to customers in the ordinary course of the trade or business, within the meaning of section 1231(b) (1) (B) of the Code. Therefore, gains or losses resulting from such sales will be treated as ordinary gains or losses.

The considerations set forth above are also applicable to sales of motion picture films by producers. Following World War II, the motion picture industry became aware that substantial profits might be realized through television exhibition of its old films and of films it would produce in the future. Beginning August 1, 1948, collective bargaining agreements in the industry incorporated provisions allowing unions to cancel the agreements if feature motion picture films made on or after that date were released to television. It is reasonable to assume that no later than that date the industry recognized the distinct possibility that its films might be sold for exhibition on television after being leased for theater showings and that producers generally contemplated sales to television following such showings as a likely means of exploiting their product. In other instances, including some cases where the films were produced prior to August 1, 1948, the producers may not have had a substantial purpose of sale at the time of production but, as the value of motion picture films for television increased, may later have developed such a purpose.

The Service will therefore determine in each case, on the basis of the relevant facts and circumstances, whether motion picture films sold by the producers were at the time of sale held by them primarily for sale to customers in the ordinary course of their trade or business, within the meaning of section 1231(b) (1) (B) of the Code. Accordingly, it is further held that motion picture films completed on or after August 1, 1948, and thereafter sold by the producers ordinarily will be considered as property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.

In Revenue Ruling 55–706, C.B. 1955–2, 300, it was determined that where a motion picture producer sold in one unusual and isolated transaction a quantity of its own films which it had previously rented, the gain realized from the sale was taxable as a long-term capital gain under section 1231 of the Code. There, the films sold had all been originally produced and released during the period from 1931 to 1946, prior to general recognition that sales of films to television might be an important future source of income to the motion picture industry and, at the time of production, the films were not held for sale to customers in the ordinary course of the taxpayer's trade or business.

Pursuant to the authority contained in section 7805(b) of the Code, this ruling will not be applied to the sale of motion picture films produced for initial theater showings either before or after August 1, 1948, and sold prior to August 27, 1962, the date of the publication of this ruling, provided that the sale is an isolated and unusual one.

Revenue Ruling 55–706, C.B. 1955–2, 300, is accordingly superseded as it applies to sales made on or after August 27, 1962.

SECTION 1233.—GAINS AND LOSSES FROM SHORT SALES

26 CFR 1.1233–1: Gains and losses from short sales. (Also Section 1223; 1.1223–1.) Rev. Rul. 62–153

> Where a taxpayer has made a short sale of the "when issued" common stock of a corporation with respect to which he holds, or later acquires, preferred stock which may be used, in a transaction which does not result in the recognition of gain or loss under section 1002 of the Internal Revenue Code of 1954, to obtain stock identical to that sold short, the conversion of the preferred stock into the common stock prior to the closing of the short sale does not constitute, at that time, the acquisition of substantially identical stock within the meaning of section 1233(b) of the Code. Any gain realized upon the closing of the short sale will not be considered to be gain realized upon the sale or exchange of a capital asset held for not more than six months by reason of that section unless the preferred and "when issued" common stock were substantially identical at the time of the short sale or at the time of the acquisition of the preferred stock when it is acquired after the short sale.

Advice has been requested with respect to the application of section 1233 of the Internal Revenue Code of 1954, relating to gain or loss from short sales, under the circumstances described below.

Taxpayer *A* purchased 10 shares of five percent cumulative preferred stock in the *M* corporation. On the same day, he entered into a contract for the sale of 333⅓ shares of *M* corporation "when issued" common stock. The shares of preferred stock are convertible on and after a specified future date, at the option of the holder, into the common stock sold short on a "when issued" basis at the rate of 33⅓ shares of common stock for each share of preferred. Both the preferred stock and the "when issued" stock are listed on the same stock exchange.

Taxpayer *B*'s circumstances are identical with taxpayer *A*'s except that he purchased the preferred stock in the *M* corporation more than six months before entering a short sale in *M* corporation "when issued" common stock.

Before closing the short sales they have entered into, both taxpayers convert their preferred stock in *M* corporation into common stock of the same corporation when that becomes possible in accordance with the privilege afforded through the preferred stock.

The specific question asked is whether, for purposes of section 1233 of the Code, the conversion of the preferred stock into the common stock constitutes an acquisition of substantially identical stock to that sold short by the taxpayers subsequent to the date of entering the short sale.

Section 1233(b) of the Code provides, in part, as follows:

> (b) SHORT-TERM GAINS AND HOLDING PERIODS.—If gain or loss from a short sale is considered as gain or loss from the sale or exchange of a capital asset under subsection (a) and if on the date of such short sale substantially identical property has been held by the taxpayer for not more than 6 months (determined without regard to the effect, under paragraph (2) of this subsection, of such short sale on the holding period), or if substantially identical property is acquired by the taxpayer after such short sale and on or before the date of the closing thereof—
>
> (1) any gain on the closing of such short sale shall be considered as a gain on the sale or exchange of a capital asset held for not more than 6 months (notwithstanding the period of time any property used to close such short sale has been held); and
>
> (2) the holding period of such substantially identical property shall be considered to begin (notwithstanding section 1273, relating to the holding period of property) on the date of the closing of the short sale, or on the date of a sale, gift, or other disposition of such property, whichever date occurs first. This paragraph shall apply to such substantially identical property in the order of the dates of the acquisition of such property, but only to so much of such property as does not exceed the quantity sold short. * * *

It will be observed from the above that if the conversion of the taxpayers' preferred stock into common stock of the *M* corporation constitutes the acquisition of such common stock for purposes of section 1233(b) of the Code, the taxpayers will have acquired substantially identical property to that sold short on or before the date of the closing of the short sale. Hence, any gain realized on the closing of the short sales will be short-term gain. Further, if the common stock obtained by converting the preferred stock is not used to close the short sales, the holding period of the common stock retained will not begin until the date of the closing of the short sale or the date of the disposition of the stock, whichever date occurs first.

However, the Internal Revenue Service has held that the owner of a convertible bond does not realize gain or loss when he exchanges it for common stock of the same corporation in accordance with a conversion privilege, and the common stock in his hands takes his gain or loss basis of the bond for determining gain or loss upon subsequent sale or other disposition of the common stock. G.C.M. 18436, C.B. 1937–1, 101. It follows that Section 1223(1) of the Code, applies for the purpose of determining the holding period of the common stock upon its later disposition. Since the instant cases bear a close analogy to these circumstances, the stock held by taxpayers *A* and *B*, as a result of the conversion, will not be considered to have been acquired on the date of the conversion.

In accordance with the above, it is held that any gain realized by taxpayer *A* under the circumstances described will not be considered to be gain realized upon the sale or exchange of a capital asset held for not more than six months by reason of section 1233 of the Code

unless the preferred stock and the "when issued" common stock were substantially identical at the time of the short sale or at the time of the acquisition of the preferred stock where it is acquired after the short sale. Whether they were substantially identical is dependent upon all the facts and circumstances at the time of such short sale or such later acquisition. See section 1.1233–1(d) of the Income Tax Regulations.

It is further held that section 1233 of the Code does not apply to gain realized by taxpayer *B* under the circumstances described regardless of whether the preferred stock and the "when issued" common stock were substantially identical since, on the date of the short sale, *B* had held the preferred stock for more than six months.

SUBCHAPTER Q.—READJUSTMENT OF TAX BETWEEN YEARS AND SPECIAL LIMITATIONS

PART I.—INCOME ATTRIBUTABLE TO SEVERAL TAXABLE YEARS

SECTION 1305.—BREACH OF CONTRACT DAMAGES

26 CFR 1.1305–1: Breach of contract damages. T.D. 6622[1]

(Also Sections 367, 368, 1306; 1.367–1, 1.368–3, 1.1306.)

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

Amendment of Income Tax Regulations under part I, subchapter Q, chapter 1 of the Internal Revenue Code of 1954, relating to income attributable to several taxable years, and under sections 367 and 368, relating to foreign corporations and definitions relating to corporate reorganizations, respectively.

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 4, 1962, notice of proposed rule making regarding amendment of the Income Tax Regulations (26 CFR Part 1) to reflect the changes in law made by sections 1, 2, and 3 of the Act of August 26, 1957 (Public Law 85–165, 71 Stat. 413, 414) [C.B. 1957–2, 1058] relating to breach of contract damages, and by section 58 of the Technical Amendments Act of 1958 (72 Stat. 1646) [C.B. 1958–3, 254], relating to damages for injuries under the antitrust laws, was published in the Federal Register (27 F.R. 50). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the amendments of the regu-

[1] The publication of this Treasury Decision in 27 F.R. 11915, dated December 4, 1962, contains (1) instructions for modifying the notice of proposed rulemaking in 27 F.R. 50, dated January 4, 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.

lations as proposed are hereby adopted. In addition, §§ 1.367–1 and 1.368–3 of such Regulations are amended as set forth below. Except as otherwise provided, the Regulations, as so amended, are applicable to taxable years beginning after December 31, 1953, and ending after August 16, 1954.

PARAGRAPH 1. Section 1.1306 is renumbered to be § 1.1307 and as so renumbered is amended to read as follows:

§ 1.1307 STATUTORY PROVISIONS; RULES APPLICABLE TO PART I (SECTION 1301 AND FOLLOWING), SUBCHAPTER Q, CHAPTER 1 OF THE CODE.

SEC. 1307. RULES APPLICABLE TO THIS PART.

(a) FRACTIONAL PARTS OF A MONTH.—For purposes of this part, a fractional part of a month shall be disregarded unless it amounts to more than half a month, in which case it should be considered as a month.

(b) TAX ON SELF-EMPLOYMENT INCOME.—This part shall be applied without regard to, and shall not affect, the tax imposed by chapter 2 relating to self-employment income.

(c) COMPUTATION OF TAX ATTRIBUTABLE TO INCOME ALLOCATED TO PRIOR PERIOD.—For the purpose of computing the tax attributable to the amount of an item of gross income allocable under this part to a particular taxable year, such amount shall be considered income only of the person who would be required to include the item of gross income in a separate return filed for the taxable year in which such item was received or accrued.

(d) EFFECTIVE DATE OF CERTAIN SUBSECTIONS.—Subsection (c) of section 1301 and subsection (c) of this section shall apply only to amounts received or accrued after March 1, 1954. Notwithstanding any other provision of this title, section 107 of the Internal Revenue Code of 1939 shall apply to amounts received or accrued as a partner on or before March 1, 1954, under this section and to the computation of tax on amounts received or accrued on or before March 1, 1954.

[Section 1307 as renumbered by sec. 1, Act of Aug. 11, 1955 (Pub. Law 366, 84th Cong., 69 Stat. 688) [C.B. 1955–2, 767]; sec. 1, Act of Aug. 26, 1957 (Pub. Law 85–165, 71 Stat. 413) [C.B. 1957–2, 1058]: sec. 58, Technical Amendments Act 1958 (72 Stat. 1646) [C.B. 1958–3, 254]]

PAR. 2. Section 1.1306–1 is renumbered to be § 1.1307–1 and as so renumbered is amended to read as follows:

§ 1.1307–1 RULES APPLICABLE TO PART I (SECTION 1301 AND FOLLOWING), SUBCHAPTER Q, CHAPTER 1 OF THE CODE.—(a) *Fractional parts of a month.*—For purposes of sections 1301, 1302, 1303, 1304, 1305, and 1306, and the regulations thereunder, a fractional part of a month shall be disregarded unless it amounts to more than one half of a month, in which case it shall be considered as a month.

(b) *Tax on self-employment income.*—The provisions of sections 1301, 1302, 1303, 1304, 1305, and 1306, and the regulations thereunder, shall be applied without regard to, and shall not affect, the tax imposed by chapter 2 of the Internal Revenue Code of 1954 and section 480 of the Internal Revenue Code of 1939, relating to the tax on self-employment income.

(c) *Computation of tax attributable to income allocated to prior period.*—In the case of either a husband or wife receiving income to which the provisions of sections 1301, 1302, 1303, 1304, 1305, or 1306 apply, the tax attributable to the portion of the income allocated to a prior period shall be computed by considering such income as includible by the spouse who would have been required to include it in a separate return for the taxable year in which such income was received or accrued, assuming a separate return had been filed for such year. For example, A, an attorney on a calendar year basis, resides in a State in which the common law with respect to the ownership of property is applicable. In 1955, A receives compensation upon the completion of an employment which began in 1945. All the requirements for the application of section 1301(a) are satisfied. A and his wife file a joint income tax return for the taxable year 1955. They filed separate returns for the years 1945, 1946, and 1947 and joint returns in 1948 and subsequent years. The entire portion of such compensation allocable to the years for which separate returns were filed shall be includible in A's return and

no part thereof shall be includible in the separate return filed by A's wife for such years.

(d) *Effective date.*—Section 1307(c) and paragraph (c) of this section shall apply only to amounts received or accrued after March 1, 1954. Pursuant to section 7851(a)(1)(C), the regulations prescribed in paragraph (c) of this section shall also apply to taxable years beginning before January 1, 1954, and ending after December 31, 1953, and to taxable years beginning after December 31, 1953, and ending before August 17, 1954, although such years are generally subject to the Internal Revenue Code of 1939. Notwithstanding any other provision of the Internal Revenue Code of 1954, section 107 of the Internal Revenue Code of 1939 shall apply to amounts received or accrued on or before March 1, 1954, and to the computation of tax on amounts received or accrued on or before March 1, 1954.

PAR. 3. Sections 1.1305–1, 1.1305–2, 1.1306, and 1.1306–1, as set forth below, are inserted immediately after § 1.1305.

§ 1.1305–1 BREACH OF CONTRACT DAMAGES.—(a) *Qualifications for limitation on tax.*—If an amount of $3,000 or more representing damages is received or accrued by a taxpayer during a taxable year as a result of a single award in a civil action for breach of contract, or breach of a fiduciary duty or relationship, then the tax attributable to the inclusion in gross income for the taxable year of that part of such amount which would have been received or accrued by the taxpayer in a prior taxable year or years but for the breach of contract, or breach of a fiduciary duty or relationship, shall not be greater than the aggregate of the increases in taxes which would have resulted had such part been included in gross income for such prior taxable year or years.

(b) *Definition of damages for breach of contract or for breach of a fiduciary duty or relationship.*—(1) For purposes of section 1305 and this section, the term "damages" used with respect to an award in a civil action for breach of contract, or breach of a fiduciary duty or relationship, means an amount awarded pursuant to a judgment or decree by a court as a result of such civil action. The term "damages" is limited to that portion of the award which represents damages to compensate the taxpayer for loss of income which he would have received or accrued but for the breach of contract, or breach of a fiduciary duty or relationship. The term does not include that portion of the award which represents damages awarded by the court over and above the amount found adequate to compensate for the breach, nor does it include attorney's fees, interest, or costs.

(2) An amount awarded pursuant to a consent decree or judgment may be considered damages for breach of contract, or breach of a fiduciary duty or relationship, for the purposes of section 1305 and this section.

(3) An amount received or accrued pursuant to a settlement of the action, after a decree or judgment awarding damages to the taxpayer has been entered, may be considered as damages for breach of contract, or breach of a fiduciary duty or relationship, even though such amount is not made a part of a consent decree. In such a case the taxpayer must show which portion of the amount received or accrued represents damages.

(4) An amount received or accrued pursuant to a settlement of the action where no judgment or decree, or consent judgment or decree, is entered will not constitute damages for breach of contract, or breach of a fiduciary duty or relationship.

(c) *Allocation of damages.*—(1) If possible a portion or all of the damages shall be allocated to a prior taxable year or years during which the taxpayer would have received or accrued such income but for the breach of contract, or breach of a fiduciary duty or relationship. Such allocation is to be determined upon the facts of each case, for example, by reference to the decree or judgment awarding damages, information contained in court records, pleadings, or other pertinent matter.

(2) If any portion of the damages is not allocable to a particular taxable year or years, or to periods within any taxable year or years, in accordance with the rule prescribed in subparagraph (1) of this paragraph, then such portion shall be allocated equally to each of the calendar months (including those of the current taxable year and subsequent taxable years) which fall within the period during which the taxpayer would have received or accrued such income but for the breach and to which no portions previously have been allocated.

(3) The amount of damages, if any, which is allocated under this paragraph to taxable years subsequent to the taxable year of receipt or accrual shall be treated as income for such taxable year of receipt or accrual. The methods enumerated in this paragraph are not mutally exclusive; thus, it is possible that allocations with respect to an award may be made under more than one method. If more than one method is applicable they shall be used only in the order of their enumeration.

(d) *Computation of tax.*—(1) The following computations shall be made in order to determine whether the limitation on tax prescribed in section 1305 and paragraph (a) of this section applies to damages received or accrued in the taxable year.

(i) Compute the tax for the current taxable year by including in the gross income of such year the entire amount of damages received or accrued in such year. In computing such tax the taxpayer shall be allowed all credits and deductions for depletion, depreciation, and other items to which he would have been entitled if the entire amount of such damages were attributable to such year.

(ii) Compute the tax for the current taxable year without the inclusion prescribed in subdivision (i) of this subparagraph.

(iii) (*a*) Compute the tax attributable to the portion of the damages allocated to each of the taxable years (including the year in which the award is received or accrued) in accordance with paragraph (c) of this section. For this purpose taxable income (or net income) and the tax shall be computed with the allowance of all credits and deductions for depletion, depreciation, and other items to which the taxpayer would have been entitled had such damages been received or accrued by the taxpayer in the year during which he would have received or accrued the damages except for the breach of contract, or for the breach of fiduciary duty or relationship.

(*b*) The amount of tax attributable to the portion of damages allocated to each of such taxable years is the difference between the tax for each year computed with the inclusion in gross income of the portion of such damages so allocated to each year and the tax for each year computed without such inclusion.

(iv) The tax for the current taxable year shall be the lesser of (*a*) the tax for the current taxable year as computed under subdivision (i) of this subparagraph, or (*b*) the tax for such year as computed under subdivision (ii) of this subparagraph, plus the aggregate of the taxes attributable to the allocated damages as computed under subdivision (iii) of this subparagraph.

The credits, deductions, or other items referred to in subdivisions (i) and (iii) of this subparagraph shall include only deductions for expenditures actually made by the taxpayer and credits or deductions arising from actual use of capital or receipt of income. Thus, if the award represents gross income which the taxpayer should have received but did not, less costs and expenses which the taxpayer would have paid but did not, no deduction shall be allowed for such costs and expenses. Furthermore, credits, deductions, or other items, attributable to property, shall be allowed only with respect to that part of the award which represents the taxpayer's share of income from the actual operation of the property. Accordingly, if the property is subject to depreciation on the units-of-production method and the taxpayer receives an award based upon certain units of production which the paying party should have produced but did not, the taxpayer shall not be entitled to a depreciation deduction with respect to such units which were not produced. However, where an award is received by the taxpayer representing the gross income from mineral property less expenses that would have been imposed upon the taxpayer but for the breach, the deduction for percentage depletion will be computed with reference to both the reconstructed gross income and taxable income from the property.

(2) If damages of the type specified in paragraph (a) of this section are received or accrued by a partnership which initially instituted the civil action then, for purposes of subparagraph (1) of this paragraph, the partnership shall take such amount into account in computing taxable income (or net income) but the limitation on the tax under section 1305 shall apply to the individual partners. Thus, in recomputing his income tax, each partner shall take into account separately his distributive share of the partnership items enumerated in section 702(a) as recomputed by the partnership under subparagraph (1) of this paragraph. Section 1305 and this section shall not apply to a partner unless his total distributive share of the amount of damages is

$3,000 or more. It is not necessary for the partner to have been a member of the partnership for the prior taxable years to which the amount of damages is allocable in order to have the limitation on tax provided by section 1305 apply.

(3) For effect of allocation of income on items based on amount of income and with respect to a net operating loss or a capital loss carryover, see paragraph (d) (2) of § 1.1301–2.

(4) See paragraph (d) (4) of § 1.1301–2 for the computations which are necessary when an amount of breach of contract damages is allocated to a period to which there has also been allocated other income entitled to the benefits of the provisions of part I (section 1301 and following), subchapter Q, chapter 1 of the Code.

(e) *Treatment of intangible drilling and development costs.*—If the breach of contract damages have been awarded as a result of a suit involving the taxpayer's claim to ownership in a developing oil or gas well and section 1305 applies with respect to such damages, he shall not be entitled to deduct as expense intangible drilling and development costs incurred in the prior taxable year or years unless he makes or has made the election to deduct such costs as expenses in the manner prescribed by § 1.612–4.

(f) *Limitation on amount of award.*—Section 1305 and this section are not applicable unless the amount representing damages is $3,000 or more and such amount is received or accrued in a taxable year as a result of a single award for breach of contract, or breach of a fiduciary duty or relationship.

(g) *Applicability of another section under part I, subchapter Q, chapter 1 of the Code.*—In any case where the amounts involved in a particular breach of contract, or breach of a fiduciary duty or relationship, are also covered by the particular terms of another section in part I, subchapter Q, chapter 1 of the Code, the rules for such other section shall apply, since those sections are directed to more specific situations than the provisions of section 1305. Thus, if a taxpayer receives an amount representing damages awarded in a civil action for breach of contract, or breach of fiduciary duty or relationship, and such award also constitutes the payment of an amount which qualifies for treatment prescribed in section 1302 and the regulations thereunder, such amount shall be subject to the provisions of section 1302 and § 1.1302–1, and section 1305 shall not apply.

(h) *Effective date of this section.*—The provisions of section 1305 and this section apply with respect to taxable years ending after December 31, 1954, but only as to amounts received or accrued after such date as the result of awards made after such date.

§ 1.1305–2 ILLUSTRATIONS.—The provisions of section 1305 and § 1.1305–1 may be illustrated by the following examples:

Example (1). On December 31, 1957, a consent judgment is entered in favor of A, an accrual method taxpayer, for $500,000 damages to compensate him for the failure of the XYZ Company to pay royalties due him under the terms of a contract involving the operation by the XYZ Company of an oil lease. The court determined that the breach of contract covered the period from July 1, 1953, through December 31, 1957. The award of $500,000 includes $40,000 representing legal fees and court costs, and $460,000 representing compensation for loss of oil royalties for the period during which the contract was breached. Of the $460,000, the court determined that $110,000 was attributable to 1956 and $130,000 to January through October 1957. Information in the court records disclosed that $60,000 was attributable to 1955. A makes his income tax return on a calendar year basis. For purposes of determining the limitation on tax under section 1305, A must first compute the tax for 1957 under paragraph (d) (1) (i) of § 1.1305–1 by including the entire amount of damages ($460,000) in gross income for such year and then compute the tax for 1957 without including the $460,000 in gross income in accordance with paragraph (d) (1) (ii) of such section. A must then compute the tax for the current year and all prior years to which the amount of the award is allocable pursuant to paragraph (d) (1) (iii) of § 1.1305–1. In making such computation, A must allocate $110,000 to 1956, $130,000 to the first ten months of 1957, and $60,000 to 1955 in accordance with paragraph (c) (1) of § 1.1305–1. The remaining $160,000 of the $460,000 would be prorated over the unallocated twenty months, two in 1957, twelve in 1954, and six in 1953 or $8,000 per month in accordance with paragraph (c) (2) of § 1.1305–1. Thus, the proper allocations would be $146,000 to 1957, $110,000 to 1956, $60,000 to 1955, $96,000 to 1954, and $48,000 to 1953. In addition, A is entitled to a

deduction for percentage depletion with respect to the amounts allocated to the current taxable year and to prior taxable years. For such purpose A must reconstruct his gross income and taxable income from the property for 1957 and for the years 1953, 1954, 1955, and 1956. A is also entitled to all credits, deductions, or other items to which he would have been entitled had the royalties been received and included in the gross income in those years. Thus, if, for 1953, prior to the allocation of a part of the award to such year, A had no gains from the sale or exchange of capital assets and no taxable income and he had a capital loss carryover of $1,500 to such year, A may deduct $1,000 as a capital loss in computing the tax for 1953 as provided in paragraph (d)(1)(iii) of § 1.1305–1. See sections 1211(b) and 1212 and the regulations thereunder.

Example (2). B, a cash method taxpayer, is the author of a play presented in New York City, Chicago, and San Francisco. The play ran from April 6, 1957, through December 27, 1959. In September 1959, B sues the producer, M, for breach of contract respecting the agreement entered into between M and B. M contends that under the terms of the contract B was entitled to a payment of $25,000 on the production of the play and royalties thereafter limited to its earnings in New York City. B insists that he is also entitled to royalties on the earnings of the two companies established by M to present the play in Chicago and San Francisco. On December 29, 1959, the court awards B the sum of $38,000 representing compensation for the loss of royalty income over the period during which the play was presented in Chicago and San Francisco, including legal fees and other costs. This award is paid to B in 1960. In its decree, the court designates royalty payments to B for such period (April 6, 1957, to December 27, 1959) of $1,000 per month or a total of $33,000 for the full period. Although B is entitled to the benefits of section 1305, he must first ascertain whether section 1302 applies, since the other sections under part I (section 1301 and following), subchapter Q, chapter 1 of the Code, have prior applicability. However, B determines that section 1302 is not applicable for the reason that he worked only 18 months on the play. For the purpose of section 1305(a) and paragraph (a) of § 1.1305–1, B may allocate the $33,000 at the rate of $1,000 per month over the 33 months extending from April 1957 through December 1959. Upon receipt of the award and pursuant to agreement with his literary agent, B pays the agent $2,500 as agent's commission; had B received his royalties when due, he would have paid his agent $3,300 under his contract with the agent. In computing his taxable income for 1960 and for the years reflected in the period April 1957 through December 1959, B may, under the limitation prescribed in paragraph (d)(1) of § 1.1305–1, deduct only $2,500 for commissions paid to his agent.

§ 1.1306 Statutory Provisions; Damages for Injuries Under the Antitrust Laws.

SEC. 1306. DAMAGES FOR INJURIES UNDER THE ANTITRUST LAWS.

If an amount representing damages is received or accrued during a taxable year as a result of an award in, or settlement of, a civil action brought under section 4 of the Act entitled "An Act to supplement existing laws against unlawful restraints and monopolies, and for other purposes", approved October 15, 1914 (commonly known as the Clayton Act), for injuries sustained by the taxpayer in his business or property by reason of anything forbidden in the antitrust laws, then the tax attributable to the inclusion of such amount in gross income for the taxable year shall not be greater than the aggregate of the increases in taxes which would have resulted if such amount had been included in gross income in equal installments for each month during the period in which such injuries were sustained by the taxpayer.

[Section 1306 as added by sec. 58(a), Technical Amendments Act 1958 (72 Stat. 1646) [C.B. 1958–3, 254]]

§ 1.1306–1 Damages for Injuries Under the Antitrust Laws.—(a) *Qualifications for limitation on tax.*—If an amount representing damages is received or accrued during a taxable year as a result of an award in, or settlement of, a civil action instituted under section 4 of the Act of October 15, 1914 (15 U.S.C. 15), commonly known as the Clayton Act, for injuries sustained by the taxpayer in his business or property by reason of anything forbidden in the antitrust laws,

then the tax attributable to the inclusion of such amount in gross income for the taxable year shall not be greater than the aggregate of the increases in taxes which would have resulted if such amount had been included in gross income in equal installments for each month during the period in which such injuries were sustained by the taxpayer.

(b) *Definition of damages.*—(1) For purposes of section 1306 and this section the term "damages" means an amount awarded pursuant to a judgment or decree by a court as the result of a civil action instituted under section 4 of the Act of October 15, 1914, for injuries sustained by the taxpayer in his business or property by reason of anything forbidden in the antitrust laws. The term "damages" includes treble damages awarded under section 4 of the Act but it does not include attorney's fees, interest, or costs.

(2) An amount awarded as damages pursuant to a consent decree or judgment shall be treated as provided in paragraph (a) of this section.

(3) An amount received or accrued as damages pursuant to a settlement of such action (after commencement of such action) shall be treated as provided in paragraph (a) of this section, regardless of whether such amount is received or accrued after a decree or judgment has been entered or whether any decree or judgment is entered.

(4) An amount received or accrued as a result of a settlement where no civil action has been brought under section 4 of the Act will not constitute damages to which section 1306 and this section are applicable.

(c) *Allocation of damages.*—The amount representing damages of the type described in section 1306 is to be treated as if it had been received in equal portions in each of the calendar months (including those of the current taxable year) which fall within the period during which the injury in the taxpayer's business or property by reason of anything forbidden in the antitrust laws is determined to have been sustained. The period during which the injury was sustained is the period established in the action, except that, if no such period is established in the action, such period is to be determined upon the basis of the facts of the particular case. The portion of the damages allocable to each taxable year involved in such period of injury is an amount equal to the entire amount of damages, divided by the entire number of calendar months included within such period, and multiplied by the number of such calendar months falling within the particular taxable year.

(d) *Computation of tax.*—(1) The computations set forth below in this subparagraph shall be made in order to determine whether the limitation on tax prescribed in section 1306 and paragraph (a) of this section applies to damages for injury sustained under the antitrust laws received or accrued in the taxable year:

(i) Compute the tax for the current taxable year by including in the gross income of such year the entire amount of damages received or accrued in such year.

(ii) Compute the tax for the current taxable year without the inclusion prescribed in subdivision (i) of this subparagraph.

(iii) Compute the tax attributable to the portion of the damages allocated to each of the taxable years in accordance with paragraph (c) of this section. The amount of tax attributable to the damages in each of such years is the difference between the tax for each year computed with the inclusion in gross income of each year of the portion of such damages so allocated to each year and the tax for such year computed without such inclusion.

(iv) The tax for the current taxable year shall be the lesser of (*a*) the tax for the current taxable year as computed under subdivision (i) of this subparagraph, or (*b*) the tax for such year computed under subdivision (ii) of this subparagraph, plus the aggregate of the taxes attributable to the allocated damages as computed under subdivision (iii) of this subparagraph.

(2) For the effect of allocation of income on items based on amount of income and with respect to a net operating loss or capital loss carryover, see paragraph (d) (2) of § 1.1301–2.

(3) See paragraph (d) (4) of § 1.1301–2 for the computations which are necessary when an amount of damages is allocated to a period to which there has also been allocated other income entitled to the benefits of part I (section 1301 and following), subchapter Q, chapter 1 of the Code.

(e) *Effective date of this section.*—The provisions of section 1306 and this section are applicable with respect to taxable years ending after September

2, 1958, but only with respect to amounts of damages received or accrued after such date as a result of awards or settlements made after such date.

(f) *Illustrations.*—The provisions of section 1306 may be illustrated by the following example:

Example. A, the proprietor of a drug manufacturing concern, brings suit against the XYZ Pharmaceutical Corporation under section 4 of the Act alleging that, by reason of an unfair contract, his competitor had succeeded in pre-empting the supply of a chemical which was essential to the manufacture of his product. A wins his suit and in the course of the action it is established that A sustained losses resulting from the injury totaling $330,000 over the period from March 1959 through November 1961. The court in November 1961, accordingly, awards A treble damages of $990,000, $25,000 in attorney's fees, and $5,000 in costs. The XYZ Pharmaceutical Corporation in the same month pays A the amount of $1,020,000 covering the damages, fees, and costs. For the purpose of determining the limitation on tax under section 1306, A may allocate only the $990,000 received as damages. A makes his return on a calendar year basis. A must therefore allocate the amount of $990,000 over the 33 calendar months at the rate of $30,000 per month as follows: $300,000 to 1959, $360,000 to 1960, and $330,000 to 1961.

PAR. 4. Section 1.367–1 is amended to provide for the filing of a statement executed under the penalties of perjury rather than under oath. As so amended, § 1.367–1 reads as follows:

§ 1.367–1 FOREIGN CORPORATIONS.—Whether any one of the exchanges or distributions described in section 332, 351, 354, 355, 356, or 361, involving a foreign corporation, is in pursuance of a plan having as one of its principal purposes the avoidance of Federal income tax, is a question of fact. In any such case if a taxpayer desires to establish that an exchange or distribution is not in pursuance of such a plan, a statement, executed under the penalties of perjury, setting forth the facts and circumstances relating to the plan under which the exchange or distribution is to be made, together with a copy of the plan, shall be forwarded to the Commissioner of Internal Revenue, Washington 25, D.C., for a ruling. A letter setting forth the Commissioner's determination will be mailed to the taxpayer. If the Commissioner determines that the exchange or distribution is not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income tax, the taxpayer should retain a copy of the Commissioner's letter as authority for treating the foreign corporation as a corporation in determining the extent to which gain is recognized from the exchange or distribution. If the transaction is not carried out in accordance with the plan submitted, the Commissioner's approval will not render the transaction tax-free.

PAR. 5. Paragraph (a)(1) of § 1.368–3 is amended to eliminate the requirement that the copy of the plan of reorganization required to be filed be certified and to provide for the filing of a statement executed under the penalties of perjury rather than under oath or affirmation. As so amended, paragraph (a)(1) of § 1.368–3 reads as follows:

§ 1.368–3 RECORDS TO BE KEPT AND INFORMATION TO BE FILED WITH RETURNS.—(a) * * *

(1) A copy of the plan of reorganization, together with a statement, executed under the penalties of perjury, showing in full the purpose thereof and in detail all transactions incident to, or pursuant to the plan.

Because the amendments made by paragraphs 4 and 5 of this Treasury Decision are merely of a liberalizing nature, it is found that it is unnecessary, with respect to such amendments, 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.

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(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).)

D. W. BACON,
Acting Commissioner of Internal Revenue.

Approved November 29, 1962.

STANLEY S. SURREY,
Assistant Secretary of the Treasury.

(Filed by the Division of the Federal Register on December 3, 1962, 8:50 a.m., and published in the issue of the Federal Register for December 4, 1962, 27 F.R. 11915)

SECTION 1306.—DAMAGES FOR INJURIES UNDER THE ANTITRUST LAWS

26 CFR 1.1306: Statutory provisions; damages for injuries under the antitrust laws.

Treatment of amount received for injuries under the antitrust laws. See T.D. 6622, page 188.

PART II.—MITIGATION OF EFFECT OF LIMITATIONS AND OTHER PROVISIONS

SECTION 1311.—CORRECTION OF ERROR

26 CFR 1.1311(b)–1: Maintenance of an inconsistent position. T.D. 6617[1]
(Also Sections 1312, 1341, 1347; 1.1312, 1.1341, 1.1347.)

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 sections 1311, 1312, 1313, 1314, 1341, and 1347 of the Internal Revenue Code of 1954 to conform to sections 59, 60, and 61 of the Technical Amendments Act of 1958 and to correct typographical errors.

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 October 28, 1961, notice of proposed rulemaking with respect to the amendments of the Income Tax Regulations (26 CFR Part 1) under sections 1311, 1312, 1313, 1314, 1341, and 1347 of the Internal Revenue Code of 1954 to reflect the changes made by sections 59, 60, and 61 of the Technical Amendments Act of 1958 (72 Stat. 1647, 1648) [P.L. 85–866, C.B. 1958–3, 254] was published in the Federal Register (26 F.R. 10132). After consideration of all such relevant matter as

[1] The publication of this Treasury Decision in 27 F.R. 10823, dated November 7, 1962, contains (1) instructions for modifying the notice of proposed rulemaking in 26 F.R. 10132, dated October 28, 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.

was presented by interested persons regarding the rules proposed, the following amendments of the regulations are hereby adopted.

PARAGRAPH 1. Section 1.1311(b)-1 is amended by revising paragraph (a) and the material preceding the examples in paragraph (b) (1) and (2) and paragraph (c) (1) and (2). These amended provisions read as follows:

§ 1.1311(b)-1 MAINTENANCE OF AN INCONSISTENT POSITION.—(a) *In general.*—Under the circumstances stated in § 1.1312-1, § 1.1312-2, paragraph (a) of § 1.1312-3, § 1.1312-5, § 1.1312-6, and § 1.1312-7, the maintenance of an inconsistent position is a condition necessary for adjustment. The requirement in such circumstances is that a position maintained with respect to the taxable year of the determination and which is adopted in the determination be inconsistent with the erroneous inclusion, exclusion, omission, allowance, disallowance, recognition, or nonrecognition, as the case may be, with respect to the taxable year of the error. That is, a position successfully maintained with respect to the taxable year of the determination must be inconsistent with the treatment accorded an item which was the subject of an error in the computation of the tax for the closed taxable year. Adjustments under the circumstances stated in paragraph (b) of § 1.1312-3 and in § 1.1312-4 are made without regard to the maintenance of an inconsistent position.

(b) *Adjustments resulting in refund or credit.*—(1) An adjustment under any of the circumstances stated in §§ 1.1312-1, 1.1312-5, 1.1312-6, or 1.1312-7 which would result in the allowance of a refund or credit is authorized only if (i) the Commissioner, in connection with a determination, has maintained a position which is inconsistent with the erroneous inclusion, omission, disallowance, recognition, or nonrecognition, as the case may be, in the year of the error, and (ii) such inconsistent position is adopted in the determination.

* * * * * * *

(2) An adjustment under circumstances stated in §§ 1.1312-1, 1.1312-5, 1.1312-6, or 1.1312-7 which would result in the allowance of a refund or credit is not authorized if the taxpayer with respect to whom the determination is made, and not the Commissioner, has maintained such inconsistent position.

* * * * * * *

(c) *Adjustments resulting in additional assessments.*—(1) An adjustment under any of the circumstances stated in § 1.1312-2, paragraph (a) of § 1.1312-3, § 1.1312-5, § 1.1312-6, § 1.1312-7 which would result in additional assessment is authorized only if (i) the taxpayer with respect to whom the determination is with the erroneous exclusion, omission, allowance, recognition, or nonrecognition, as the case may be, in the year of the error, and (ii) such inconsistent position is adopted in the determination.

* * * * * * *

(2) An adjustment under the circumstances stated in § 1.1312-2, paragraph (a) of § 1.1312-3, § 1.1312-5, § 1.1312-6, or § 1.1312-7 which would result in an additional assessment is not authorized if the Commissioner, and not the taxpayer, has maintained such inconsistent position.

PAR. 2. Section 1.1312 is amended by redesignating paragraph (6) of section 1312 as paragraph (7), inserting a new paragraph (6) immediately after paragraph (5) of section 1312, and adding a historical note at the end thereof. These amended provisions read as follows:

§ 1.1312 STATUTORY PROVISIONS; CIRCUMSTANCES OF ADJUSTMENT.

SEC. 1312. CIRCUMSTANCES OF ADJUSTMENT.

The circumstances under which the adjustment provided in section 1311 is authorized are as follows:

* * * * * * *

(6) CORRELATIVE DEDUCTIONS AND CREDITS FOR CERTAIN RELATED CORPORATIONS. The determination allows or disallows a deduction (including a credit) in computing the taxable income (or, as the case may be, net income, normal tax net income, or surtax net income) of a corporation, and a correlative deduction or credit has been erroneously allowed, omitted, or disallowed, as the case

may be, in respect of a related taxpayer described in section 1313(c)(7).

(7) BASIS OF PROPERTY AFTER ERRONEOUS TREATMENT OF A PRIOR TRANSACTION—

(A) *General rule.* The determination determines the basis of property, and in respect of any transaction on which such basis depends, or in respect of any transaction which was erroneously treated as affecting such basis, there occurred, with respect to a taxpayer described in subparagraph (B) of this paragraph, any of the errors described in subparagraph (C) of this paragraph.

(B) *Taxpayers with respect to whom the erroneous treatment occurred.* The taxpayer with respect to whom the erroneous treatment occurred must be—

(i) The taxpayer with respect to whom the determination is made,

(ii) A taxpayer who acquired title to the property in the transaction and from whom, mediately or immediately, the taxpayer with respect to whom the determination is made derived title, or

(iii) A taxpayer who had title to the property at the time of the transaction and from whom, mediately or immediately, the taxpayer with respect to whom the determination is made derived title, if the basis of the property in the hands of the taxpayer with respect to whom the determination is made is determined under section 1015(a) (relating to the basis of property acquired by gift).

(C) *Prior erroneous treatment.* With respect to a taxpayer described in subparagraph (B) of this paragraph—

(i) There was an erroneous inclusion in, or omission from, gross income,

(ii) There was an erroneous recognition, or nonrecognition, of gain or loss, or

(iii) There was an erroneous deduction of an item properly chargeable to capital account or an erroneous charge to capital account of an item properly deductible.

[Sec. 1312 as amended by sec. 59(a), Technical Amendments Act 1958 (72 Stat. 1647)]

PAR. 3. The following new section is inserted immediately after § 1.1312–5:

§ 1.1312–6 CORRELATIVE DEDUCTIONS AND CREDITS FOR CERTAIN RELATED CORPORATIONS.—(a) Paragraph (6) of section 1312 applies if the determination allows or disallows a deduction (including a credit) to a corporation, and if a correlative deduction or credit has been erroneously allowed, omitted, or disallowed in respect of a related taxpayer described in section 1313(c)(7).

(b) The application of paragraph (a) of this section may be illustrated by the following examples:

Example (1). X Corporation is a wholly-owned subsidiary of Y Corporation. In 1955, X Corporation paid $5,000 to Y Corporation and claimed an interest deduction for this amount in its return for 1955. Y Corporation included this amount in its gross income for 1955. In 1958, the Commissioner asserted a deficiency against X Corporation for 1955, contending that the deduction for interest paid should be disallowed on the ground that the payment was in reality the payment of a dividend to Y Corporation. X Corporation contested the deficiency, and ultimately in June 1959, a final decision of the Tax Court sustained the Commissioner. Since the amount of the payment is a dividend, Y Corporation should have been allowed for 1955 the corporate dividends-received deduction under section 243 with respect to such payment. However, the Tax Court's decision sustaining the deficiency against X Corporation occurred after the expiration of the period for filing claim for refund by Y Corporation for 1955. An adjustment is authorized with respect to Y Corporation for 1955.

Example (2). Assume the same facts as in example (1) except that, instead of the Commissioner asserting a deficiency against X Corporation for 1955, Y Corporation filed a claim for refund in 1958, alleging that the payment received

in 1955 from X Corporation was in reality a dividend to which the corporate dividends-received deduction (section 243) applies. The Commissioner denied the claim, and ultimately in June 1959, the district court, in a final decision, sustained Y Corporation. Since the amount of the payment is a dividend, X Corporation should not have been allowed an interest deduction for the amount paid to Y Corporation. However, the district court's decision sustaining the claim for refund occurred after the expiration of the period of limitations for assessing a deficiency against X Corporation for the year 1955. An adjustment is authorized with respect to X Corporation's tax for 1955.

PAR. 4. Section 1.1312-6 is amended by redesignating such section as § 1.1312-7 and by revising the portion of paragraph (a) which precedes subparagraph (1) to read as follows:

§ 1.1312-7 BASIS OF PROPERTY AFTER ERRONEOUS TREATMENT OF A PRIOR TRANSACTION.—(a) Paragraph (7) of section 1312 applies if the determination establishes the basis of property, and there occurred one of the following types of errors in respect of a prior transaction upon which such basis depends, or in respect of a prior transaction which was erroneously treated as affecting such basis:

PAR. 5. Section 1.1312-7 is redesignated as § 1.1312-8. The title of this section, as redesignated, reads as follows:

§ 1.1312-8 Law applicable in determination of error.

PAR. 6. Section 1.1313(c)-1 is amended to read as follows:

§ 1.1313(c)-1 RELATED TAXPAYER.—An adjustment in the case of the taxpayer with respect to whom the error was made may be authorized under section 1311 although the determination is made with respect to a different taxpayer, provided that such taxpayers stand in one of the relationships specified in section 1313(c). The concept of "related taxpayer" has application to all of the circumstances of adjustment specified in § 1.1312-1 through § 1.1312-5 if the related taxpayer is one described in section 1313(c); it has application to the circumstances of adjustment specified in § 1.1312-6 only if the related taxpayer is one described in section 1313(c)(7); it does not apply in the circumstances specified in § 1.1312-7. If such relationship exists, it is not essential that the error involve a transaction made possible only by reason of the existence of the relationship. For example, if the error with respect to which an adjustment is sought under section 1311 grew out of an assignment of rents between taxpayer A and taxpayer B, who are partners, and the determination is with respect to taxpayer A, an adjustment with respect to taxpayer B may be permissible despite the fact that the assignment had nothing to do with the business of the partnership. The relationship need not exist throughout the entire taxable year with respect to which the error was made, but only at some time during that taxable year. For example, if a taxpayer on February 15 assigns to his fiancee the net rents of a building which the taxpayer owns, and the two are married before the end of the taxable year, an adjustment may be permissible if the determination relates to such rents despite the fact that they were not husband and wife at the time of the assignment. See § 1.1311(b)-3 for the requirement in certain cases that the relationship exist at the time an inconsistent position is first maintained.

PAR. 7. Section 1.1314(c) is amended to read as follows:

§ 1.1314(c) STATUTORY PROVISIONS; AMOUNT AND METHOD OF ADJUSTMENT; ADJUSTMENT UNAFFECTED BY OTHER ITEMS.

SEC. 1314. AMOUNT AND METHOD OF ADJUSTMENT. * * *

(c) ADJUSTMENT UNAFFECTED BY OTHER ITEMS. The amount to be assessed and collected in the same manner as a deficiency, or to be refunded or credited in the same manner as an overpayment, under this part, shall not be diminished by any credit or set-off based upon any item other than the one which was the subject of the adjustment. The amount of the adjustment under this part, if paid, shall not be recovered by a claim or suit for refund or suit for erroneous refund based upon any item other than the one which was the subject of the adjustment.

[Sec. 1314(c) as amended by sec. 59(b), Technical Amendments Act 1958 (72 Stat. 1647)]

PAR. 8. Section 1.1341 is amended to read as follows:

§ 1.1341 STATUTORY PROVISIONS; COMPUTATION OF TAX WHERE TAXPAYER RESTORES SUBSTANTIAL AMOUNT HELD UNDER CLAIM OF RIGHT.

SEC. 1341. COMPUTATION OF TAX WHERE TAXPAYER RESTORES SUBSTANTIAL AMOUNT HELD UNDER CLAIM OF RIGHT.

(a) GENERAL RULE.—If—

(1) An item was included in gross income for a prior taxable year (or years) because it appeared that the taxpayer had an unrestricted right to such item;

(2) A deduction is allowable for the taxable year 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 to a portion of such item; and

(3) The amount of such deduction exceeds $3,000, then the tax imposed by this chapter for the taxable year shall be the lesser of the following:

(4) The tax for the taxable year computed with such deduction; or

(5) An amount equal to—

(A) The tax for the taxable year computed without such deduction, minus

(B) The decrease in tax under this chapter (or the corresponding provisions of prior revenue laws) for the prior taxable year (or years) which would result solely from the exclusion of such item (or portion thereof) from gross income for such prior taxable year (or years).

For purposes of paragraph (5)(B), the corresponding provisions of the Internal Revenue Code of 1939 shall be chapter 1 of such code (other than subchapter E, relating to self-employment income) and subchapter E of chapter 2 of such code.

(b) SPECIAL RULES.

(1) If the decrease in tax ascertained under subsection (a)(5)(B) exceeds the tax imposed by this chapter for the taxable year (computed without the deduction) such excess shall be considered to be a payment of tax on the last day prescribed by law for the payment of tax for the taxable year, and shall be refunded or credited in the same manner as if it were an overpayment for such taxable year.

(2) Subsection (a) does not apply to any deduction allowable with respect to an item which was included in gross income by reason of the sale or other disposition of stock in trade of the taxpayer (or other property of a kind which would properly have been included in the inventory of the taxpayer if on hand at the close of the prior taxable year) or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business. This paragraph shall not apply if the deduction arises out of refunds or repayments with respect to rates made by a regulated public utility (as defined in section 1503(c) without regard to paragraph (2) thereof) if such refunds or repayments are required to be made by the Government, political subdivision, agency, or instrumentality referred to in such section, or by an order of a court, or are made in settlement of litigation or under threat of imminence of litigation. This paragraph shall not apply if the deduction arises out of payments or repayments made pursuant to a price redetermination provision in a subcontract entered into before January 1, 1958, between persons other than those bearing the relationship set forth in section 267(b), if the subcontract containing the price redetermination provision is subject to statutory renegotiation and section 1481 (relating to mitigation of effect of renegotiation of Government contracts) does not apply to such payment or repayment solely because such payment or repayment is not paid or repaid to the United States or any agency thereof.

(3) If the tax imposed by this chapter for the taxable year is the amount determined under subsection (a)(5), then the deduction

referred to in subsection (a)(2) shall not be taken into account for any purpose of this subtitle other than this section.

[Sec. 1341 as amended by sec. 60, Technical Amendments Act 1958 (72 Stat. 1647)]

PAR. 9. Section 1.1341–1 is amended by revising paragraph (b) (1) (ii) and (2), correcting examples (2) and (3) in paragraph (d) (4) (iii), revising subparagraphs (1) and (2) and adding new subparagraph (3) to paragraph (f), and revising paragraph (i). These amended provisions read as follows:

§ 1.1341–1 RESTORATION OF AMOUNTS RECEIVED OR ACCRUED UNDER CLAIM OF RIGHT.

* * * * * * *

(b) *Determination of tax.* (1) * * *

(ii) The tax for the taxable year computed under section 1341(a)(5), that is, without taking such deduction into account, minus the decrease in tax (under chapter 1 of the Internal Revenue Code of 1954, under chapter 1 (other than subchapter E) and subchapter E of chapter 2 of the Internal Revenue Code of 1939, or under the corresponding provisions of prior revenue laws) for the prior taxable year (or years) which would result solely from the exclusion from gross income of all or that portion of the income included under a claim of right to which the deduction is attributable. For the purpose of this subdivision, the amount of the decrease in tax is not limited to the amount of the tax for the taxable year. See paragraph (i) of this section where the decrease in tax for the prior taxable year (or years) exceeds the tax for the taxable year.

(2) If the taxpayer computes his tax for the taxable year under the provisions of section 1341(a)(5) and subparagraph (1)(ii) of this paragraph, the amount of the restoration shall not be taken into account in computing taxable income or loss for the taxable year, including the computation of any net operating loss carryback or carryover or any capital loss carryover. However, the amount of such restoration shall be taken into account in adjusting earnings and profits for the current taxable year.

* * * * * * *

(d) *Determination of decrease in tax for prior taxable years.* * * *

(4) *Computation of amount of decrease in tax.* * * *

(iii) The rules provided in this subparagraph may be illustrated as follows:

* * * * * * *

Example (2). Assume the same facts as in example (1) except that, instead of the corporation being entitled to an additional deduction of $5,000 for 1954, it is determined that the corporation failed to include an item of $5,000 in gross income for that year. The decrease in tax for 1954 is computed as follows:

Tax shown on return for 1954		$12,700
Taxable income for 1954 upon which tax shown on return was based		35,000
Plus: Additional income (on account of which deficiency assessment could be made)		5,000
Total		40,000
Tax on $40,000 (adjusted taxable income for 1954)		15,300
Tax on $40,000 (adjusted taxable income for 1954)		15,300
Taxable income for 1954 as adjusted	$40,000	
Less: Exclusion of amount restored	10,000	
Taxable income for 1954 by applying paragraph (b)(1)(ii) of this section	30,000	
Tax on $30,000		10,100
Decrease in tax for 1954 by applying paragraph (b)(1)(ii) of this section		5,200
Tax for 1957 without taking the restoration into account		1,500
Amount by which decrease exceeds the tax for 1957 computed without taking the restoration into account		3,700

(The $3,700 is treated as having been paid on the last day prescribed by law for the payment of the tax for 1957 and is available as a refund. In addition the taxpayer has a deficiency of $2,600 ($15,300 less $12,700) for 1954 because of the additional income of $5,000.)

Example (3). For the taxable year 1954, a corporation had taxable income of $25,000, on which it paid a tax of $7,500. Included in gross income for the year was $10,000 received under a claim of right as commissions. In 1956, the corporation is required to return $5,000 of the commissions. The corporation has a net operating loss of $10,000 for 1956, excluding the deduction for the $5,000 restored. When a computation is made under either paragraph (b)(1)(i) or paragraph (b)(1)(ii) of this section, the corporation has no tax for the taxable year 1956. The decrease in tax for 1954 is computed as follows:

Tax shown on return for 1954		$7,500
Taxable income for 1954 upon which tax shown on return was based		25,000
Less: Additional deduction (on account of net operating loss carryback from 1956)		10,000
Net income as adjusted		15,000
Tax on $15,000 (adjusted taxable income for 1954)		4,500
Tax on $15,000 (adjusted taxable income for 1954)		4,500
Taxable income for 1954, as adjusted	$15,000	
Less: Exclusion of amount restored	5,000	
Taxable income for 1954 by applying paragraph (b)(1)(ii) of this section	10,000	
Tax on $10,000		3,000
Decrease in tax for 1954 by applying paragraph (b)(1)(ii) of this section		1,500
Tax for 1956 without taking the restoration into account		None
Amount by which decrease exceeds the tax for 1956 computed without taking the restoration into account		1,500

(The $1,500 is treated as having been paid on the last day prescribed by law for the payment of the tax for 1956 and is available as a refund. In addition, the taxpayer has an overpayment of $3,000 ($7,500 less $4,500) for 1954 because of the net operating loss deduction of $10,000.)

* * * * * * *

(f) *Inventory items, stock in trade, and property held primarily for sale in the ordinary course of trade or business.* (1) Except for amounts specified in subparagraphs (2) and (3) of this paragraph, the provisions of section 1341 and this section do not apply to deductions attributable to items which were included in gross income by reason of the sale or other disposition of stock in trade of the taxpayer (or other property of a kind which would properly have been included in the inventory of the taxpayer if on hand at the close of the prior taxable year) or property held by the taxpayer primarily for sale to customers in the ordinary course of the taxpayer's trade or business. This section is, therefore, not applicable to sales returns and allowances and similar items.

(2)(i) In the case of taxable years beginning after December 31, 1957, the provisions of section 1341 and this section apply to deductions which arise out of refunds or repayments with respect to rates made by a regulated public utility, as defined in section 1503(c)(1) or (3) and paragraph (g) of § 1.1502-2, if such refunds or repayments are required to be made by the Government, political subdivision, agency, or instrumentality referred to in such section, or are required to be made by an order of a court, or are made in settlement of litigation or under threat or imminence of litigation. Thus, deductions attributable to refunds of charges for the sale of natural gas under rates approved temporarily by a proper governmental authority are, in the case of taxable years

beginning after December 31, 1957, eligible for the benefits of section 1341 and this section, if such refunds are required by the governmental authority, or by an order of a court, or are made in settlement of litigation or under threat or imminence of litigation.

(ii) In the case of taxable years beginning before January 1, 1958, the provisions of section 1341 and this section apply to deductions which arise out of refunds or repayments (whether or not with respect to rates) made by a regulated public utility, as defined in section 1503(c) (1) or (3) and paragraph (g) of § 1.1502–2, if such refunds or repayments are required to be made by the Government, political subdivision, agency, or instrumentality referred to in such section. Thus, in the case of taxable years beginning before January 1, 1958, deductions attributable to refunds or repayments may be eligible for the benefits of section 1341 and this section, even though such refunds or repayments are not with respect to rates. On the other hand, in the case of such taxable years, section 1341 and this section do not apply to any deduction which arises out of a refund or repayment (whether or not with respect to rates) which is required to be made by an order of a court, or which is made in settlement of litigation or under threat or imminence of litigation.

(3) The provisions of section 1341 and this section apply to a deduction which arises out of a payment or repayment made pursuant to a price redetermination provision in a subcontract—

(i) If such subcontract was entered into before January 1, 1958, between persons other than those bearing a relationship set forth in section 267(b):

(ii) If such subcontract is subject to statutory renegotiation; and

(iii) If section 1481 (relating to mitigation of effect of renegotiation of Government contracts) does not apply to such payment or repayment solely because such payment or repayment is not paid or repaid to the United States or any agency thereof.

Thus, a taxpayer who enters into a subcontract to furnish items to a prime contractor with the United States may, pursuant to a price redetermination provision in the subcontract, be required to refund an amount to the prime contractor or to another subcontractor. Since the refund would be made directly to the prime contractor or to another subcontractor, and not directly to the United States, the taxpayer would be unable to avail himself of the benefits of section 1481. However, the provisions of section 1341 and this section will apply in such a case, if the conditions set forth in subdivisions (i), (ii), and (iii) of this subparagraph are met. For provisions relating to the mitigation of the effect of a redetermination of price with respect to subcontracts entered into after December 31, 1957, when repayment is made to a party other than the United States or any agency thereof, see section 1482.

* * * * * * *

(i) *Refunds.* If the decrease in tax for the prior taxable year (or years) determined under section 1341(a)(5)(B) and paragraph (b)(1)(ii) of this section exceeds the tax imposed by chapter 1 of the Code for the taxable year computed without the deduction, the excess shall be considered to be a payment of tax for the taxable year of the deduction. Such payment is deemed to have been made on the last day prescribed by law for the payment of tax for the taxable year and shall be refunded or credited in the same manner as if it were an overpayment of tax for such taxable year. However, no interest shall be allowed or paid if such as excess results from the application of section 1341(a)(5)(B) in the case of a deduction described in paragraph (f)(3) of this section (relating to payments or repayments pursuant to price redetermination).

PAR. 10. Section 1.1347 is amended to read as follows:

§ 1.1347 STATUTORY PROVISIONS; CLAIMS AGAINST UNITED STATES INVOLVING ACQUISITION OF PROPERTY.

SEC. 1347. CLAIMS AGAINST UNITED STATES INVOLVING ACQUISITION OF PROPERTY.

In the case of amounts (other than interest) received by a taxpayer from the United States with respect to a claim against the United States involving the acquisition of property and remaining unpaid for more

than 15 years, the surtax imposed by section 1 attributable to such receipt shall not exceed 30 percent of the amount (other than interest) so received. This section shall apply only if claim was filed with the United States before January 1, 1958.

[Sec. 1347 as amended by sec. 61, Technical Amendments Act 1958 (72 Stat. 1648)]

PAR. 11. Paragraphs (a) and (b) of § 1.1347–1 are amended to read as follows:

§ 1.1347–1 TAX ON CERTAIN AMOUNTS RECEIVED FROM THE UNITED STATES. (a) In the case of an amount (other than interest) received from the United States by an individual under a claim involving acquisition of property and remaining unpaid for more than 15 years, the surtax (or, in the case of taxable years beginning before January 1, 1958, the tax) imposed by section 1 attributable to such amount shall not exceed 30 percent of the amount (other than interest) so received. For the purpose of section 1347 and this section, such amount shall not include any amount received from the United States which constitutes interest, whether such interest was included in the claim or in any judgment thereon or has accrued on such judgment. Section 1347 and this section shall only apply with respect to amounts received under a claim filed with the United States before January 1, 1958.

(b) To determine the application of section 1347 and this section to a particular amount, the taxpayer shall first compute the surtax (or, in the case of taxable years beginning before January 1, 1958, the tax) imposed by section 1 upon his entire taxable income, including the amount specified in paragraph (a) of this section, without regard to the limitation on tax provided in section 1347. The proportion of the surtax (or tax), so computed, indicated by the ratio which the taxpayer's taxable income attributable to the amount specified in paragraph (a) of this section, computed as prescribed in paragraph (c) of this section, bears to his total taxable income, is the portion of the surtax (or tax) attributable to such amount. If this portion of the surtax (or tax) exceeds 30 percent of the amount specified in paragraph (a) of this section, that portion of the surtax (or tax) shall be reduced to 30 percent of such amount.

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 1, 1962.

STANLEY S. SURREY,
Assistant Secretary of the Treasury.

(Filed by the Division of the Federal Register on November 6, 1962, 8:53 a.m., and published in the issue of the Federal Register for November 7, 1962, 27 F.R. 10823)

SECTION 1312.—CIRCUMSTANCES OF ADJUSTMENT

26 CFR 1.1312: Statutory provisions; circumstances of adjustment.

Correlative deductions and credits for certain related corporations. See T.D. 6617, page 196.

PART V.—CLAIM OF RIGHT

SECTION 1341.—COMPUTATION OF TAX WHERE TAXPAYER RESTORES SUBSTANTIAL AMOUNT HELD UNDER CLAIM OF RIGHT

26 CFR 1.1341: Statutory provisions; computation of tax where taxpayer restores substantial amount held under claim of right.

Refund or repayment of rates by regulated public utility pursuant to litigation; payments or repayments made pursuant to a price redetermination provision in certain subcontracts. See T.D. 6617, page 196.

PART VI.—OTHER LIMITATIONS

SECTION 1347.—CLAIMS AGAINST UNITED STATES INVOLVING ACQUISITION OF PROPERTY

26 CFR 1.1347: Statutory provisions; claims against United States involving acquisition of property.

Amounts received under a claim filed with the United States before January 1, 1958. See T.D. 6617, page 196.

SUBCHAPTER S.—SELECTION OF CERTAIN SMALL BUSINESS CORPORATIONS AS TO TAXABLE STATUS

SECTION 1372.—ELECTION BY SMALL BUSINESS CORPORATION

26 CFR 1.1372: Statutory provisions; election by small business corporation. T.D. 6615[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 to reflect the amendment of section 1372 of the Internal Revenue Code of 1954 made by section 2 of the Act of May 4, 1961 (Public Law 87–29, 75 Stat. 64), and to make clarifying changes.

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

[1] 27 F.R. 10454.

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

On May 1, 1962, notice of proposed rulemaking with respect to the amendment of the Income Tax Regulations (26 CFR Part 1) under section 1372 of the Internal Revenue Code of 1954 to conform the regulations to changes made by the Act of May 4, 1961 (Pub. Law 87–29, 75 Stat. 64) [C.B. 1961–2, 307], and to make clarifying changes was published in the Federal Register (27 F.R. 4153). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the following amendments of the regulations are hereby adopted.

PARAGRAPH 1. Section 1.1372 is amended by adding a new subsection (g) at the end of section 1372 and by revising the historical note at the end of the section. These amended provisions read as follows:

§ 1.1372 STATUTORY PROVISIONS; ELECTION BY SMALL BUSINESS CORPORATION.

SEC. 1372. ELECTION BY SMALL BUSINESS CORPORATION. * * *

(g) CONSENT TO ELECTION BY CERTAIN SHAREHOLDERS OF STOCK HELD AS COMMUNITY PROPERTY.—If a husband and wife owned stock which was community property (or the income from which was community income) under the applicable community property law of a State, and if either spouse filed a timely consent to an election under subsection (a) for a taxable year beginning before January 1, 1961, the time for filing the consent of the other spouse to such election shall not expire prior to May 15, 1961.

[Sec. 1372 as added by sec. 64(a), Technical Amendments Act of 1958 (72 Stat. 1650) [P.L. 85–866, C.B. 1958–3, 254]; amended by sec. 2, Act of May 4, 1961 (Pub. Law 87–29, 75 Stat. 64) [C.B. 1961–2, 307]]

PAR. 2. Paragraph (a) of § 1.1372–3 is amended to read as follows:

§ 1.1372–3 SHAREHOLDERS' CONSENT.—(a) *In general.*—The consent of a shareholder to an election by a small business corporation shall be in the form of a statement signed by the shareholder in which such shareholder consents to the election of the corporation. Such shareholder's consent is binding and may not be withdrawn after a valid election is made by the corporation. The consent of a minor shall be made by the minor or by his legal guardian, or his natural guardian if no legal guardian has been appointed. The consent of an estate shall be made by the executor or administrator thereof. The statement shall set forth the name and address of the corporation and of the shareholder, the number of shares of stock owned by him, and the date (or dates) on which such stock was acquired. The consents of all shareholders may be incorporated in one statement. The consents of all persons who are shareholders at the time the election is made shall be attached to the election of the corporation. If the election is made before the first day of the corporation's taxable year for which it is effective, the consents of persons who become shareholders after the date of election and are shareholders on such first day shall be filed with the district director with whom the election was filed as soon as practicable after such first day. The consent referred to in the preceding sentence will be considered timely if it is filed on or before the last day prescribed for making the election. Where a consent is filed after the date of election, a copy of the consent shall also be filed with the return required to be filed under section 6037. In the case of a shareholder in a community-property State whose spouse has filed a timely consent to an election under section 1372(a) for a taxable year beginning before January 1, 1961, the time for filing the consent of such shareholder shall not expire prior to May 15, 1961; in the case of a shareholder in a community-property State whose spouse has filed a timely consent to an election under section 1372(a) for a taxable year beginning after December 31, 1960, and on or before October 26, 1962, the consent of such shareholder shall be considered timely if it is filed on or before the last day prescribed for making the election. An election under section 1372(a) will not be valid if any of the consents are

not timely filed. However, an election which was timely filed for any taxable year beginning before March 1, 1960, and which would be valid but for the fact that the consent of any shareholder of the corporation was not filed or was defective in any manner, will not be invalid if—

(1) A proper consent is filed by such shareholder after December 19, 1959, and on or before March 1, 1960,

(2) All shareholders of the corporation who previously filed timely and proper consents file new consents within the period mentioned in subparagraph (1) of this paragraph, and

(3) The shareholders show to the satisfaction of the district director with whom the election under section 1372(a) was filed that the failure to file timely and proper consents was not due to an intention to avoid making a valid election.

(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 October 22, 1962.
STANLEY S. SURREY,
Assistant Secretary of the Treasury.

(Filed by the Division of the Federal Register on October 25, 1962, 8:52 a.m., and published in the issue of the Federal Register for October 26, 1962, 27 F.R. 10454)

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26 CFR 1.1372-3: Shareholders' consent. Rev. Rul. 62-116

Where stock in a small business corporation owned by a decedent at the time of his death is properly subject to the possession of the executor or administrator of his estate for purposes of administration, the estate becomes a shareholder in the corporation and is, therefore, a "new shareholder" within the meaning of section 1372(e)(1) of the Internal Revenue Code of 1954, notwithstanding the fact that under applicable state law legal title to the stock passes directly to the legatees under the decedent's will or to his heirs at law.

Advice has been requested as to whether the death of a shareholder in an electing small business corporation results in the decedent's estate being a "new shareholder" within the meaning of section 1372(e)(1) of the Internal Revenue Code of 1954, under the circumstances described below.

The decedent, a shareholder in a small business corporation as defined in section 1371(b) of the Code, died domiciled in the State of Missouri. In his will, he bequeathed all of his stock in the corporation to his wife, who was already a shareholder in the corporation. The decedent's wife acquired possession of the decedent's stock as executrix of his estate for purposes of administration. Upon settlement of the estate, the stock was transferred to the wife as legatee in accordance with an order of distribution which declared her title thereto as of the date of the decedent's death.

The Missouri law relating to collection and management of assets of decedents' estates, including the devolution of an estate at death, is contained in the Missouri Probate Code of 1955, Laws of 1955, as amended, and is found in Title XXXI, Chapter 473, sections 473.260 through 473.357 of Vernon's Annotated Missouri Statutes.

Section 473.260 of Chapter 473 provides as follows:

When a person dies, his real and personal property, except exempt property, passes to the persons to whom it is devised by his last will, or, in the absence of such disposition, to the persons who succeed to his estate as his heirs; but it is subject to the possession of the executor or administrator and to the election of the surviving spouse and is chargeable with the expenses of administering the estate, the payment of other claims and allowances to the family, except as otherwise provided in this law.

Section 473.263 of Chapter 473 provides, in part, as follows:

1. Every executor or administrator has a right to and shall take possession of all the personal property of the decedent except exempt property of the surviving spouse and unmarried minor children, and administer it in accordance with this law.

In addition, section 351.260 of Chapter 351 of Title XXIII, relating to corporations, associations and partnerships, of Vernon's Annotated Missouri Statutes provides, in part, as follows:

2. Shares standing in the name of a deceased person may be voted by his administrator or executor, either in person or by proxy. * * *

Section 1372(e)(1) of the Code provides, in effect, that an election not to be taxed as a corporation made under section 1372(a) by a small business corporation shall terminate if a "new shareholder" in such corporation fails to file a timely consent to the election.

Section 1371(a)(2) of the Code, in defining the term "small business corporation," indicates clearly that an estate may be a shareholder in such a corporation.

Section 1.1371–1(d)(1) of the Income Tax Regulations states that ordinarily the persons who would have to include in gross income dividends distributed with respect to the stock of a small business corporation are considered to be the shareholders of the corporation.

If real and personal property owned by a decedent at his death is properly subject to administration of the estate and to possession of the executor or administrator, although legal title thereto passes directly under state law to the devisees under the decedent's will or to his heirs-at-law, the estate is a taxable entity during the period of administration and any income earned on the property during such period is taxable to the estate. See *Edwin M. Petersen et al.* v. *Commissioner*, 35 T.C. 962 (1961), acquiescence, page 5, this Bulletin; *Marin Caratan* v. *Commissioner*, 14 T.C. 934 (1950); *R. C. Kuldell* v. *Commissioner*, 69 Fed. (2d) 739 (1934).

Pursuant to the Missouri Probate Code, legal title to the small business corporation stock owned by the decedent in the instant case at the time of his death passed directly to his wife under his will. However, the stock was properly subject to administration of the estate and to the possession of the wife in her capacity as executrix. Therefore, the estate was the taxable entity as to income on the stock during the period of administration.

The fact that an executor or administrator has power under the Missouri Corporation Code to vote stock held by a decedent at his death is further evidence that a legatee of such stock in Missouri is not considered as the shareholder of the stock from the date of the decedent's death for all purposes.

Other states having title passage rules similar to that of Missouri also provide that the decedent's estate may exercise certain powers

with respect to the stock. In California, for example, section 2220 of the Corporations Code, West's Annotated California Codes, provides that "shares standing in the name of a deceased person may be voted and all rights incident thereto may be exercised only by his executor or administrator, in person or by proxy."

A holding that a legatee or heir becomes the shareholder of a decedent's stock for purposes of section 1372(e)(1) of the Code immediately at the date of the decedent's death would often result in automatic termination of the corporation's election, such as where the passage of title to several legatees or heirs would result in the ten shareholder limit being exceeded or where a legatee or heir is a nonresident alien. In view of these possibilities, the fact that Congress specifically allowed an estate to be a shareholder of a small business corporation can be taken to indicate an intent to prevent the fortuitous circumstance of a death from automatically terminating the corporation's election in such cases.

Furthermore, such a holding could lead to needless confusion and complexity in the following situations: (1) where the legatee or heir never receives the stock because it is sold to satisfy debts of the decedent, family allowances or estate administration expenses; (2) where the will is held invalid, where the legatee renounces the legacy, or where legatees or heirs are unknown or cannot be located, etc.; and (3) where the small business corporation, or one or more of its shareholders, wishes to exercise an option to purchase the deceased shareholder's stock from the estate which, in the meantime, could have filed the requisite Subchapter S consent.

In *Herbert's Estate et al.* v. *Commissioner*, 139 Fed. (2d) 756, at 757 (1943), certiorari denied, 322 U.S. 752 (1944), the court stated, "Whatever status a personal representative may have for other purposes, he is treated by the Revenue Acts as a new owner of the decedent's property for income tax purposes."

Similarly, it is concluded that if a decedent's Subchapter S stock is properly subject to the possession of the executor or administrator of the estate for purposes of administration, the executor or administrator is considered to be the "new owner" of the stock for the purpose of section 1372(e)(1) of the Code, regardless of who technically has legal title to such stock under applicable state law. See also section 1.1372-3(b) of the regulations.

Accordingly, in view of the foregoing, it is held that as a result of the death of the decedent in the instant case, the decedent's estate became a "new shareholder" in the small business corporation within the meaning of section 1372(e)(1) of the Code.

SUBCHAPTER T.—COOPERATIVES AND THEIR PATRONS

PART II.—TAX TREATMENT BY PATRONS OF PATRONAGE DIVIDENDS

SECTION 1385.—AMOUNTS INCLUDABLE IN PATRON'S GROSS INCOME

Consent to a written notice of allocation required by bylaw. See Rev. Proc. 62-36, page 537.

PART III.—DEFINITIONS; SPECIAL RULES

SECTION 1388.—DEFINITIONS; SPECIAL RULES

Consent to a written notice of allocation required by bylaw. See Rev. Proc. 62–36, page 537.

CHAPTER 2.—TAX ON SELF-EMPLOYMENT INCOME

SECTION 1402.—DEFINITIONS

26 CFR 1.1402(c)–1: Trade or business. Rev. Rul. 62–97

The performance of service by an individual in the exercise of his profession as a doctor of osteopathy, who is not a doctor of medicine, is not excluded from the term "trade or business" within the meaning of section 1402(c) of the Self-Employment Contributions Act of 1954, as amended by the Social Security Amendments of 1956. The income derived from the performance of such service is includible in computing the individual's net earnings from self-employment for purposes of such Act.

The Internal Revenue Service has been requested to state whether the performance of service as a doctor of osteopathy is excluded from the term "trade or business" for purposes of the Self-Employment Contributions Act of 1954 (chapter 2, subtitle A, Internal Revenue Code of 1954), as amended by the Social Security Amendments of 1956, under the circumstances set forth herein.

The taxpayer has a degree of Doctor of Osteopathy, but does not possess a degree of Doctor of Medicine. However, the board of medical examiners for the state in which the taxpayer performs his services is authorized by statute to license doctors of osteopathy to practice medicine and surgery to the same extent as a doctor of medicine, and the taxpayer was so licensed by this board.

Prior to the enactment of the Social Security Amendments of 1956, section 1402(c)(5) of the Self-Employment Contributions Act of 1954 excluded from the term "trade or business" the performance of service by an individual in the exercise of his profession as a physician, lawyer, dentist, osteopath, veterinarian, chiropractor, naturopath, optometrist, or Christian Science practitioner; or the performance of such service by a partnership. For taxable years ending after 1955, section 1402(c)(5) of the Act, as amended, excludes from the term "trade or business" the performance of service by an individual in the exercise of his profession as a doctor of medicine or Christian Science practitioner; or the performance of such service by a partnership. The designations of the excluded professions are given their commonly accepted meanings.

The legislative history of the amendment of the Self-Employment Contributions Act of 1954, whereby certain previously excluded professions were brought within the scope of its provisions, clearly indicates that it was the intention of the Congress to exclude only physicians who are doctors of medicine and specifically to extend self-

employment coverage to doctors of osteopathy. See H. Conf. Rept. 2936, 84th Cong., 2d Sess., 27 (1956), 3 U.S. Cong. News 1956, 3954, 3958. The fact that a doctor of osteopathy may be authorized by a particular state statute to perform the same services as a doctor of medicine would appear to be immaterial, considering the intent of the Congress.

In view of the foregoing, it is held that services performed by a doctor of osteopathy, who is not a doctor of medicine within the commonly accepted meaning of that term, are not excepted from the term "trade or business" within the intendment of section 1402(c) of the Act, as amended. Accordingly, the income derived by a doctor of osteopathy from the practice of his profession is includible in computing his net earnings from self-employment notwithstanding that he was licensed to practice medicine and surgery.

Rev. Rul. 62–200

Information concerning the status, under the Self-Employment Contributions Act of 1954, of missionaries who are not citizens of the United States but who are associated with a religious denomination which has its corporate headquarters in the United States.

Several inquiries have been presented to the Internal Revenue Service relative to the status, under the Self-Employment Contributions Act of 1954 (chapter 2, subtitle A, Internal Revenue Code of 1954), of foreign missionaries, not citizens of the United States, who are associated with a religious denomination which has its corporate headquarters in the United States.

Some of these missionaries have permanent resident visas in the United States which they keep valid, although they perform some services in other countries. All of the missionaries are duly ordained ministers of a church. Some of them perform services in the exercise of their ministry in the United States while on furlough, for which they receive separate compensation.

The specific questions presented and answers thereto are set forth below.

Question 1. May nonresident alien missionaries who are associated with a religious denomination, whose corporate headquarters is in the United States, have income subject to the tax imposed under the Self-Employment Contributions Act while serving outside the territorial limits of the United States?

Answer. No. Section 1402(b) of the Act excludes from the term "self-employment income" the net earnings from self-employment of a nonresident alien individual. However, for purposes of the tax on self-employment income, an individual who is not a citizen of the United States but who is a resident of the Virgin Islands, Puerto Rico, Guam, or American Samoa is not considered to be a nonresident alien individual. See section 1402(b)(2) of the Act.

Question 2. May a resident alien missionary performing ministerial services outside the United States elect, on a voluntary basis, to be covered under the insurance system established by Title II of the Social Security Act?

Answer. A resident alien missionary who is a duly ordained, commissioned, or licensed minister of a church, or a member of a religious order (other than a member of a religious order who has taken a vow of poverty as a member of such order), may elect on a voluntary basis to be covered under the insurance system established by Title II of the Social Security Act by filing Form 2031, Waiver Certificate For Use by Ministers, Certain Members of Religious Orders, and Christian Science Practitioners, in accordance with section 1402(e) of the Internal Revenue Code of 1954. Provided a valid waiver certificate is filed, a tax is imposed, under section 1401 of the Code, on all "self-employment income," which includes income earned both within and without the United States. Also the entire income of a resident alien derived from all sources, including income derived from sources without the United States is includible in his gross income for Federal income tax purposes. See Rev. Rul. 55–62, C.B. 1955–1, 212.

Question 3. Does remuneration received by a resident alien missionary for ministerial services performed while in the United States on regular furlough constitute "self-employment income?"

Answer. As indicated in question 2 above, such remuneration constitues "self-employment income" provided the missionary filed a valid waiver certificate on Form 2031.

Question 4. Are alien missionaries who contemplate performing ministerial services in the United States eligible to file a waiver certificate under the provisons of section 1402(e) of the Self-Employment Contributions Act?

Answer. Only resident alien missionaries, as described in answer to question 2, above, may file a Form 2031, waiver certificate, in contemplation of having net earnings from self-employment for purposes of the Self-Employment Contributions Act.

CHAPTER 6.—CONSOLIDATED RETURNS

SUBCHAPTER A.—RETURNS AND PAYMENT OF TAX

SECTION 1501.—PRIVILEGE TO FILE CONSOLIDATED RETURNS

26 CFR 1.1501–1: Privilege to file consolidated returns. (Also Section 1502, 1.1502–11)

Rev. Rul. 62–204[1]

Affiliated corporations filing consolidated returns may make a new election to file separate returns for either the first taxable year for which returns are due to be filed after the date of enactment of the Revenue Act of 1962, or the first taxable year ending after the date of such enactment.

Inquiries have been received whether enactment of the Revenue Act of 1962, Public Law 87–834, 76 Stat. 960, approved October 16, 1962,

[1] Also released as Technical Information Release 412, dated November 9, 1962; this Revenue Ruling was clarified by Revenue Ruling 63–18, I.R.B. 1963–8, 16, dated February 25, 1963.

C.B. 1962–3, page 111, will permit affiliated corporations a new election to file separate returns in lieu of consolidated returns and as to the year for which such new elections will be available.

Since the Revenue Act of 1962 constitutes a significant change in the tax laws, the Treasury Department has authorized a new election to file separate returns for either the first taxable year for which returns are due to be filed after the date of enactment of the Act, or the first taxable year ending after the date of such enactment.

In this regard, returns due to be filed after the date of enactment of the Act (including any extensions of time granted by the Commissioner) will be considered as filed and the election exercised on such due date even though the return was filed prior to the due date. However, the last return (or returns), whether original or revised, filed on or before the due date for the return (including any extensions of time for filing such return), will be considered the return or returns filed on such due date. For example: An affiliated group whose taxable year ended on February 28, 1962, received an extension of time to file its consolidated return until November 15, 1962; however, it filed its original return on October 15, 1962. The group may exercise its election to file separate returns in lieu of consolidated returns by filing either revised returns for its taxable year ended February 28, 1962, on a separate return basis on or before November 15, 1962; or, original returns for its taxable year ending February 28, 1963, on a separate return basis.

SECTION 1502.—REGULATIONS

26 CFR 1.1502–11: Consolidated returns for subsequent years.

Affiliated corporations filing consolidated returns may make a new election to file separate returns. See Rev. Rul. 62–204, page 212.

SUBTITLE C.—EMPLOYMENT TAXES

CHAPTER 21.—FEDERAL INSURANCE CONTRIBUTIONS ACT

SUBCHAPTER C.—GENERAL PROVISIONS

SECTION 3121.—DEFINITIONS

26 CFR 31.3121(a)–1: Wages. (Also Section 3306; 31.3306(b)–1.) Rev. Rul. 62–150

Whether the value of meals furnished by an employer to his employees is "wages" for Federal employment tax purposes depends upon whether the value of the meals represents an appreciable part of the remuneration of the employees. The value of one free meal a day is considered appreciable for employment tax purposes.

Whether the meals are furnished "for the convenience of the employer" is immaterial for employment tax purposes.
S.S.T. 302, C.B. 1938–1, 456, revoked; Revenue Ruling 57–471, C.B. 1957–2, 630, modified.

Advice has been requested whether the value of meals furnished by a hospital to its employees represents "wages" for purposes of the Federal Insurance Contributions Act (Chapter 21, subtitle C, Internal Revenue Code of 1954).

The hospital, a taxable entity for Federal Insurance Contributions Act purposes, furnished one free meal a day to each employee under conditions which would satisfy the convenience-of-the-employer test for Federal income tax purposes. Inasmuch as the value of the meals in question is excludable from the employees' gross income under section 119 of the Internal Revenue Code of 1954, the hospital asks whether the value of the meals is also excludable from the employees' "wages" for Federal employment tax purposes.

In Revenue Ruling 57–471, C.B. 1957–2, 630, it is held that the value of meals furnished certain employees constitutes "wages" for Federal Insurance Contributions Act purposes. In that case a company operates a chain of variety stores within which luncheon-counters or cafeterias are operated for the purpose of serving food to customers. Each lunch-counter and cafeteria employee is entitled to a meal without charge for each meal period occurring during his work shift. Employees who do not avail themselves of the meals have no right to their cash value. The conclusion in that ruling is based on the principle that meals provided free to employees of employers in the restaurant industry do not fall within the category of "facilities and privileges" within the meaning of the applicable employment tax regulations.

S.S.T. 302, C.B. 1938–1, 456, which holds that the value of lunches furnished without charge by the *M* company to its employees is not "wages" for Federal employment tax purposes, was cited in Revenue Ruling 57–471. S.S.T. 302 was distinguished from the Revenue Ruling mainly on the basis that the company was not engaged in the business of preparing and serving food to customers. When S.S.T. 302 was issued, Article 207 of Regulations 90 contained the following provision:

Ordinarily, facilities or privileges (such as entertainment, *cafeterias, restaurants*, medical services or so-called "courtesy" discounts on purchases), furnished or offered by an employer to his employees generally, are not considered as remuneration for services if such facilities or privileges are offered or furnished by the employer *merely as a convenience to the employer or* as a means of promoting the health, good will, contentment, or efficiency of his employees. [Italics supplied.]

The current regulations issued under section 3121 of the Federal Insurance Contributions Act do not list cafeterias and restaurants as examples of facilities or privileges which are not considered as remuneration for services, and the convenience-of-the-employer language has long been eliminated from the Federal employment tax regulations. Section 31.3121(a)–1(f) of the current regulations provides as follows:

Ordinarily, facilities or privileges (such as entertainment, medical services, or so-called 'courtesy' discounts on purchases), furnished or offered by an employer to his employees generally, are not considered as remuneration for employ-

ment *if such facilities or privileges are of relatively small value and* are offered or furnished by the employer merely as a means of promoting the health, good will, contentment, or efficiency of his employees. *The term 'facilities or privileges', however, does not ordinarily include the value of meals or lodging* furnished, for example, to restaurant or hotel employees, or to seamen or other employees aboard vessels, *since generally these items consitute an appreciable part of the total remuneration of such employees.* [Italics supplied.]

Although the "convenience-of-the-employer" test has been used in the income tax area to determine if the value of meals furnished is includible in gross income, this is no longer a test for Federal employment tax purposes. See paragraph 6 of Mim. 5657, C.B. 1944, 550. The furnishing of one or more free meals daily by an employer to an employee is an appreciable part of the remuneration of the employee. Whether the employer is in the business of preparing and serving meals to customers is immaterial since, in applying the "relatively small value" test under the applicable regulations, it is obviously impossible to distinguish between the value of a meal furnished, for example, to a bank employee and the value of one furnished to an employee of a hospital or restaurant.

In view of the foregoing, it is held that the fair value of meals furnished by the hospital, in the instant case, to its employees respresents "wages" for purposes of the Federal Insurance Contributions Act. This conclusion is also applicable for purposes of the Federal Unemployment Tax Act (Chapter 23, subtitle C, of the Code).

S.S.T. 302, C.B. 1938–1, 456, is hereby revoked; Revenue Ruling 57–471, C.B. 1957–2, 630, with respect to the statement that S.S.T. 302 is "still in full force and effect," is hereby modified.

Pursuant to the authority contained in section 7805(b) of the Code, the revocation of S.S.T. 302 will not be applied retroactively to taxable periods beginning prior to January 1, 1963.

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26 CFR 31.3121(d)–1: Who are employees. (Also Sections 3306, 3401; 31.3306(i)–1, 31.3401(a)–1.) Rev. Rul. 62–124

> Under an agreement, a husband and wife manage a trailer park for the owner thereof. They hire the necessary helpers, fix their wages, pay them from a petty cash account and have charge of all operating details of the trailer park. They are paid as compensation a stated percentage of the gross collections from the trailer park rentals and the laundry service meters. The contract may be terminated upon thirty days' notice. *Held*, the individuals are employees of the owner for Federal employment tax purposes.

Advice has been requested as to the status, for Federal employment tax purposes, of a husband and wife with respect to services performed by them in the management of a trailer park for the owner thereof.

The husband and wife entered into an agreement with the owner of a trailer park to manage the park for him. Under the agreement, they maintain orderly operation of the park, enforce all rules and regulations and, within their capabilities, preserve the property of the park. They attend to such duties as cutting the grass, maintaining and draining streets, excluding peddlers and other unauthorized per-

sons from the park and assisting guests with the parking of their vehicles. They also collect rental payments, make meter collections from the washing and drying machines, deposit the collections daily in a designated bank to the account of the owner and make daily reports to the owner of all collections for the previous day's business. They keep a petty cash account on the premises to take care of urgent expenses, such as minor repairs, park labor, gasoline and other incidentals. At the end of each month, they render to the owner a statement covering the account. They are authorized to hire helpers and have complete charge of all details as to their wages, duties, etc. The wages of the helpers are paid from the petty cash account. As compensation for their service, the individuals are paid a stated percentage of the gross collections from the park rentals and laundry service. The agreement may be terminated by the owner or the individuals upon thirty days' notice.

Section 3121(d) of the Federal Insurance Contributions Act (chapter 21, subtitle C, Internal Revenue Code of 1954) provides that the term "employee" means, among other things, any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee. The guides for determining whether, under such rules, an employer-employee relationship exists are found in section 31.3121(d)–1(c) of the Employment Tax Regulations.

It is concluded, upon the basis of the stated facts, that the owner of the trailer park exercises, or has the right to exercise, such control and direction over the two individuals in question as is necessary to establish the relationship of employer and employee under the usual common law rules. Accordingly, it is held that such individuals, and the helpers hired by them, are employees of the owner for purposes of the taxes imposed by the Federal Insurance Contributions Act, with respect to the services performed in the operation of the trailer park.

This conclusion is also applicable for purposes of the Federal Unemployment Tax Act and the Collection of Income Tax at Source on Wages (chapters 23 and 24, respectively, subtitle C, Internal Revenue Code of 1954).

(Also Sections 3306, 3401; 31.3306(i)–1, 31.3401(c)–1.) Rev. Rul. 62–157[1]

Where individuals mingle with and encourage customers to buy drinks in night clubs or similar-type establishments for remuneration determined on a commission basis or otherwise (the so-called B-Girls), they are employees of the operators of the establishments with respect to such services for purposes of the Federal employment taxes. This is true regardless of whether they may be considered independent contractors with respect to the performance of a particular act or specialty in the same establishment. See Mim. 6715, C.B. 1951–2, 171. Accordingly, the remuneration (including commissions) for these services as B-Girls constitutes wages subject to the taxes imposed by

[1] Based on Technical Information Release 396, dated September 7, 1962.

the Federal Insurance Contributions Act and the Federal Unemployment Tax Act, and for purposes of the Collection of Income Tax at Source on Wages (Chapters 21, 23, and 24, respectively, subtitle C, Internal Revenue Code of 1954).

CHAPTER 23.—FEDERAL UNEMPLOYMENT TAX ACT

SECTION 3306.—DEFINITIONS

26 CFR 31.3306(b)-1: Wages.

Free meals furnished employees by their employers. See Rev. Rul. 62–150, page 213.

26 CFR 31.3306(i)-1: Who are employees.

Individuals performing services as manager of a trailer park for the owner thereof. See Rev. Rul. 62–124, page 215.

Individuals performing services as "B-Girls" in night clubs and other similar establishments. See Rev. Rul. 62–157, page 216.

CHAPTER 24.—COLLECTION OF INCOME TAX AT SOURCE ON WAGES

SECTION 3401.—DEFINITIONS

26 CFR 31.3401(a)-1: Wages.

Commissions received by individuals performing services as manager of a trailer park for the owner thereof. See Rev. Rul. 62–124, page 215.

26 CFR 31.3401(c)-1: Employee.

Individuals performing services as "B-Girls" in night clubs and other similar establishments. See Rev. Rul. 62–157, page 216.

SECTION 3402.—INCOME TAX COLLECTED AT SOURCE

26 CFR 31.3402(a)-1: Requirement of withholding.

Statutory pay of a cadet of the United States Coast Guard Academy. See Rev. Rul. 62–122, page 12.

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.

Whether the retailers excise tax and the cabaret tax are applicable where articles subject to the retailers excise tax are sold in a cabaret in transactions which also establish liability for the cabaret tax. See Rev. Rul. 62–185, page 253.

Applicability of the retailers excise tax on clocks where an advertising company contracts to display for a period of time advertisements of customers on the company's outdoor signboards which contain clocks. See Rev. Rul. 62–192, page 229.

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26 CFR 48.4001–2: Jewelry. Rev. Rul. 62–100

The retailers excise tax on jewelry and related items, imposed by section 4001 of the Internal Revenue Code of 1954, does not apply to a retailer's separate sale of a ring guard, unless it is made of, ornamented, mounted, or fitted with precious metals or imitations thereof. However, when a retailer sells a ring guard on or with a ring, the tax applies to the total selling price of the ring and the ring guard, regardless of the material of which made.

Advice has been requested whether the retailers excise tax on jewelry and related items applies to the sale at retail of a ring guard.

A retailer sells ring guards, which are strips of material which can be clipped to rings to keep them in position. A ring guard may prevent the loss of a ring which otherwise is too loose for the finger. Some ring guards have a spring-type construction which slips on the rings, whereas others have tabs which can be bent to fit the rings. Ring guards are usually made of or plated with gold, silver, brass or some other metal. Many are plated with gold or some other precious metal which is one one-hundred-thousandth of an inch or more in thickness. Occasionally, the retailer sells a ring guard on or with a ring.

Section 4001 of the Internal Revenue Code of 1954 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, 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.

Section 48.4001–4(a) of the regulations provides, in part, 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 precious metals, provided such platings are one one-hundred-thousandth of an inch or more in thickness.

A ring guard, by itself, is not considered to be an article commonly or commercially known as jewelry within the meaning of section 4001 of the Code. Therefore, it is held that the retailers excise tax, imposed by section 4001 of the Code, does not apply to a retailer's separate sales of those ring guards which are made of, or plated with, brass or some other nonprecious metal. However, the tax applies to separate sales by a retailer of those ring guards which are made of, ornamented, mounted, or fitted with precious metals or imitations thereof.

On the other hand, when a retailer sells a ring guard on or with a ring, the tax applies to the total selling price of the ring and ring guard, regardless of the material of which made. Under these circumstances, the ring guard is considered to be a part of the ring.

See Revenue Ruling 58–196, C.B. 1958–1, 366, which sets forth a similar conclusion with respect to the taxability of wrist watch bands when sold separately or when sold on or with wrist watches.

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26 CFR 48.4001–3: Certain real or synthetic stones. Rev. Rul. 62–219

> For purposes of the retailers excise tax on the sale at retail of certain real or synthetic stones, imposed by section 4001 of the Internal Revenue Code of 1954, the term "sapphire" includes all precious corundum, irrespective of color, other than that referred to as "ruby." Accordingly, a stone produced from synthetic corundum the color of alexandrite and having a molecular composition similar to a natural sapphire comes within the scope of the tax imposed by that section.

Advice has been requested whether a stone produced from synthetic corundum the color of alexandrite comes within the scope of the retailers excise tax imposed by section 4001 of the Internal Revenue Code of 1954.

Section 4001 of the Code, insofar as material here, imposes a tax on the sale at retail of certain enumerated stones, by whatever name called, whether real or synthetic. Included in that enumeration of stones is "corundum" of the "ruby" and "sapphire" types.

In accordance with the provisions of section 48.4001–3 of the Manufacturers and Retailers Excise Tax Regulations, the tax imposed by section 4001 applies to the sale at retail of any synthetic stone which has a molecular composition similar to a natural stone which is listed in that section.

Information available to the Internal Revenue Service indicates that corundum is a mineral, the transparent varieties of which are used as gems. The gem varieties of corundum are referred to as "precious corundum," as distinguished from other varieties of corundum, such as "emery" and "common corundum," which are not used as gems. "Ruby" and "sapphire" are the gem varieties of corundum. "Ruby" refers to precious corundum which varies in color from a light to a dark red. "Sapphire," as the term is generally used, refers to precious corundum other than "ruby." However, in a more restricted meaning, the term is sometimes used to refer to corundum of a rich blue color.

Although the synthetic corundum in the instant case has a molecular composition similar to natural sapphire, it is contended that synthetic corundum the color of alexandrite does not come within the scope of the tax because it is neither the red color of "ruby" nor the rich blue color of "sapphire" within the restricted meaning of the latter term.

For purposes of the retailers excise tax, the terms "ruby" and "sapphire" as used in section 4001 of the Code are intended to limit the application of the tax to those varieties of corundum that are used as gems and to exclude from the tax the other varieties of corundum which are not used as gems. Thus, the tax is intended to apply to all gem varieties of corundum, regardless of color, rather than to be limited to corundum of red and blue colors only.

Accordingly, the term "sapphire," as used in section 4001 of the Code, includes all precious corundum other than that referred to as "ruby." Therefore, it is held that a stone produced from synthetic corundum the color of alexandrite and having a molecular composition similar to a natural sapphire comes within the scope of the tax imposed by that section.

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26 CFR 48.4001–4: Articles made of, or ornamented, mounted or fitted with, precious metals or imitations thereof. — Rev. Rul. 62–103

Sterling silver shoe buckles are subject to the retailers excise tax imposed by section 4001 of the Internal Revenue Code of 1954 upon articles made of precious metals. Where they are sold in combination with nontaxable shoes, the tax applies to that portion of the total retail sale price which is allocable to the taxable buckles. This allocation may be made in accordance with the principles set forth in Revenue Ruling 58–551, C.B. 1958–2, 747.

Pursuant to the ruling cited above, the basis for tax is determined by applying to the retail sale price of the combination, the ratio which the separate retail sale prices of the taxable articles bear to the sum of the separate retail sale prices of both the taxable and nontaxable articles when sold separately at retail. However, in case certain taxable and nontaxable articles in a combination are not sold separately at retail and do not have established retail sale prices, the taxable portion may be determined by applying to the retail sale price of the combination, the ratio that the costs of the taxable articles bear to the

total costs of the taxable and nontaxable articles. Where the retailer does not have such cost-ratio information, he may obtain it from the person who assembles the combination.

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26 CFR 48.4001–8: Repairs. Rev. Rul. 62–176

The applicability of the retailers excise tax on jewelry and related items, imposed by section 4001 of the Internal Revenue Code of 1954, to operations involving the repair of a customer's article depends upon whether the repairer furnishes an article which, if sold separately, would be subject to the tax. Furnishing such a taxable article constitutes the sale of that article to the customer, and the tax applies to the price charged for the taxable article. However, the tax does not apply to charges for labor and nontaxable materials used in repairing the customer's article, if billed separately. The retailer's records should establish that any allocation of the total charges between taxable and nontaxable items is reasonable and proper under the circumstances.

Advice has been requested concerning the applicability of the retailers excise tax on jewelry and related items to charges made by a repairer who furnishes materials and articles used in certain repair transactions.

Section 4001 of the Internal Revenue Code of 1954 imposes a tax on the sale at retail of several categories of articles, referred to generally as "jewelry and related items," including to the extent involved here certain categories of articles as follows:

(1) All articles commonly or commercially known as jewelry, whether real or imitation.

(2) Certain enumerated stones, by whatever name called, whether real or synthetic.

(3) Articles made of, or ornamented, mounted or fitted with, precious metals or imitations thereof.

(4) Gold, gold-plated, silver, silver-plated or sterling hollow ware.

Section 48.4001–8(a) of the Manufacturers and Retailers Excise Tax Regulations provides that if an item is repaired and in connection therewith the person making the repair furnishes an article which would be subject to the tax imposed by section 4001 of the Code if sold separately at retail, the tax applies to the charge made for the article so furnished. In such case, the total charge made for the repair shall be deemed to be the price charged for the taxable article used in the repair, unless the portion of the total charge attributable to labor and to the use of any nontaxable materials is billed as a separate item. Examples of articles which are taxable when furnished in connection with the repair of other articles include (1) articles made of, or ornamented, mounted or fitted with, precious metals or imitations thereof, such as a ring mounting or setting, a bracelet link or safety chain, a complete shank of a ring (extending from one side of the head of the ring to the other side), a spring ring or swivel, catch, earring back or screw, and (2) a stone enumerated in section 4001.

Section 48.4001–8(b) of the regulations provides that if an article referred to in section 4001 is repaired and the repair operation consists of labor only, the repair operation is not subject to the tax. Also the tax does not apply to repair operations (1) where the repairer

furnishes only materials such as unfabricated metal, wire, solder, etc., or (2) where the repairer furnishes only a portion of an article made of, or ornamented, mounted or fitted with, a precious metal or imitation thereof, such as a section of a shank of a ring.

The applicability of the tax to repair operations depends, therefore, upon whether in repairing an article belonging to a customer the repairer furnishes an article which, if sold separately, would be subject to the tax. Furnishing such a taxable article under those circumstances constitutes the sale of that article to the customer. If, in connection with the repair of a customer's article, the repairer furnishes one of the stones enumerated in section 4001 of the Code, the tax applies to the price charged for that stone.

In addition to the examples set forth in section 48.4001–8(a) of the regulations, certain "findings" are considered to be taxable articles if made of, or ornamented, mounted or fitted with, precious metals or imitations thereof. Included among such taxable "findings" are gold posts and nuts, backs for brooches, and plates for rings, or galleries (used beneath the stones in most men's rings and in some ladies' rings to prevent the stones from slipping through). However, the tax does not apply to charges for operations such as cleaning, polishing, soldering, resetting and tightening of stones, sizing of rings, etc., which do not involve the furnishing of a taxable article.

For the further guidance of repairers, there are set forth below the tax consequences of various types of retail transactions.

(1) *Heads and crowns.*—If a repairer replaces the full head or crown (or a four-prong or six-prong tiffany head or crown) of a customer's ring, the transaction is deemed to include the sale of the head or crown. If the head or crown is made of a precious metal or an imitation thereof, the tax imposed by section 4001 of the Code applies to the price charged for the head or crown. On the other hand, the mere "building up" of the prongs of a ring, when only solder, sizing wire, or similar materials are used, does not involve the sale of a taxable article.

(2) *Overlays.*—If a repairer makes an overlay for a customer's ring (such as one which has worn thin) by removing a ring from stock and fastening or soldering it around or over the customer's ring, the transaction is considered to include the sale of the ring taken from stock. Therefore, the tax imposed by section 4001 of the Code applies to the price charged for that ring. On the other hand, the mere plating of a customer's ring with a precious metal to make an overlay does not involve the sale of a taxable article.

(3) *Recasting.*—If a retailer produces an article of jewelry in accordance with a customer's specifications and accepts in trade an article belonging to the customer, the tax imposed by section 4001 of the Code applies to the entire price charged for the new article produced and sold to the customer without reduction for the amount credited for the customer's article which was traded in. On the other hand, if the retailer accepts an article from a customer, melts down and refines the metal in that article, and uses that metal exclusively in the production of a new article for that customer, no tax applies to the retailer's charge for his labor.

(4) *Hollow ware.*—If, in connection with the repair of an article of gold, gold-plated, silver, silver-plated or sterling hollow ware, the

repairer furnishes a replacement cover, handle, leg, spout, or other complete article, the transaction is considered to include the sale of the taxable article furnished, and the tax imposed by section 4001 of the Code applies to the price charged for that article. On the other hand, the tax does not apply to a charge for replating or repairing hollow ware if the repairer furnishes gold or silver solder but does not furnish a taxable article.

In accordance with the provisions of section 48.4001–8(a) of the regulations, the total charge for the repair operation shall be deemed to be the price charged for the taxable article furnished, unless itemized to show separately the amount attributable to nontaxable materials and to labor used (1) in the repair of the customer's existing article and (2) for installation of additional articles, as distinguished from labor used to produce or assemble a taxable article prior to its installation. The retailer's records should be sufficient to establish that the allocation of the total charge between taxable and nontaxable items is reasonable and proper under the circumstances.

SUBCHAPTER B.—FURS

SECTION 4011.—IMPOSITION OF TAX

26 CFR 48.4011–1: Imposition of tax.

Whether the retailers excise tax and the cabaret tax are applicable where articles subject to the retailers excise tax are sold in a cabaret in transactions which also establish liability for the cabaret tax. See Rev. Rul. 62–185, page 253.

SUBCHAPTER C.—TOILET PREPARATIONS

SECTION 4021.—IMPOSITION OF TAX

Rev. Rul. 62–151

So-called "artificial fingernails" which are intended to be applied as coverings for fingernails for the purpose of improving the appearance of the nails are "cosmetics" within the purview of section 4021 of the Internal Revenue Code of 1954. Accordingly, sales at retail of such articles are subject to the retailers excise tax imposed by that section of the Code.

Advice has been requested concerning the applicability of the retailers excise tax on toilet preparations to retail sales of the articles described below.

A company sells at retail so-called "artificial fingernails," which are fingernail coverings of the "press-on" type. They are made of a plastic material which has a pressure-sensitive adhesive back. They may be clear or colored. These articles are precut in the shape of fingernails, but they are of sufficient size that they may be trimmed to the size of the natural nails after having been applied by pressure.

The company also sells at retail another type of so-called "artificial fingernails," consisting of a powder substance and a liquid substance. When these substances are mixed and applied to fingernails, the resultant mixture hardens to form a covering for the nails. This mixture is recommended for use to cover cracked or broken nails. Because of the hardening characteristic of this article, it is also recommended for use to reshape or "build on" fingernails for the purpose of enhancing the appearance of the wearer's hands.

Section 4021 of the Internal Revenue Code of 1954 imposes a tax upon the sale at retail of certain enumerated toilet articles, including "cosmetics," and any other similar substance, article, or preparation, by whatsoever name known or distinguished, which are used or applied or intended to be used or applied for toilet purposes.

Section 320.50(a) of Regulations 51, made applicable to the 1954 Code by Treasury Decision 6091, C.B. 1954–2, 47, provides that any article advertised or held out for toilet purposes, or for any purpose for which the articles enumerated in the law are customarily used, will be subject to the tax regardless of the name by which it may be known or distinguished. That section of the regulations also provides that the tax attaches to the sale by the retailer of any preparation which is used or applied or intended to be used or applied for toilet purposes or used in connection with the bath or care of the body, or applied to the clothing as a perfume or to the body as a toilet article.

Revenue Ruling 58–38, C.B. 1958–1, 376, sets forth a list of articles which have been held to be toilet substances, articles, or preparations subject to tax when sold at retail. Nail enamels, nail lacquers, and nail polishes (paste, powder, or liquid) are among the articles listed as taxable in that Revenue Ruling.

The fingernail coverings described above are sold for use in grooming the hands. They are intended for use in improving the appearance of the nails, thereby improving the appearance of the person. Consequently, these products are toilet articles or preparations classifiable as "cosmetics" within the purview of section 4021 of the Code.

Accordingly, it is held that sales at retail of the articles described are subject to the retailers excise tax imposed by that section 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 retailers on and after November 1, 1962.

Whether the retailers excise tax and the cabaret tax are applicable where articles subject to the retailers excise tax are sold in a cabaret in transactions which also establish liability for the cabaret tax. See Rev. Rul. 62–185, page 253.

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26 CFR 48.4021–1: Imposition of tax. Rev. Rul. 62–207

The retailers excise tax imposed on toilet articles and similar substances, imposed by section 4021 of the Internal Revenue Code of 1954, applies to so-called "towelettes," "lotion cleansing tissues," and similar paper products which are saturated with skin cleansing and freshening preparations, and which are folded, sealed in envelopes, and sold for use in cleansing, cooling, soothing, and refreshing the skin.

Advice has been requested concerning the applicability of the retailers excise taxes on toilet preparations to sales at retail of so-called "towelettes," "lotion cleansing tissues," and similar paper products which are saturated with substances such as skin cleansers, fresheners, lotions, antiseptics, or other similar substances.

These products sometimes are referred to as "towels." Each "towel" is approximately the size of a small handkerchief and is folded and sealed in an envelope to keep it fresh and moist until used. These products are recommended for "washing" or cleansing the face and hands without the use of soap or water. Also, they are advertised as having a cooling, soothing, and refreshing effect on the skin.

Section 4021 of the Internal Revenue Code of 1954 provides as follows:

> There is imposed upon the following articles sold at retail a tax equivalent to 10 percent of the price for which so sold—
>
> Perfume.
> Essences.
> Extracts.
> Toilet waters.
> Cosmetics.
> Petroleum jellies.
> Hair oils
> Pomades.
> Hair dressings.
> Hair restoratives.
> Hair dyes.
> Toilet powders.
>
> Any other similar substance, article, or preparation, by whatsoever name known or distinguished; any of the above which are used or applied or intended to be used or applied for toilet purposes.

Section 48.4021–1(a)(1) of the Manufacturers and Retailers Excise Tax Regulations provides that any substance, article, or preparation advertised or held out for toilet purposes shall be subject to the tax regardless of the name by which it may be known or distinguished. That section of the regulations also provides that the tax attaches to the sale by the retailer of any substance, article, or preparation which is used or applied, or intended to be used or applied, for toilet purposes or used in connection with the bath or care of the body, or applied to the clothing as a perfume or to the body as a toilet article. That section further states that factors which shall be taken into account in determining the purpose of a product include the advertising and promotional claims made for the product, its packaging, labeling, and display, and the class or classes of consumers to which the composition of the advertising and promotional material is directed.

Revenue Ruling 58–409, C.B. 1958–2, 751, holds that fabric pads saturated with toilet preparations are toilet articles or similar substances used or intended to be used or applied for toilet purposes within the meaning of section 4021 of the Code. Accordingly, sales at retail of fabric pads saturated with toilet preparations are subject to the retailers excise tax.

Similarly, it is held that the articles described in the instant case are toilet articles or similar substances used or intended to be used or applied for toilet purposes within the meaning of section 4021 of the Code. Therefore, those articles are subject to the tax imposed by that section when sold at retail.

Under the authority contained in section 7805(b) of the Code, the conclusion set forth above will not be applied to sales of such articles before February 1, 1963.

T.D. 6612 [1]

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER D, PART 48.—MANUFACTURERS AND RETAILERS EXCISE TAXES

Regulations under section 4021 of the Internal Revenue Code of 1954, as amended, relating to the tax on the sale of toilet preparations.

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 March 20, 1962, notice of proposed rulemaking with respect to the regulations under section 4021 of the Internal Revenue Code of 1954, as amended (relating to the retailers excise tax on toilet preparations) was published in the Federal Register (27 F.R. 2607). The regulations, except as otherwise provided, are effective January 1, 1959. After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the following regulations are hereby adopted.

§ 48.4021–1 IMPOSITION OF TAX.—(a) *Toilet articles.*—(1) The tax attaches to the sale by the retailer of the following articles specifically enumerated in section 4021—

Perfume	Hair oils
Essences	Pomades
Extracts	Hair dressings
Toilet waters	Hair restoratives
Cosmetics	Hair dyes
Petroleum jellies	Toilet powders

and similar articles commonly or commercially known as toilet articles which are used or applied, or intended to be used or applied, for toilet purposes. Any substance, article, or preparation advertised or held out for toilet purposes shall be subject to the tax regardless of the name by which it may be known or distinguished. The tax attaches to the sale by the retailer of any substance, article, or preparation which is used or applied, or intended to be used or applied, for toilet purposes or used in connection with the bath or care of the body, or applied to the clothing as a perfume or to the body as a toilet article. Factors which shall be taken into account in determining the purpose of a product include the advertising and promotional claims made for the product, its packaging, labeling, and display, and the class or classes of consumers to which the composition of the advertising and promotional material is directed.

(2) A product which is used, or held out for use, as an adjunct to the toilet or for toilet purposes, is subject to the tax even though such product may have, or may be held out to have, a medicinal, stimulating, remedial, or curative value. Thus, for example, lotions, creams, oils, etc., even though having or held out as having medicinal properties, are subject to the tax if used or held out for use for such toilet purposes as:

[1] The publication of this Treasury Decision in 27 F.R. 9983, dated October 11, 1962, contains (1) instructions for modifying the notice of proposed rulemaking published in 27 F.R. 2607, dated March 20, 1962, and (2) the full content of the regulations with such modifications. As here published, the Treasury Decision reflects the full content of such regulations, with modifications. The individual instructions have been omitted.

(i) The treatment of dry, oily, or falling hair;

(ii) A skin cleanser, astringent, make-up base, or other agent for conditioning or improving the appearance of the skin;

(iii) The care of the skin before exposure to the sun, wind, cold, or other weather conditions, such as for the prevention of sunburn or chapped lips, or for the care of the skin before exposure to household irritants, such as dirt, grime, cleaning products, etc.;

(iv) The care of the skin after exposure to weather conditions or to household irritants, unless the product is a medication which meets the requirements of paragraph (b).

(b) *Medication.*—A product shall not be subject to the tax if the product is a medication and if the product is held out for use for:

(1) The relief, remedy, or cure of diseased or injured conditions of the skin, such as those caused by acne, "athlete's foot", dandruff, or burns (including sunburn);

(2) The relief, remedy, or cure of irritated conditions of the lips, such as cold sores, fever blisters, and other irritations of the lips caused by sun, wind, or other elements; or

(3) Other medicinal purposes, such as for use as an antiseptic or for the relief of muscular aches.

(c) *Effective date.*—Paragraphs (a) and (b) of this section shall be effective with respect to sales by the retailer made on or after the first day of the first month which begins more than 60 days after the date of publication of this section in the Federal Register. For regulations applicable to sales prior to such first day of articles subject to tax under section 4021, see Regulations 51 (1941 Edition, as amended), 26 CFR (1939) Part 320, which were made applicable under the Internal Revenue Code of 1954 by Treasury Decision 6091 (19 F.R. 5167, August 17, 1954) [C.B. 1954–2, 47].

(d) *Aromatic cachous.*—The tax on sales at retail of aromatic cachous does not apply to sales after April 30, 1960.

(e) *Rate of tax.*—The tax is imposed at the rate of 10 percent of the price for which the taxable article is sold at retail. For definition of the term "price", see section 4051 and the regulations thereunder contained in Subpart G.

(f) *Liability for tax.*—The tax is payable by the person who sells at retail any article subject to tax under section 4021.

(g) *Sales by United States.*—For provisions relating to sales at retail made by the United States, its agencies or instrumentalities, see section 4054 and the regulations thereunder contained in Subpart G.

(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 October 4, 1962.

STANLEY S. SURREY,
Assistant Secretary of the Treasury.

(Filed by the Division of the Federal Register on October 10, 1962, 8:48 a.m., and published in the issue of the Federal Register for October 11, 1962, 27 F.R. 9983)

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SUBCHAPTER D.—LUGGAGE, HANDBAGS, ETC.

SECTION 4031.—IMPOSITION OF TAX

26 CFR 48.4031–1: Imposition of tax. Rev. Rul. 62–129

Revenue Ruling 59–4, C.B. 1959–1, 295, contains an illustrative list of taxable and nontaxable articles for use by retailers as a guide in determining their liability for the retailers excise tax imposed on the sale of luggage, handbags, etc., by section 4031 of the Internal Revenue Code of 1954, as amended by the Excise Tax Technical Changes Act of 1958, Public Law 85–859, C.B. 1958–3, 92.

As a supplement to Revenue Ruling 59–4, there are listed below other items which the Internal Revenue Service has held to be taxable or nontaxable, as indicated, when sold at retail.

TAXABLE	NONTAXABLE
Boy Scout "bear paw" pack	
	Game Bags (for use while hunting)
	Jewelry cases and receptacles (designed for storing jewelry in the home or for carrying jewelry as personal effects)
	Lunch kits or cases (with or without thermos bottles, designed to carry an individual's lunch)
	Prayer cap cases
	Shoeshine equipment cases
Shoe "socks or mittens"	
Slipper cases	
	Stud or cuff link boxes

Revenue Ruling 59–4 is hereby supplemented.

Rev. Rul. 62–220

A manufacturer of salesmen's sample cases sells the cases to a merchandising company. These cases are articles of a special type, and they are not ordinarily sold to the general public. The company furnishes the cases to its salesmen for use in displaying the company's line of products. In most instances, if a salesman's employment with the company terminates, the sample case is left with the company for reassignment to another salesman. However, in some instances, the salesman is permitted to keep the case, without charge. *Held*, sales of sample cases by the manufacturer to the merchandising company, under the circumstances described above, are sales of articles at retail which are subject to the retailers excise tax imposed by section 4031 of the Internal Revenue Code of 1954.

Whether the retailers excise tax and the cabaret tax are applicable where articles subject to the retailers excise tax are sold in a cabaret under conditions which establish liability for the cabaret tax. See Rev. Rul. 62–185, page 253.

SUBCHAPTER F.—SPECIAL PROVISIONS APPLICABLE TO RETAILERS TAX

SECTION 4052.—LEASE CONSIDERED SALE

(Also Section 4001; 26 CFR 48.4001–1.) Rev. Rul. 62–192

An advertising company displays clients' advertising copy by means of outdoor signs which contain clocks, under certain contracts which are considered to be merely arrangements for an advertising service. Therefore, no liability for the retailers excise tax is incurred on payments received for the service under the provisions of sections 4001 and 4052 of the Internal Revenue Code of 1954, which provide for the imposition of the tax on the lease of clocks.

Advice has been requested whether liability for the retailers excise tax is incurred under the circumstances described below.

A company is engaged in the business of displaying its clients' advertising copy by means of outdoor signs, some of which contain clocks. These signs are located on structures erected on land owned or leased by the company. Under the terms of its contracts with advertisers, the company agrees to place messages or other types of advertising copy upon signs for a specified period of time and to provide the necessary lighting and maintenance of the signs. The company also provides ideas for the messages, etc., and makes suggestions concerning the type of signs to be used. The signs are prepared by and remain the property of the company during the contract period. In no case does a contract give an advertiser access to the signs or the right to use them.

Section 4001 of the Internal Revenue Code of 1954 imposes a tax on the sale at retail of several enumerated articles, including clocks. Section 4052 of the Code provides that, for purposes of the retailers excise taxes, the lease of an article shall be considered the sale of such article.

Under the provisions of section 320.10(a) of Regulations 51, made applicable to the 1954 Code by Treasury Decision 6091, C.B. 1954–2, 47, the term "lease" means a continuous right to the possession or use of a particular article for a period of time. It does not include the use of an article merely as occasion demands, but the contract must give the lessee the right to possess or use the article, without interruption, for a period of time.

Since the contracts here considered do not give the advertisers the right to possession or use of the sign-clock combinations, within the meaning of the regulations, these contracts are not *leases* of the sign-clock combinations.

Accordingly, it is held that no liability for the retailers excise tax is incurred with respect to the payments received under the contracts entered into by the company in the manner set forth above.

The circumstances here are distinguishable from those present in Revenue Ruling 57–570, C.B. 1957–2, 711, which relates to *sales* of advertising signs which contain clocks.

(Also Section 4217.) Rev. Rul. 62-134

Under the provisions of section 4052 of the Internal Revenue Code of 1954, when a retailer leases an article subject to the retailers excise taxes, the tax applies to the total amount paid to the retailer for the lease of the article, irrespective of whether the payments are made under the initial lease or under a renewal of the lease. The provisions of section 4217(b) of the Code, relating to the limitation on the amount of tax to be paid on the lease of an article subject to the manufacturers excise taxes, are not applicable to leases of articles subject to the retailers excise taxes.

Advice has been requested concerning the applicability of the retailers excise taxes imposed by chapter 31 of the Internal Revenue Code of 1954 to the renewal of a lease of an article under the circumstances described below. Specifically, the question is whether liability for these taxes is affected by the provisions of section 4217(b) of the Code which relate to the limitation on the amount of tax to be paid on the lease of an article subject to the manufacturers excise taxes.

A retailer is engaged in the business of selling and leasing clocks. Normally, the clocks are leased for a period of 60 months. In establishing the monthly charge for the lease of a clock, the retailer amortizes the cost of the clock over the life of the lease and takes into account the anticipated costs of maintenance as well as an element of profit. When the lease terminates, the customer may renew it at a smaller monthly charge than under the initial lease.

During the period of the initial lease of each of these clocks, the company reports and pays the retailers excise tax imposed by section 4001 of the Code with respect to the clock. The tax is computed and paid in accordance with the provisions of section 4053(a)(1) of the Code, set forth below.

Section 4052 of the Code provides that, for purposes of the retailers excise taxes, the lease of an article shall be considered the sale of such article.

Section 4053(a)(1) of the Code provides that, in the case of a lease, there shall be paid upon each payment with respect to the article that portion of the total tax which is proportionate to the portion of the total amount to be paid represented by such payment.

The effect of section 4217(b) of the Code is to limit, under certain circumstances, the amount of tax to be paid on the lease of an article, subject to the manufacturers excise taxes, to the amount of tax that would be due if the manufacturer had sold the article instead of leasing it. This limitation on liability for tax provided by section 4217(b) of the Code relates only to the lease of articles subject to the manufacturers excise taxes and does not apply to leases of articles subject to the retailers excise taxes. Moreover, there is no provision in the law for a similar limitation on the amount of tax to be paid on leases of articles subject to the retailers excise taxes.

Therefore, it is held that, in accordance with the provisions of sections 4001 and 4052 of the Code, when the retailer in the instant case leases a clock, the retailers excise tax applies to the total amount paid to the retailer for the lease of the clock, irrespective of whether the payments are made under the initial lease or under a renewal of the lease.

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. Rev. Rul. 62–98

A "two and one-half ton, six-by-six" chassis and the chassis and body of a "quarter ton, four-by-four" truck, which are manufactured according to military specifications, are considered to be designed for use both on and off the highway. Therefore, the chassis and the trucks are taxable motor vehicle articles for purposes of the manufacturers excise tax imposed by section 4061(a)(1) of the Internal Revenue Code of 1954.

Advice has been requested whether the articles described below are taxable motor vehicle articles for purposes of the manufacturers excise tax imposed by section 4061(a)(1) of the Internal Revenue Code of 1954.

Situation (1). A company manufactures and sells certain "two and one-half ton, six-by-six" automobile truck chassis which are constructed according to military specifications for general use in transporting personnel or cargo or in performing special transportation tasks for the Armed Forces. These chassis are designed to accommodate various types of bodies, including personnel, cargo, cargo van, dump, shop, medical van, gasoline tank, and water tank bodies. They also are adaptable for use as wreckers or as truck-tractors.

When specified by the purchasing agency, the manufacturer will furnish and install modification kits which allow the chassis to be used under extreme or unusual conditions of climate, weather, and terrain, and to perform special military services without interfering with the use, operation, and performance of the chassis under normal operating conditions.

The front-axle drive mechanisms on these chassis are designed to provide for automatic engagement in the event the rear axles lose traction. The chassis are capable of traveling at maximum speeds of from 55 to 65 miles per hour, and they are equipped with necessary head lamps, stop lamps, and tail lamps to permit general use on the highway.

Situation (2). Another company manufactures and sells a "quarter-ton, four-by-four" lightweight automobile truck which also is constructed according to military specifications. These specifications generally require that the vehicle be durable enough to withstand rugged cross-country use but that it be light enough to be used in the air-borne phases of amphibious operations. These specifications require that the vehicle be an all-wheel drive vehicle capable of transporting its rated cross-country payload, which consists of military supplies, equipment, or personnel, at relatively high rates of speed over all types of roads and hilly cross-country terrain. The trucks must be able to ford hard-bottom water crossings with the engine completely submerged. They must be able to transport the rated highway payload, while towing the applicable trailed load, over

prepared roads. The trucks are equipped with the necessary head lamps, etc., to permit general use on the highway.

Section 4061(a)(1) of the Code imposes a tax upon the sale by the manufacturer, producer, or importer of certain enumerated articles, including chassis and bodies for automobile trucks. A sale of an automobile truck shall, for purposes of this paragraph, be considered to be a sale of the chassis and of the body.

Section 40.4061(a)-(1)(d) of the Manufacturers and Retailers Excise Tax Regulations provides, in part, that a chassis or body which is not designed for highway use is not subject to the tax imposed by section 4061(a) of the Code.

Revenue Ruling 57-440, C.B. 1957-2, 721, holds, in part, that the manufacturers excise tax imposed by section 4061(a)(1) of the Code shall not apply to sales by the manufacturer, producer, or importer of any motor vehicle article, regardless of width, which is designed or adapted by the manufacturer for purposes predominantly other than the transportation of persons or property on the highway even though incidental highway use may occur.

Although the articles described in situations (1) and (2) above are intended for use over rough terrain and for military use off the highway, they have features which render them equally suitable for highway use. For example, they are designed to transport personnel and cargo over the highways; they are capable of attaining relatively high speeds; and they are designed with the head lamps, etc., required for use on the highways. Therefore, these articles are considered to be designed for use both on and off the highway, rather than for purposes predominantly other than highway use.

Accordingly, it is held that, for purposes of the manufacturers excise tax imposed by section 4061(a)(1) of the Code, the chassis described in *situation* (1) and the truck chassis and body described in *situation* (2) are taxable motor vehicle articles.

For purposes of the manufacturers excise tax on motor vehicle articles, whether automobile buses may be considered as sold "for the exclusive use of" a State or local government when sold to a county school district for use in transporting school children, and the school district immediately resells the buses to the bus operators. See Rev. Rul. 62-99, page 252.

Rev. Rul. 62-108

The manufacturers excise tax on motor vehicle articles, imposed by section 4061(a)(1) of the Internal Revenue Code of 1954, applies to the sale by the manufacturer of automobile truck chassis, designed mainly for cement mixer and dumper services, which have features indicating that the chassis are designed for general use both on and off the highway rather than for purposes predominantly other than for highway use.

Advice has been requested whether the manufacturers excise tax on motor vehicle articles applies to the sale by the manufacturer of the automobile truck chassis described below.

A company manufactures and sells automobile truck chassis which are designed mainly for cement mixer and dumper services, although they are used, to some extent, in other construction operations. The

chassis have reinforced frames, gross vehicle weight ratings of from 40,000 to 50,000 pounds, front axle capacities of from 8,000 to 15,000 pounds, and rear axle capacities of from 34,000 to 38,000 pounds. They are equipped with six-wheel drives for difficult traction conditions at delivery locations.

The front drive on each chassis can be disengaged when the chassis is in use on hard surface roads, and the gear ratios are such as to permit speeds up to 50 miles per hour. Standard equipment on each chassis includes combination stop and tail lights, three marker lights, and turn signals. The cab of each chassis is equipped with lights on all corners of the cab roof.

Section 4061(a)(1) of the Internal Revenue Code of 1954 imposes a tax upon the sale by the manufacturer, producer, or importer of certain enumerated articles, including chassis for automobile trucks.

Section 40.4061(a)–(1)(d) of the Manufacturers and Retailers Excise Tax Regulations provides, in part, that a chassis or body which is not designed for highway use is not subject to the tax imposed by section 4061(a) of the Code.

Revenue Ruling 57–440, C.B. 1957–2, 721, holds, in part, that the manufacturers excise tax imposed by section 4061(a)(1) of the Code shall not apply to sales by the manufacturer, producer, or importer of any motor vehicle article, regardless of width, which is designed or adapted by the manufacturer for purposes predominantly other than the transportation of persons or property on the highway even though incidental highway use may occur.

In the instant case, the automobile truck chassis have certain features (such as reinforced frames, six-wheel drives, and high-capacity axles) which indicate that the chassis are designed and suitable for use off the highway. However, the chassis also have features (such as front drives that can be disengaged, gross weight ratings, and certain lights which are required for highway travel) which indicate that the chassis are also designed and suitable for more than incidental use on the highway. Therefore, these chassis are considered to be designed for general use both on and off the highway, rather than for purposes predominantly other than for highway use.

Accordingly, it is held that the manufacturers excise tax imposed by section 4061(a)(1) of the Code applies to the sale by the manufacturer of the automobile truck chassis described above.

Rev. Rul. 62–118

So-called "mountings" or "undercarriages" are designed, constructed, and sold for use in transporting various items of equipment, such as air compressors, arc welders, and pumps. Some of these "mountings" or "undercarriages" have four wheels and others have two wheels, with tongue assemblies or hitches for towing. Each is intended to provide mobility for the item of equipment which is to be bolted or otherwise attached to an identifiable chassis frame which is an integral part of the "mounting" or "undercarriage." *Held*, these articles are truck trailer or semitrailer chassis within the meaning of section 4061(a)(1) of the Internal Revenue Code of 1954 and are subject to the manufacturers excise tax imposed by that section. On the other hand, a two-wheel "mounting" or "undercarriage" which does not have an identifiable chassis frame is considered to be an assembly of chassis parts rather than a truck trailer or semitrailer chassis.

Advice has been requested whether the manufacturers excise tax on motor vehicle articles applies to sales by the manufacturer of the so-called "mountings" or "undercarriages" described below.

A company manufactures and sells several models of two-wheel and four-wheel mountings or undercarriages (hereinafter referred to as undercarriages) which are designed, constructed, and sold for use in transporting various items of equipment, such as air compressors, arc welders, and pumps. Each undercarriage is intended to provide mobility for the item of equipment which is to be bolted or otherwise attached to an identifiable chassis frame which is an integral part of the undercarriage.

Each of the two-wheel models is constructed with either leaf springs or rubber torsion springs on the axle and is equipped with either a clevis type or a lunette type hitch. Each of the four-wheel models is constructed with leaf springs on the front and rear axles and is equipped with either a clevis type or a lunette type hitch. The undercarriages are equipped with pneumatic implement tires.

Occasionally, the company manufactures and sells a two-wheel model which does not have an identifiable chassis frame but which consists of a spring and axle assembly with wheels and a separate tongue assembly. These two assemblies are constructed so that they may be bolted directly to the base of the machinery for which they are to serve as an undercarriage.

Section 4061(a)(1) of the Internal Revenue Code of 1954 imposes a tax upon the sale by the manufacturer, producer, or importer of certain enumerated motor vehicle articles, including truck trailer and semitrailer chassis.

The two-wheel undercarriage described above which does not have an identifiable chassis frame is considered to be an assembly of chassis parts under the provisions of section 4061(b) of the Code, rather than a truck trailer or semitrailer chassis under the provisions of section 4061(a) of the Code.

On the other hand, both the four-wheel and two-wheel undercarriages described above which have identifiable chassis frames are considered to be truck trailer or semitrailer chassis within the meaning of section 4061(a)(1) of the Code. Moreover, such undercarriages are considered to be primarily designed and constructed to transport property over the highway.

Therefore, it is held that the manufacturers excise tax on motor vehicle articles imposed by section 4061(a)(1) of the Code applies to the manufacturer's sales of those undercarriages which have identifiable chassis frames.

Under the authority contained in section 7805(b) of the Code, the conclusion in the preceding paragraph of this Revenue Ruling will be applied only to sales made on and after September 1, 1962.

Rev. Rul. 62–158

Certain three-wheel electrically-powered motor vehicles which are designed for the transportation of persons on streets and highways are automobiles within the meaning of section 4061(a)(2) of the Internal Revenue Code of 1954. Therefore, sales of these vehicles by the manufacturer thereof are subject to the tax imposed by that section.

Advice has been requested whether the manufacturers excise tax on motor vehicle articles applies to sales by the manufacturer of the three-wheel electrically-powered motor vehicles described below.

A company manufactures and sells three-wheel electrically-powered motor vehicles which are designed for use on streets and highways for shopping, local visiting, and relatively short pleasure trips. These vehicles, which are powered by three or four heavy duty six-volt storage batteries, are about 80 inches long and 38 inches wide, and they weigh about 425 pounds each without the batteries. Each vehicle has one front wheel and two rear wheels and is driven by means of a direct chain drive.

Included as standard equipment on each of these vehicles are dual headlights and taillights, an electric horn, a rearview mirror, and two-wheel automotive-type internal expanding brakes. They are also equipped with either hand controls or foot controls. Wrap-around windshields and custom-type tops are available as optional accessories.

These vehicles, which are designed to accommodate two persons each, have three forward and three reverse speeds, the maximum speed being approximately 16 miles per hour. Normally, they may be driven more than 30 miles before the batteries need recharging. The recharging of the batteries is accomplished by plugging into standard house current.

Although these vehicles are widely used on streets and highways they are not recommended for use on high-speed "freeways"; in fact, their use on such freeways is prohibited in some areas.

Section 4061(a)(2) of the Internal Revenue Code of 1954 imposes a tax upon sales by the manufacturer, producer, or importer of automobile chassis and bodies other than those taxable under section 4061(a)(1) of the Code. A sale of an automobile, for purposes of this paragraph of the Code, is considered to be a sale of the chassis and of the body.

The fact that a vehicle has less than four wheels does not, of itself, place the vehicle outside the scope of the articles taxable under section 4061(a)(2) of the Code. Moreover, in determining taxability it is immaterial that a vehicle is propelled by a self-contained electric power source rather than by an internal combustion engine.

The three-wheel electrically-powered motor vehicles described above, which are designed for the transportation of persons on streets and highways, are considered to be "automobiles" within the meaning of section 4061(a)(2) of the Code. Therefore, it is held that the manufacturers excise tax imposed by that section applies to sales of these vehicles by the manufacturer thereof.

See Revenue Ruling 60–212, C.B. 1960–1, 413, which holds that a certain four-wheel electrically-operated motor vehicle is an automobile within the meaning of section 4061(a)(2) of the Code.

Rev. Rul. 62–218

A "housing" which is designed to be mounted on a truck chassis to enclose a so-called "mobile furnace vacuum cleaner" apparatus is considered to be an automobile truck body within the meaning of section 4061(a)(1) of the Internal Revenue Code of 1954. Therefore, the manufacturer's sale of such a housing is subject to the manufacturers excise tax imposed by that section. However, the

canvas filter bags, blower, blower motor, fittings, and hoses which are parts of the apparatus are not considered to be parts or accessories for the body. Therefore, sales of those articles are not subject to the manufacturers excise tax, irrespective of whether they are sold separately or on or in connection with the taxable body.

Advice has been requested concerning the applicability of the manufacturers excise tax on motor vehicle articles to sales by the manufacturer of the articles described below.

A company manufactures and sells a so-called "mobile furnace vacuum cleaner" which is used for cleaning furnaces and related ducts, pipes, register boxes, and chimneys in homes and commercial establishments. This vacuum cleaning system is built on a base made of channel iron spaced to fit on the chassis of an automobile truck. A dust box, in which the soot, dirt, dust, and residue from the various heating systems is deposited, is built over the channel iron base. A hinged "cleanout" door is built into the rear of the dust box for the removal of the refuse.

A series of canvas filter bags, a blower, and a blower motor are mounted on top of the dust box. A length of hose is attached to the blower for connecting to the heating system located on the premises being serviced. A "housing" with a canopy type door is constructed around the entire apparatus described above to afford protection from the elements and to provide storage space for tools, fittings, hoses, and nozzles.

Section 4061(a) of the Internal Revenue Code of 1954 imposes a tax upon certain enumerated articles (including in each case parts and accessories therefor sold on or in connection therewith or with the sale thereof) sold by the manufacturer, producer, or importer. Section 4061(a)(1) of the Code enumerates, among other taxable articles, automobile truck bodies.

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 motor vehicle articles enumerated in section 4061(a) of the Code.

The housing, including the channel iron base and the dust box, is considered to be an automobile truck body within the meaning of section 4061(a)(1) of the Code. Therefore, it is held that sales of such body by the manufacturer thereof are subject to the manufacturers excise tax imposed by that section.

On the other hand, the canvas filter bags, blower, blower motor, fittings, and hoses which are parts of the furnace vacuum cleaner do not constitute parts or accessories for the taxable body. Accordingly, the manufacturer's sales of such articles, whether sold separately or on or in connection with the taxable body, are not subject to the manufacturers excise taxes imposed by section 4061 of the Code.

Whether, under certain circumstances, a company's actual cost of manufacturing a particular type of automobile truck body during the preceding year may be used as the "cost" of a body of that type for purposes of determining the constructive sale price of such bodies sold during the current year. See Rev. Rul. 62–221, page 251.

26 CFR 40.4061(b)–1: Imposition of tax.

Whether, for purposes of determining a constructive sale price for specially designed automobile trucks, the manufacturer's "cost" of the trucks should include only the tax-excluded, rather than the tax-included, purchase price of parts or accessories, tires, inner tubes, and automobile radio receiving sets. See Rev. Rul. 62–173, page 249.

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26 CFR 40.4061(b)–2: Definition of parts or accessories. Rev. Rul. 62–209

A company manufactures and sells so-called "battery booster cables," which are designed for use in transferring electrical energy from a "live" storage battery to a battery which has become weak or discharged. These cables, which are sold in pairs, are produced in various lengths. Each cable consists of an insulated flexible electrical conductor (the most common being four-gauge or six-gauge stranded copper or aluminum) at each end of which is a spring-loaded, pliers-type clamp made of copper, brass, or copper-coated steel.

Particularly since the advent of automatic transmissions in automobiles, these battery booster cables have been sold in increasing numbers to motorists to be carried in automobiles for use in starting the motor of a vehicle with a weak or discharged battery. When so used, the cable clamps are attached to the terminals of the "live" battery in an assisting vehicle and to the terminals of the battery in a stalled vehicle. The predominant use of these cables is in connection with automobiles, and the manufacturer's methods of packaging, advertising, and selling the cables are primarily directed to this use. However, the manufacturer also advertises the cables as being suitable for use in starting other articles such as marine engines and outboard motors.

Held, the battery booster cables described above are automobile "parts or accessories" within the meaning of section 4061(b) of the Internal Revenue Code of 1954, since they are designed to be used in connection with the motor vehicle articles taxable under section 4061 (a) of the Code. Moreover, the primary use of the cables is in connection with such articles. Therefore, the tax imposed by section 4061(b) of the Code applies to these battery booster cables when sold by the manufacturer.

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 February 1, 1963.

Rev. Rul. 62–215 [1]

Different types of so-called "cushions," which are primarily used in connection with taxable automobiles, trucks, etc., are subject to the manufacturers excise tax on automobile "parts or accessories" under the provisions of section 4061(b) of the Internal Revenue Code of 1954 and section 40.4061(b)–2(a) of the Manu-

[1] As originally published in Internal Revenue Bulletin 1962–53, 29, dated December 31, 1962, the effective date of this Revenue Ruling was expressed as February 1, 1963; however, that date was extended to August 1, 1963, by Technical Information Release 449 dated January 29, 1963, which was published as a Special Announcement in Bulletin 1963–8, 9, dated February 25, 1963.

facturers and Retailers Excise Tax Regulations. However, the tax does not apply to other types of cushions which are neither designed to be used in connection with taxable vehicles nor primarily used in connection with such vehicles.

Advice has been requested concerning the applicability of the manufacturers excise tax on automobile "parts or accessories" to the several types of articles described below, which are referred to generally as "cushions."

Type (1): These articles are referred to as "farm tractor seat" cushions. They are designed to fit the contours of the seats of farm tractors, which are nontaxable, and they have tie cords by which they can be tied in position on the seats of tractors. They are made of heavy water-repellant duck material filled with shredded foam rubber.

Type (2): These articles are referred to as "general purpose" cushions. They are made in a variety of sizes and shapes, usually round, square, or rectangular. These cushions are stuffed with various materials and are covered with plastic, vinyl-leather, fibre, or similar material. They are advertised as all purpose or utility cushions for use in the home, in an automobile, at the office, at the stadium, etc.

Type (3): These articles are referred to as "ventilated," "air-cooled," or "summer" seat cushions. They are flat, relatively thin, and may be provided with carrying loops or handles. These cushions consist primarily of an inner core of interlocking spiral steel springs covered by fibre-mesh material. This construction permits the circulation of air between the user of the cushion and the surface on which the cushion is placed.

Type (4): These "ventilated," "air-cooled," or "summer" seat cushions are identical in construction to the *type* (3) articles described above except that each cushion consists of two connecting sections, one for the seat and one for the back of the article with which it is used. These cushions are produced in so-called "double" and "single" sizes.

The double cushions are designed for full coverage of the seats of automobiles, trucks, etc. When intended for use in the front seats of two-door automobiles, the back sections are "split" to permit either portion to tilt forward without interfering with the other. The single cushions are used extensively in automotive vehicles, either by the drivers or by the passengers.

Because of the widespread public acceptance of these articles for use in automotive vehicles within recent years, they are sold primarily through automobile accessory outlets. They are packaged, advertised, and marketed in such a manner as to indicate that their primary use is with automotive vehicles, although they also are suitable for other uses.

Type (5): These articles are referred to as "wedge-type" cushions because their thickness is tapered in the shape of an elongated triangle. These cushions, which are not "ventilated," are stuffed with various types of material and are often covered with automobile seat cover material. They are recommended for use to ease back strain on long trips. In addition to their use as back rests, they also may be used as seat cushions. Because of their tapered thickness, they change the angle of incline of the seat. Most sales of these "wedge-type" cushions are through automobile seat-cover and other automobile accessory outlets. Furthermore, they are packaged, advertised, and marketed in

such a manner as to indicate that their primary use is with automotive vehicles, although they also are suitable for other uses.

Type (6): These articles are referred to as "head rest" cushions. They are rectangular cushions which have a concave surface on one or more sides to fit a person's head. These cushions are filled with various types of material, are covered with fabric, and are fitted with brackets by which they may be fastened to the backs of automobile seats. These cushions are packaged, advertised, and marketed in such a manner as to indicate that their primary use is with automotive vehicles, although they also are suitable for other uses.

Section 4061(b) of the Internal Revenue Code of 1954 imposes a tax on sales 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 motor vehicle articles enumerated in section 4061(a) of the Code.

Section 40.4061(b)–2(a) of the Manufacturers and Retailers Excise Tax Regulations provides that, in general, the term "parts or accessories" includes (1) any article, the primary use of which is to improve, repair, replace, or serve as a component part of an automobile truck or bus chassis or body, or other automobile chassis or body, or taxable tractor, (2) any article designed to be attached to or used in connection with such chassis, body, or tractor to add to its utility or ornamentation, and (3) any article, the primary use of which is in connection with such chassis, body, or tractor, whether or not essential to its operation or use.

It should be noted that, under the provisions of the regulations, the tax applies to any article which is designed to be used in connection with a taxable vehicle to add to its utility or ornamentation. Furthermore, the tax also applies to any article the primary use of which is in connection with a taxable vehicle, irrespective of the purpose for which it may have been originally designed. Therefore, the tax applies to any article which is primarily used in connection with a taxable vehicle for the convenience or comfort of either the driver or the passengers. The primary use of an article in connection with taxable vehicles may be indicated by the nature of the manufacturer's advertising, the channels of distribution, and the general customer acceptance of the article.

The stated facts regarding the articles identified above as *type* (1), *type* (2), and *type* (3) do not indicate that they are either designed to be used in connection with taxable vehicles or primarily used in connection with such vehicles within the meaning of the regulations. Accordingly, it is held that they are not subject to the manufacturers excise tax on automobile "parts or accessories."

On the other hand, the stated facts indicate that the articles identified above as *type* (4), *type* (5), and *type* (6) are primarily used in connection with taxable vehicles. Therefore, it is further held that those articles are subject to the manufacturers excise tax on automobile "parts or accessories" under the provisions of section 4061(b) of the Code and section 40.4061(b)–2(a) of the regulations.

Under the authority granted by section 7805(b) of the Code, the conclusion of the above paragraph will not be applied to articles sold by manufacturers, producers or importers, prior to August 1, 1963.

26 CFR 40.4061(b)–3: Rebuilt, reconditioned, or repaired parts or accessories. Rev. Rul. 62–142

A company restores unserviceable tubular type automobile shock absorbers to serviceable condition for the purpose of sale by drilling and tapping a hole in each shock absorber and installing a filler plug to allow the addition of fluid. *Held*, these operations constitute "rebuilding" (manufacturing) within the meaning of section 40.4061(b)–3 of the Manufacturers and Retailers Excise Tax Regulations. Therefore, sales of such rebuilt shock absorbers by the company are subject to the manufacturers excise tax on automobile parts or accessories imposed by section 4061(b) of the Internal Revenue Code of 1954.

For purposes of determining the applicability of the manufacturers excise tax on automobile parts or accessories, advice has been requested whether the restoration of automobile shock absorbers in the manner and for the purpose described below is considered to be "rebuilding" (which constitutes "manufacturing") as distinguished from "reconditioning."

A company is engaged in the business of restoring and selling automobile shock absorbers of the tubular type. The company obtains unserviceable shock absorbers (either by outright purchase or in exchange transactions) and restores them to serviceable condition in the manner described below for sale (either outright or on an exchange basis).

The major operations in the company's restoration of the unserviceable shock absorbers to serviceable condition involve drilling and tapping a hole in each article and installing a filler plug to allow the addition of fluid. This process changes the article from an unserviceable shock absorber of the nonrefillable type to a serviceable shock absorber of the refillable type. Upon completion of the restoration process, the shock absorbers are placed in stock for sale.

Section 4061(b) of the Internal Revenue Code of 1954 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 motor vehicle articles enumerated in section 4061(a) of the Code.

Section 40.4061(b)–3(a) of the Manufacturers and Retailers Excise Tax Regulations provides that rebuilding of automobile parts or accessories, as distinguished from reconditioning or repairing, constitutes manufacturing, and the rebuilder of such parts or accessories is liable for the tax imposed by section 4061(b) with respect to his sales of such rebuilt parts or accessories. Reboring or other machining, rewinding and comparable major operations constitute rebuilding.

The operations which are performed by the instant company in restoring unserviceable shock absorbers to serviceable condition for sale constitute "rebuilding" (manufacturing) within the meaning of section 40.4061(b)–3(a) of the regulations. Therefore, it is held that the manufacturers excise tax on automobile parts or accessories, imposed by section 4061(b) of the Code, applies to the company's sales of the rebuilt shock absorbers.

When the rebuilt shock absorbers are sold on an exchange basis, the sale price upon which the tax is to be computed does not include the value of the like articles accepted in exchange, under the provisions of section 4062(b) of the Code and section 40.4062(b)–1 of the regulations.

Rev. Rul. 62–162

A company restores unserviceable automobile bumpers to serviceable condition for the purpose of sale by reshaping, grinding, stripping off the old chrome, polishing, electroplating with a copper base, and replating with new chrome. Held, this operation constitutes "rebuilding" (manufacturing) within the meaning of section 40.4061(b)–3 of the Manufacturers and Retailers Excise Tax Regulations. Therefore, sales of the rebuilt bumpers by the company are subject to the manufacturers excise tax on parts or accessories imposed by section 4061(b) of the Internal Revenue Code of 1954.

For purposes of determining the applicability of the manufacturers excise tax on automobile parts or accessories, advice has been requested whether the restoration of automobile bumpers in the manner and for the purpose described below is considered to be "rebuilding" (which constitutes "manufacturing") as distinguished from "reconditioning."

A company is engaged in the business of restoring and selling automobile bumpers. The company obtains unserviceable bumpers (either by outright purchase or in exchange transactions) from automobile collision shops, garages, and other sources. These bumpers have been bent or otherwise damaged in collisions, etc. The company restores them to serviceable condition in the manner described below for the purpose of sale (either outright or on an exchange basis).

The first step performed by the company in restoring an unserviceable bumper is to straighten and reshape it. After removing all defects, the bumper is ground. The old chrome deposits are stripped off in temperature controlled chemical tanks and the bumper is polished to remove all imperfections. The bumper is electroplated first with a copper base, then with nickel and, finally, with chromium. This restored bumper is then wrapped in protective paper and placed in stock for sale as a replacement part.

The situation in the instant case should be distinguished from a situation in which the company might similarly restore a bumper belonging to the owner of an automobile for his personal use. The latter situation, which is referred to as "repairing," does not involve the manufacturers excise tax simply because there is no sale of the restored bumper.

Section 4061(b) of the Internal Revenue Code of 1954 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 40.4061(b)–3(a) of the Manufacturers and Retailers Excise Tax Regulations provides that rebuilding of automobile parts or accessories, as distinguished from reconditioning or repairing, constitutes manufacturing, and the rebuilder of such parts or accessories is liable for the tax imposed by section 4061(b) with respect to his sales of such rebuilt parts or accessories. Reboring or other machining, rewinding and comparable major operations constitute rebuilding. The person owning the part or accessory being rebuilt is the manufacturer of the article and is liable for the tax on his sale of the rebuilt part or accessory. The tax attaches whether the machining or other operation is performed by the rebuilder himself or by some other person on his behalf.

Section 40.4061(b)-3(b) of the regulations provides that the mere disassembling, cleaning, and reassembling (with any necessary replacements of worn parts) of automobile parts or accessories are regarded as reconditioning operations rather than the manufacturing or production of rebuilt parts or accessories.

It is held that the restoration of bumpers for sale by the process described above constitutes "rebuilding" (manufacturing) within the meaning of section 40.4061(b)-3(a) of the regulations. Accordingly, the manufacturers excise tax on automobile parts or accessories, imposed by section 4061(b) of the Code, applies to the company's sales of the rebuilt bumpers.

This Revenue Ruling will not be applied to sales made prior to November 1, 1962, under the authority set forth in section 7805(b) of the Code.

PART III.—PETROLEUM PRODUCTS

Subpart A.—Gasoline

SECTION 4082.—DEFINITIONS

26 CFR 48.4082-1: Definitions. Rev. Rul. 62-109

For purposes of determining the applicability of the manufacturers excise tax on gasoline, section 48.4082-1(b) of the Manufacturers and Retailers Excise Tax Regulations provides that the term "gasoline" includes all products commonly or commercially known as gasoline but that term does not include certain other petroleum products having "an A.S.T.M. octane number of less than 70." A similar provision was contained in section 314.30 of the previously applicable Regulations 44. Two methods (the "motor" method and the "research" method) are in common use for determining the octane number of petroleum products. However, the "motor" method was used in establishing the regulations provisions. Accordingly, the "motor" method should be used in determining whether products have "an A.S.T.M. octane number of less than 70," for purposes of the definition set forth in section 48.4082-1(b) of the regulations.

SUBCHAPTER B.—HOUSEHOLD TYPE EQUIPMENT, ETC.

PART II.—ELECTRIC, GAS, AND OIL APPLIANCES

SECTION 4121.—IMPOSITION OF TAX

26 CFR 48.4121-2: Definitions. Rev. Rul. 62-168

For purposes of the manufacturers excise tax on gas water heaters of the household type, imposed by section 4121 of the Internal Revenue Code of 1954, gas water heaters having *either* (1) a storage tank capacity of 60 gallons or less *or* (2) an American Gas Association approved natural gas input rating of 75,000 B.T.U. per

hour or less are considered to be "of the household type," unless by reason of their design and construction they are primarily adapted for other than household use.

Revenue Ruling 55–645, C.B. 1955–2, 455, superseded.

In view of the current situation in the gas water heater industry, the Internal Revenue Service has reconsidered its administrative test for determining which gas water heaters should be considered to be "of the household type" for purposes of the manufacturers excise tax.

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 gas water heaters.

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.

Effective November 1, 1951, the manufacturers excise tax on gas water heaters, among other articles, was limited to those "of the household type." In the years following the enactment of that limitation, it was found that those gas water heaters having a gas input rating of 50,000 or more British thermal units per hour were of the non-household type, whereas those having a gas input rating of less than 50,000 B.T.U. per hour generally were of the household type. Therefore, in an attempt to provide a convenient and uniform guide for determining which articles were subject to the tax, the Service adopted the administrative test of taxability set forth in Revenue Ruling 55–645, C.B. 1955–2, 455, which provides that a gas water heater having a gas input rating of less than 50,000 B.T.U. per hour is a heater of the household type, unless the heater by reason of design and construction is primarily adapted for purposes other than household use.

In recent years, however, there has been a considerable increase in the household consumption of hot water. Because of the increased need in the average home for more hot water in faster time than heretofore, there is a definite trend in the industry to manufacture and sell *specifically for household use* gas water heaters with a gas input rating of more than 50,000 B.T.U. per hour. In view of this change in the industry, the 50,000 B.T.U. test is no longer appropriate in determining whether a particular gas water heater is an "article of the household type" within the meaning of the Code and the regulations.

It has been found that the two primary factors which ordinarily distinguish gas water heaters of the household type from those not of the household type are (1) the water storage capacity and (2) the B.T.U. gas input rating. In order to promote uniformity in the application of the tax, it is deemed advisable, in establishing an administrative test of taxability, to base the distinction upon these two factors.

Accordingly, in view of the current situation in the industry, gas water heaters having *either* (1) a storage tank capacity of 60 gallons or less *or* (2) an American Gas Association approved natural gas input rating of 75,000 B.T.U. per hour or less are considered to be "of the household type," *unless* by reason of their design and construc-

tion they are primarily adapted for other than household use. This test has equal application to water heaters using natural, manufactured, or liquified petroleum gas.

Under the authority contained in section 7805(b) of the Code, the test established by this Revenue Ruling will be applied only to sales made by manufacturers, producers, or importers on and after December 1, 1962.

Revenue Ruling 55–645 is hereby superseded.

SUBCHAPTER C.—ENTERTAINMENT EQUIPMENT

PART I.—RADIO AND TELEVISION SETS, PHONOGRAPHS AND RECORDS, ETC.

SECTION 4141.—IMPOSITION OF TAX

26 CFR 48.4141–1: Imposition and rate of tax. Rev. Rul. 62–170

A company manufactures a device known as a "stereophonic fidelity phonograph" which is equipped for stereophonic sound reproduction except that it does not contain a built-in speaker. This device is designed to operate two separately housed speakers located at the desired distance apart and connected to a dual channel amplifier in the device to obtain the stereophonic effect in sound reproduction. The company also manufactures the separately housed speakers. Sometimes, these "stereophonic fidelity phonographs" are sold without the speakers; in other cases, they are sold with the speakers. *Held*, the above-described stereophonic device is a phonograph within the meaning of section 4141 of the Internal Revenue Code of 1954 whether it is sold with or without the speakers. Therefore, the manufacturers excise tax imposed on phonographs applies to sales of these devices either with or without speakers.

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. 62–184

> A so-called "golf cart," which contains, as an integral part, a permanently attached golf bag 26 inches or more in length, is considered to be a combination of a taxable golf bag and a nontaxable golf cart for purposes of the manufacturers excise tax imposed by section 4161 of the Internal Revenue Code of 1954. Accordingly, when the combination is sold by the manufacturer, the tax applies to that portion of the price for which the combination is sold which is properly allocable to the bag portion of the combination.

Advice has been requested concerning the applicability of the manufacturers excise tax on sporting goods to sales by manufacturers of the articles described below.

Several companies manufacture and sell so-called "golf carts," which contain permanently attached golf bags as integral parts of the carts. The bags vary in length from 28 inches to 32 inches and are usually equipped with tubular pockets for holding up to 14 golf clubs. The bags are made of various materials, such as vinyl leatherette or a durable canvas-like material.

Some of the bags have pockets for golf balls, tees, etc. All of these carts have wheels and handles. Most models may be folded for easy carrying and storage. As an additional feature, some models also contain folding seats permanently attached to the carts.

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 (including in each case parts or accessories of such articles sold on or in connection therewith, or with the sale thereof). Included among the articles enumerated are "golf bags (measuring 26 inches or more in length)." No tax is imposed on sales of "golf carts."

A manufacturer's sale of a golf cart containing a permanently attached golf bag of more than 26 inches in length is considered to be a combination sale of a taxable golf bag and a nontaxable golf cart. Accordingly, it is held that the tax imposed by section 4161 of the Code applies to that portion of the price for which the combination is sold which is properly allocable to the bag portion of the combination.

The portion of the selling price of the combination article which is subject to tax must be determined by one of two methods. If the manufacturer makes separate sales of the carts and bags at the same level of distribution, the taxable selling price of the bag will be determined by applying to the actual selling price of the combination article, the ratio which the separate selling price of the bag bears to the total of the separate selling prices of the bag and the cart. If the manufacturer does not make separate sales of the bag and the cart at the same level of distribution, the taxable selling price of the bag will be determined by applying to the actual selling price of the combination article, the ratio which the cost of the bag bears to the total of the costs of the bag and the cart.

PART III.—FIREARMS

SECTION 4181.—IMPOSITION OF TAX

26 CFR 48.4181–1: Imposition and rates of tax. Rev. Rul. 62–169

> For purposes of the manufacturers excise tax imposed by section 4181 of the Internal Revenue Code of 1954, "kits" which contain all of the necessary component parts for the assembly of shotguns are complete firearms in knockdown condition even though, in assembling the shotguns, the purchaser must "final-shape," sand, and finish the fore-arm and the stock. Accordingly, the manufacturers excise tax applies to these "kits" when sold by the manufacturer, producer, or importer.

Advice has been requested whether the manufacturers excise tax on firearms, imposed by section 4181 of the Internal Revenue Code of 1954, applies to the shotgun "kits" described below when sold by the manufacturer, producer, or importer.

Each kit contains all of the necessary component parts for the assembly of a shotgun. An action, barrel, fore-arm, stock, butt plate, and other fittings are included in each kit. The fore-arm and the stock, which are the wood components of the gun, are cut to the proper length and shape. However, in assembling the shotgun, it is necessary for the purchaser to "final-shape," sand, and finish the fore-arm and the stock.

Section 4181 of the Code imposes a tax upon the sale by the manufacturer, producer, or importer of pistols, revolvers, other firearms, shells, and cartridges.

Section 48.4181–1 (a) (2) of the Manufacturers and Retailers Excise Tax Regulations provides that the tax imposed by section 4181 of the Code attaches to the sales of complete firearms, pistols, revolvers, shells, and cartridges, or to sales of such articles which, although in a knockdown condition, are complete as to all component parts.

The kits which are described above are complete as to all component parts. The fact that the person who assembles the components must "final-shape," sand, and finish the wood components is not material in determining the taxability of the kit.

Accordingly, it is held that the manufacturers excise tax imposed by section 4181 of the Code applies to the kits described in the instant case when they are sold by the manufacturer, producer, or importer.

SUBCHAPTER E.—OTHER ITEMS

PART 1.—BUSINESS MACHINES

SECTION 4191.—IMPOSITION OF TAX

26 CFR 48.4191–1: Imposition and rate of tax.

The Internal Revenue Service rules on the acceptability of a certain method for computing the tax on business machines under circumstances in which a manufacturer leases a taxable machine to a customer who later purchases a new machine of the same type and the manufacturer allows the customer credit for the lease payments on the original machine. See Rev. Rul. 62–125, page 251.

Rev. Rul. 62–193

A magnetic character check sorting machine is a sorting machine within the meaning of section 4191 of the Internal Revenue Code of 1954 and, accordingly, is subject to the manufacturers excise tax imposed by that section of the Code. However, a central control unit for magnetic character check sorting machines is not among the articles enumerated under section 4191 of the Code and, therefore, is not subject to the tax imposed by that section unless sold on or in connection with the sale of a magnetic character check sorting machine. On the other hand, an inproof and outproof listing machine designed to provide subtotals and batch totals of checks being sorted is a combination listing and adding machine within the meaning of section 4191 of the Code and, therefore, is subject to the tax imposed by that section. Encoder machines designed to prepare checks for sorting by imprinting specified information on them with magnetic ink do not come within the scope of section 4191 of the Code and are not subject to the tax imposed by that section.

Advice has been requested whether the manufacturers excise tax imposed under section 4191 of the Internal Revenue Code of 1954 applies to the separate sales of the bank automation equipment described below.

The equipment consists of several machines, each of which is a separate salable article. Although the machines may be modified for other business uses, they are primarily sold for use in banking institutions for the purpose of sorting checks.

Item (1): *A magnetic character check sorting machine.*—This machine is equipped with an electronic scanning mechanism which "reads" magnetic characters previously printed on checks. This mechanism enables the machine to sort checks drawn on banks other than the bank using the machine according to their transit numbers and to sort checks drawn on the particular bank using the machine according to their account numbers. It has sixteen pockets for regular items and two pockets for rejects. By passing a group of checks through the machine several times, all checks are placed in their respective pockets in proper numerical sequence according to the numbers imprinted on them.

Item (2): *A magnetic character check sorting machine central control unit.*—This machine contains an electronic memory unit which enables it to control the operation of several magnetic character check sorting machines when they are performing the function of transit number sorting. It is equipped with a dictionary look-up feature which stores the transit routing numbers of up to 4,000 destinations. In operation, as the magnetic coding of each check is "read," the complete transit routing number is referred to the dictionary look-up feature which, in turn, "instructs" one of the magnetic character check sorting machines to place the check in the proper pocket.

Item (3): *An inproof and outproof listing machine.*—This machine is a separate attachment for the magnetic character check sorting machine described in *item* (1) above. It is used to provide subtotals, batch totals, and grand totals for the inproof and outproof process. The listing and adding operation is done simultaneously with the passing of the checks through the magnetic character check sorting machine during the regular sorting operation.

Item (4): *A transit number routing symbol encoder.*—This machine prints in magnetic ink the bank transit number on checks drawn on other banks which are in transit and which have not been preprinted with magnetic ink. It operates mechanically by an electric powered motor. In operation, each check is manually inserted into the machine and the proper transit number is indexed on the keyboard. After printing has been completed, the encoded checks are automatically stacked in a receiving bin in the order in which they were inserted into the machine.

Item (5): *A customer account number encoder.*—This machine prints a maximum ten-digit customer account number on those checks which are drawn on the particular bank using the machine and which have not been preprinted with magnetic ink. In operation, each check is manually inserted into the machine and the customer account number is indexed on the keyboard. After printing is completed, the checks are automatically stacked in a receiving bin in the same order in which they were inserted into the machine.

Item (6): *An adding machine amount encoder.*—This machine is an attachment for a regular adding machine. It operates mechanically, deriving its power from the motor of the adding machine to which it is attached. The machine is used to print in magnetic ink on each check inserted therein the amount of the check. In operation, each check is manually inserted into the machine and the amount of the check is indexed on the keyboard. The check amount is then encoded in magnetic ink on the check and also listed on the adding machine tape for the purpose of providing batch totals.

Item (7): *A proof machine amount encoder.*—This machine is an attachment for a standard proof machine. It is electrically operated and is completely controlled by the action of the proof machine to which it is attached. The machine is used for the purpose of encoding checks with magnetic characters so that they may be sorted at a later stage by a magnetic character check sorting machine. In operation, if the amount of a check which is going through the proof machine has not been previously encoded with magnetic ink, this machine will print the amount thereon with magnetic ink. However, if the check has already been printed with magnetic ink, the machine will permit it to go through the proof machine without any additional printing of magnetic ink thereon.

Section 4191 of the Code imposes a tax upon the sale by the manufacturer, producer, or importer of certain enumerated business machines (including in each case parts or accessories of such articles sold on or in connection therewith or with the sale thereof). Included in the enumeration of articles are adding machines, listing machines, sorting machines, and combinations of any of the foregoing.

It is held that the magnetic character check sorting machine identified above as *item* (1) is a sorting machine within the meaning of section 4191 of the Code, since its primary purpose is to sort checks into particular pockets according to their transit and account numbers. Therefore, sales of such a machine by the manufacturer thereof are subject to the manufacturers excise tax imposed by that section of the Code.

It is further held that the magnetic character check sorting machine central control unit identified as *item* (2) above does not come within the scope of any of the articles enumerated in section 4191 of the Code, since its primary function is to electronically control the operation of several magnetic character check sorting machines. Accordingly, the manufacturers excise tax imposed by that section does not apply to the separate sales of such a machine. However, where the magnetic character check sorting machine central control unit is sold on or in connection with, or with the sale of, a taxable magnetic character check sorting machine by the manufacturer of the sorting machine, the central control unit is considered, for purposes of section 4191 of the Code, to be a part or accessory for such sorting machine and, therefore, is includible in the tax base of the sorting machine.

Since the inproof and outproof listing machine identified as *item* (3) above lists and adds the amounts of checks, it is held that it is a combination listing and adding machine within the meaning of section 4191 of the Code. Therefore, sales of such a machine by the manufacturer thereof are subject to the tax imposed by that section.

The various encoder machines identified as *items* (4), (5), (6), and

(7) above do not come within the scope of any of the articles enumerated in section 4191 of the Code, since their primary function is only to imprint magnetic characters on checks for purposes of sorting them at a later stage of processing. Accordingly, separate sales of these machines by the manufacturer thereof are not subject to the tax imposed by section 4191 of the Code. However, where such machines are sold on or in connection with, or with the sale of, a taxable machine by the manufacturer of the taxable machine for use therewith, the nontaxable machines are considered to be parts or accessories for the taxable machine and are, therefore, includible in the tax base.

SUBCHAPTER F.—SPECIAL PROVISIONS APPLICABLE TO MANUFACTURERS TAX

SECTION 4216.—DEFINITION OF PRICE

(Also Section 4061; 26 CFR 40.4061(b)-1.) Rev. Rul. 62-173

A company manufactured and sold specially designed automobile trucks under such circumstances that, pursuant to the provisions of section 4216(b)(1) of the Internal Revenue Code of 1954, the constructive sale price, for purposes of computing the manufacturers excise tax, has been determined to be a stated percentage of the price for which the articles are sold at retail but not less than the company's cost of the trucks. For this purpose, the company's "cost" of parts or accessories purchased on a tax-paid basis from other manufacturers and used in the manufacture of the trucks is the tax-excluded purchase price rather than the tax-included purchase price. On the other hand, the company's "cost" of tires, inner tubes, and automobile radio receiving sets purchased from other manufacturers is the total, or tax-included, purchase price.

Advice has been requested concerning the manner in which the manufacturers excise tax imposed by section 4061(a) of the Internal Revenue Code of 1954 should be applied to a company's sales of specially designed automobile trucks manufactured and sold by the company under the circumstances described below.

For use in the manufacture of these trucks, the company purchased from other manufacturers various articles which are subject to the manufacturers excise tax on automobile parts or accessories, imposed by section 4061(b) of the Code. Although these articles could have been purchased tax free under the provisions of section 4221(a)(1) and section 4222 of the Code, they were purchased on a tax-paid basis, and the tax on those parts or accessories was paid by the manufacturers thereof.

Also, for sale on or in connection with these trucks, the company purchased on a tax-paid basis tires and inner tubes, which are taxable under section 4071 of the Code, and automobile radio receiving sets, which are taxable under section 4141 of the Code.

The company sells these trucks only at retail. Pursuant to the provisions of section 4216(b)(1) of the Code, the constructive sale price of the trucks has been determined to be a stated percentage of the established retail price for the articles, but not less than the company's cost of the trucks. The specific question presented is whether, in com-

puting the company's "cost" of the trucks for this purpose, there should be included the total tax-paid cost of the taxable articles purchased for use in the manufacture of the trucks.

Section 6416(b)(3)(B) of the Code provides, insofar as applicable here, that if the tax imposed on a part or accessory taxable under section 4061(b) has been paid with respect to the sale of any article by the manufacturer, producer, or importer thereof to a second manufacturer or producer, such tax shall be deemed to be an overpayment by such second manufacturer or producer if such article is used by the second manufacturer or producer as material in the manufacture or production of, or as a component part of, any other article manufactured or produced by him.

The statute contains no similar provision regarding tires or inner tubes taxable under section 4071 or automobile radio receiving sets taxable under section 4141. However, section 6416(c) of the Code provides, insofar as applicable to the situation presented here, that if tires, inner tubes, or automobile radio receiving sets on which tax has been paid are sold on or in connection with, or with the sale of, another article subject to the manufacturers excise tax, there shall be credited against the tax imposed on the sale of such other article an amount determined by multiplying the applicable percentage rate of tax for such other article by the purchase price of the tires, inner tubes, or automobile radio receiving sets.

For purposes of computing the manufacturers excise tax in those cases in which a manufacturer's "cost" of taxable articles becomes relevant, that "cost" should be determined in accordance with accepted accounting methods. Thus, the "cost" of the taxable articles should include all manufacturing, selling, and administrative expenses attributable to the articles except those expenses relating to charges which are excludable from the sale price under section 4216(a) of the Code. However, it should not include an amount which has been paid by the manufacturer but to which he has a right of reimbursement.

The manufacturers excise tax is imposed upon the seller of taxable articles rather than upon the purchaser. Therefore, the total, or tax-included, price of the articles ordinarily represents the cost of the articles to the purchaser. However, under the provisions of section 6416(b)(3)(B) of the Code, the amount of tax which has been paid by the manufacturers of the parts or accessories used in the manufacture of the trucks in the instant case is deemed to be an "overpayment" by the company which manufactures the trucks. The company is entitled to a credit or refund in the amount of that "overpayment."

Accordingly, it is held that, for purposes of computing the company's "cost" of the trucks, its "cost" of the parts or accessories referred to above is the tax-excluded purchase price rather than the tax-included purchase price.

On the other hand, although section 6416(c) of the Code permits the company to take a credit *against the tax imposed on the trucks*, and that credit is *based upon* its purchase price of the tires, inner tubes, and automobile radio receiving sets, there is no provision that the tax which has been paid on the tires, inner tubes, and automobile radio receiving sets purchased by the company is deemed to be an "overpayment." Therefore, the company's "cost" of those articles is the total, or tax-included, purchase price.

26 CFR 148.1–5: Constructive sale price. Rev. Rul. 62–221
(Also Section 4061; 40.4061(a)–1.)

A company manufactures various types of automobile truck bodies, all of which are subject to the manufacturers excise tax on motor vehicle articles imposed by section 4061(a) of the Internal Revenue Code of 1954. The company sells these bodies at retail only. Under the provisions of section 4216(b)(1) of the Code, it has been determined that the constructive sale price of the bodies is a specified percentage of the company's established retail price *but not less than* the manufacturer's *cost* of the bodies.

Under the company's cost accounting system, the actual cost of a particular body cannot be accurately determined at the time the body is sold; however, the company's annual cost records show very little fluctuation in the cost of manufacturing each of the various types of bodies and placing them in condition for delivery.

Held, under these circumstances, the company's actual cost of a particular type of body during the preceding year (determined in accordance with accepted accounting methods) may be used as the "cost" of a body of that type for purposes of determining the constructive sale price of such bodies sold during the current year.

SECTION 4217.—LEASES

(Also Section 4191; 26 CFR 48.4191–1) Rev. Rul. 62–125

A manufacturer of business machines which are subject to tax under section 4191 of the Internal Revenue Code of 1954, leases the machines and also sells them at retail. Under the terms of the lease contract rent is payable monthly and the lessee has the option to purchase the leased machine, or a new machine of the same model, at any time during the term of the lease. If the lessee exercises the option, the contract provides that the accumulated lease payments will be credited against the purchase price of the machine. In computing the excise tax due on the sale of a new machine under these circumstances, the manufacturer proposes to reduce the tax normally due on the sale by an amount equal to the tax paid in connection with the purchaser's prior lease. To compensate for this tax credit, the manufacturer proposes also to reduce by an equal amount the tax paid toward the "total tax" due on the leased machine, as computed under section 4217 of the Code. *Held*, there is no provision of law which would permit a taxpayer to credit excise tax paid on the lease of one article against the excise tax due on the sale of another article, under the circumstances outlined above. Accordingly, the proposed method of tax computation for the new machine is not acceptable. With respect to the computation of tax on the subsequent sale of the machine which had been leased, see section 4217(d) of the Code.

Whether the provisions of section 4217(b) of the Internal Revenue Code of 1954 are applicable to the renewal of a lease of an article subject to the retailers excise taxes. See Rev. Rul. 62–134, page 236.

SUBCHAPTER G.—EXEMPTIONS, REGISTRATION, ETC.

SECTION 4221.—CERTAIN TAX-FREE SALES

(Also Section 4061; 26 CFR 40.4061(a)-1.) Rev. Rul. 62-99

A manufacturer sells automobile buses to a county school district. The school district immediately transfers the buses, under oral financing agreements, to individuals who transport pupils to and from public schools pursuant to contracts entered into with the school district. For purposes of state motor vehicle registration, titles to the buses remain in the name of the school district. However, the operators use the buses for transportation other than for the school district and otherwise treat the buses as being their own property. *Held*, sales of those buses by the manufacturer to the school district under these circumstances are not "for the exclusive use of" a State or local government within the meaning of section 4221(a)(4) of the Internal Revenue Code of 1954. Therefore, sales of the buses to the school district under such circumstances are not exempt from the manufacturers excise tax imposed by section 4061(a)(1) of the Code.

Advice has been requested whether, for purposes of exemption from the manufacturers excise tax, automobile buses may be considered as sold "for the exclusive use of" a State or local government when sold to a county school district under the circumstances described below.

In order to provide transportation for pupils to and from public schools, a county school district enters into contracts with various individuals under which each individual contractor agrees to furnish and operate at his own expense a school bus which meets the specifications of the State board of education. The school bus operators are paid periodically by the county school district for the transportation services furnished under the terms of the contract.

In some instances, manufacturers sell school buses to the school district, and the school district immediately transfers them to the operators under financing plans which are orally agreed upon. Under the terms of these agreements, the operators' periodic payments for the buses are deducted from the payments due them for transportation services furnished. For purposes of State motor vehicle registration, titles to the buses are in the name of the school district, and they normally remain in the name of the school district even after the operators complete payment to the district for the buses. However, after completion of payment, the titles may be transferred at the request of the operators.

These buses are used to a substantial extent by the operators for transportation other than for the school district. Fares charged for this transportation are collected and retained by the operators. The operators furnish the gasoline, oil, and maintenance for the buses and otherwise treat them as being their own property.

Section 4061(a)(1) of the Internal Revenue Code of 1954 imposes a tax upon the sale by the manufacturer, producer, or importer of certain enumerated motor vehicle articles, including automobile bus chassis and bodies.

Section 4221(a)(4) of the Code provides that, under regulations prescribed by the Secretary of the Treasury or his delegate, no manufacturers excise tax shall be imposed on the sale by the manufacturer of an article to a State or local government for the exclusive use of a State or local government, but only if such use is to occur before any other use. A county school district comes within the meaning of the term "State or local government" as defined in section 4221(d)(4) of the Code.

Based on the facts set forth above, it is held that the sales of the buses by the manufacturer to the school district are not "for the exclusive use of" a State or local government within the meaning of section 4221(a)(4) of the Code. Therefore, such sales are not exempt from the manufacturers excise tax imposed by section 4061(a)(1) of the Code.

For a similar conclusion, see Revenue Ruling 58–413, C.B. 1958–2, 813, which holds that sales of automobiles to a county expressly for resale to the sheriff and his deputies are not considered to be for the exclusive use of the State or political subdivision. Also, see Revenue Ruling 58–572, C.B. 1958–2, 815, and Revenue Ruling 60–116, C.B. 1960–1, 508, which hold that sales of new automobiles by dealers to a State and to a city school district are not "for the exclusive use of" those governmental units where the automobiles are sold under certain described agreements which provide that the State or local government will trade or return the automobiles to the dealers after a limited period of ownership.

CHAPTER 33.—FACILITIES AND SERVICES

SUBCHAPTER A.—ADMISSIONS AND DUES

PART I.—ADMISSIONS

SECTION 4231.—IMPOSITION OF TAX

(Also Sections 4001, 4011, 4021, and 4031; 26 CFR 48.4001–1, 48.4011–1, 48.4031–1.) Rev. Rul. 62–185

Where articles which are subject to the retailers excise taxes, imposed by sections 4001, 4011, 4021, and 4031 of the Internal Revenue Code of 1954, are sold at retail in transactions which also establish a liability for the cabaret tax imposed by section 4231(6) of the Code, the amounts paid for that merchandise are subject to both the retailers excise tax and the cabaret tax. Thus, an article sold under such circumstances for a tax-excluded price of $25 would be subject to a retailers excise tax in the amount of $2.50 and a cabaret tax in the amount of $2.50, or a tax-included sale price of $30.

Applicability of cabaret tax to a "dinner club" organized as a private club. See Ct. D. 1872, page 356.

SUBCHAPTER B.—COMMUNICATIONS

SECTION 4251.—IMPOSITION OF TAX

26 CFR 42.4251–1: Imposition and rates of taxes. Rev. Rul. 62–126

(Also Sections 4252, 4253; 42.4253–2, 42.4253–6.)

A certain microwave relay service between two cities, which is furnished by a telephone company to a company operating a community television antenna service, comes within the definition of the term "wire mileage service." Furthermore, under the circumstances described, the microwave relay service does not come within the scope of the exemptions provided by section 4253(b) and section 4253(f) of the Internal Revenue Code of 1954.

Advice has been requested whether the tax on "wire mileage service," which is imposed by section 4251(a) of the Internal Revenue Code of 1954, applies to amounts paid to a telephone company for a microwave relay service which is furnished to a company operating a community television antenna service.

A television service company has its own facilities and equipment in the city of *M* for the purpose of intercepting the regular broadcast signals of the television stations in that city. These signals are transferred to the facilities of a telephone company in that city. By means of microwave relay methods, the telephone company transmits the signals to its terminus in the city of *N*, which is outside the broadcasting range of the television stations in the city of *M*. The telephone company then relays the signals to the receiving equipment of the television service company in the city of *N*, from whence the television service company transmits the signals over its own cable system to the receiving sets of its subscribers in the city of *N*.

The basic question presented is whether the microwave transmission service furnished by the telephone company between the cities of *M* and *N* constitutes "wire mileage service" within the meaning of section 4251(a) of the Code. If so, there is presented the further question of whether either of the exemptions provided by section 4253(b) and section 4253(f) of the Code applies under the circumstances described.

Section 4251(a) of the Code imposes on amounts paid for the communication services enumerated in the following table a tax equal to the percent of the amount so paid as specified in such table:

Taxable Service	*Rate of tax percent*
General telephone service	10
Toll telephone service	10
Telegraph service	10
Teletypewriter exchange service	10
Wire mileage service	10
Wire and equipment service	8

Section 4252(e) of the Code, as amended by the Excise Tax Technical Changes Act of 1958, Public Law 85–859, C.B. 1958–3, 92, defines the term "wire mileage service" to include any wire or radio circuit service which is not included in any other subsection of section 4252,

except that such term does not include service used exclusively in furnishing wire and equipment service.

The microwave relay service provided by the telephone company between the cities of *M* and *N* is a "wire or radio circuit service" which does not come within the scope of any of the communication services defined in section 4252 of the Code other than "wire mileage service". Therefore, this microwave relay service constitutes "wire mileage service," as that term is defined in section 4252(e) of the Code, unless the microwave relay service is *used exclusively in furnishing wire and equipment service.* However, it cannot be said that the microwave relay service is used exclusively in furnishing wire and equipment service.

A central television antenna service of the type furnished by the television service company to its subscribers in the city of *N* is not now considered to come within the scope of the term "wire and equipment service," as defined in section 4252(f) of the Code. See *DeForrest Lilly, et al.* v. *United States*, 238 Fed. (2d) 584 (1956); *Gust Pahoulis* v. *United States*, 242 Fed. (2d) 345 (1957); and Revenue Ruling 57-362, C.B. 1957-2, 745. Therefore, since the service furnished by the television service company does not constitute "wire and equipment service" for the purpose of determining the taxability of amounts paid by the subscribers for that service, it follows that the same service does not constitute "wire and equipment service" for the purpose of excluding from the term "wire mileage service" any "wire or radio circuit service" obtained from the telephone company for use in furnishing that television antenna service.

Accordingly, the microwave relay service furnished by the telephone company between the cities of *M* and *N* comes within the scope of the term "wire mileage service," as defined in section 4252(e) of the Code.

Section 4253(b) of the Code provides that no tax shall be imposed under section 4251, except with respect to general telephone service, on any payment received for services used in the collection or in the dissemination of news by certain news services. Section 42.4253-2(a) of the Facilities and Services Excise Tax Regulations provides that this exemption will apply only with respect to payments for services and facilities which are utilized exclusively (1) in the collection of news for the public press or radio or television broadcasting or in the dissemination of news through the public press or by means of radio or television broadcasting, or (2) in the collection or dissemination of news by a news ticker service furnishing a general news service similar to that of the public press.

The only portion of this exemption which might apply to the microwave relay service in this case is that which relates to "wire mileage service" utilized *exclusively* in the collection of news for radio or television broadcasting or in the dissemination of news by means of radio or television broadcasting. However, news programs constitute only a minor portion of the total television programming of the type which is furnished to the subscribers in this case. Furthermore, the programs are not "broadcast" by the television service company; rather, they are furnished only to a selected audience (the subscribers) by means of the television company's cables to the subscribers' premises.

Therefore, since the microwave relay service ("wire mileage service") furnished by the telephone company to the television service company is not utilized exclusively by the latter for any of the purposes specified in section 4253(b) of the Code, the exemption provided by that section does not apply to the amounts paid by the television service company to the telephone company.

Section 4253(f) of the Code provides, in part, that no tax shall be imposed under section 4251 on the amount paid for any "wire mileage service" or "wire and equipment service" to the extent that the amount so paid is for use by a common carrier, telephone or telegraph company, or radio broadcasting station or network in the conduct of its business as such.

A company operating a community television antenna service is not considered to be a "common carrier," or "telephone or telegraph company," as those terms are used in section 4253(f) of the Code. Furthermore, such a company operating in the manner described in the instant case is not a "broadcasting station or network." See Revenue Ruling 56–90, C.B. 1956–1, 520, which holds that the closed-circuit transmission of events or activities for private screening for limited audiences is not the conducting of the business of a "broadcasting station or network." Therefore, the exemption provided by section 4253(f) of the Code does not apply under the circumstances described in the instant case.

In view of the foregoing, it is held that the tax on "wire mileage service" imposed by section 4251(a) of the Code applies to amounts paid to the telephone company by the television service company for the microwave relay service.

SECTION 4252.—DEFINITIONS

(Also Section 4253.) Rev. Rul. 62–119

A new type of private line service known as "telpak," which offers broadband communication paths to customers who need to transmit large amounts of different forms of communications, comes within the scope of the term "wire mileage service" as defined by section 4252(e) of the Internal Revenue Code of 1954. Accordingly, the tax imposed by section 4251(a) of the Code on amounts paid for wire mileage service applies to amounts paid for "telpak" service.

Advice has been requested whether, for purposes of the excise tax on certain communication services, the private line service described below comes within the scope of the term "wire mileage service" as defined in section 4252(e) of the Internal Revenue Code of 1951.

Telephone companies have introduced a new type of private line service known as "telpak." This service offers broadband communication paths to customers who need to transmit large amounts of different forms of communications, such as telephone, telephotograph, teletypewriter, control, signaling, facsimile, and data transmission.

Four classifications of "telpak" are available to subscribers, which are equivalent to the capacity of 12, 24, 60, and 240 voice circuits, respectively. The subscriber pays the telephone company a monthly charge composed of (1) an amount, which varies according to the classification selected, for each mile in length of the "telpak" channel furnished and (2) an amount for the channel terminations provided.

The channel terminations consist of arrangements of equipment at the terminals of the "telpak" channel which adapt the communication path to the various types of communication the subscriber desires to transmit. Depending upon the type of channel terminations provided by the telephone company, the entire width of a "telpak" channel may be used for the transmission of a single kind of communication, or the channel may be split to accommodate the simultaneous transmission of two or more kinds of communications. This channel terminating equipment does not come within the scope of the term "any sending or receiving set or device which is station terminal equipment" for purposes of the exemption provided by section 4253(h) of the Code.

A telephone company which provides "telpak" service may use different means of transmission, depending upon the availability of plant facilities in the area to be covered. For example, a "telpak" channel may be furnished in part by microwave, in part by telephone wires, and in part by coaxial cable. These means of transmission and the plant employed may have the same characteristcs as the means of transmission and plant employed in the past in rendering private line services.

Section 4251(a) of the Code imposes a tax on amounts paid for certain enumerated communication services, as follows:

Taxable service	*Rate of tax (percent)*
General telephone service	10
Toll telephone service	10
Telegraph service	10
Teletypewriter exchange service	10
Wire mileage service	10
Wire and equipment service	8

Section 4252(e) of the Code defines the term "wire mileage service" to mean any telephone or radio telephone service and any other wire or radio circuit service which is not included in any other subsection of section 4252, except that such term does not include service used exclusively in furnishing wire and equipment service.

The "telpak" service described above, as a whole, is a type of private line service which does not come within the scope of any of the communication services defined in section 4252 of the Code other than "wire mileage service." Accordingly, "telpak" service constitutes "wire mileage service" as that term is defined in section 4252(e) of the Code. Therefore, it is held that the tax imposed on "wire mileage service" by section 4251(a) of the Code applies to amounts paid for the "telpak" service.

It should be noted, however, that since the "telpak" service constitutes "wire mileage service," it comes within the scope of the exemption provided by section 4253(b) of the Code, with respect to certain news services, and the exemption provided by section 4253(f) of the Code, with respect to common carriers and communication companies.

Whether a microwave relay service furnished to a community television antenna system by a telephone company comes within the scope of the term "wire mileage service." See Rev. Rul. 62–126, page 254.

Revenue Ruling 62–11, C.B. 1962–1, 440, holds that a musical program service furnished by means of radio circuits comes within the definition of "wire mileage service" provided in section 4252(e) of the Internal Revenue Code of 1954, as added by the Excise Tax Technical Changes Act of 1958.

Under the authority contained in section 7805(b) of the Code, the conclusion of Revenue Ruling 62–11 with respect to the tax on "wire mileage service" will not be applied to amounts paid before April 1, 1962, for such musical program services.

SECTION 4253.—EXEMPTIONS

Whether amounts paid for a new type of private line service known as "telpak" come within the scope of the exemptions from the communications tax for news services and for common carriers and communications companies. See Rev. Rul. 62–119, page 256.

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26 CFR 42.4253–2: Exemption for news services.

Whether amounts paid for a microwave relay service furnished to a community television antenna system by a telephone company are exempt from the communications tax. See Rev. Rul. 62–126, page 254.

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26 CFR 42.4253–6: Exemption for special wire service in company business.

Whether amounts paid for a microwave relay service furnished to a community television antenna system by a telephone company are exempt from the communications tax. See Rev. Rul. 62–126, page 254.

SUBCHAPTER C.—TRANSPORTATION OF PERSONS BY AIR

SECTION 4261.—IMPOSITION OF TAX

26 CFR 49.4261: Statutory provisions; imposition of tax; amounts paid within the United States; amounts paid without the United States; seats, berths, etc.; by whom paid.
(Also Section 6421; 48.6421(b).)
(Also Part II, Tax Rate Extension Act of 1962; 49.9000.)

T. D. 6618 [1]

[1] The publication of this Treasury Decision in 27 F.R. 11221, dated November 14, 1962, contains (1) instructions for modifying the notice of proposed rule making in 27 F.R. 9142, dated September 14, 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.

TITLE 26—INTERNAL REVENUE.—CHAPTER I. SUBCHAPTER D. PART 48.—MANUFACTURERS AND RETAILERS EXCISE TAXES; PART 49.—FACILITIES AND SERVICES EXCISE TAXES

Amendment of the Manufacturers and Retailers Excise Tax Regulations and the Facilities and Services Excise Tax Regulations to conform to the appropriate section of the Tax Rate Extension Act of 1962.

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 14, 1962, notice of proposed rule making with respect to the amendment of the Manufacturers and Retailers Excise Tax Regulations (26 CFR Part 48) under section 6421 of the Internal Revenue Code of 1954 and the Facilities and Services Excise Tax Regulations (26 CFR Part 49) under sections 4261, 4262, 4263, and 4264 of the Code to conform such regulations to section 5 of the Tax Rate Extension Act of 1962 (Public Law 87–508, 76 Stat. 115) [C.B. 1962–3, page 58] was published in the Federal Register (27 F.R. 9142). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the following amendments of the regulations are hereby adopted.

Manufacturers and Retailers Excise Taxes
(26 CFR Part 48)

PARAGRAPH 1. Section 48.6421(b) is amended by revising paragraphs (1) (B) and (2) of section 6421(b) and by revising the historical note. These amended provisions read as follows:

§ 48.6421 (b) STATUTORY PROVISIONS; GASOLINE USED FOR CERTAIN NONHIGHWAY PURPOSES OR BY LOCAL TRANSIT SYSTEMS; LOCAL TRANSIT SYSTEMS.

SEC. 6421. GASOLINE USED FOR CERTAIN NONHIGHWAY PURPOSES OR BY LOCAL TRANSIT SYSTEMS. * * *

(b) LOCAL TRANSIT SYSTEMS—

(1) ALLOWANCE. * * *

(B) The percentage which the ultimate purchaser's commuter fare revenue derived from such scheduled service during such quarter was of his total passenger fare revenue derived from such scheduled service during such quarter.

(2) LIMITATION.—Paragraph (1) shall apply in respect of gasoline used during any calendar quarter only if at least 60 percent of the total passenger fare revenue derived during such quarter from scheduled service described in paragraph (1) by the person filing the claim was attributable to commuter fare revenue derived during such quarter by such person from such scheduled service.

[Sec. 6421(b) as added and in effect Jan. 1, 1959, and as amended by sec. 201(d)(2), Federal-Aid Highway Act 1959 (73 Stat. 615) [P.L. 86–342, C.B. 1959–2, 697]; sec. 5(c)(2)(A), Tax Rate Extension Act 1962 (76 Stat. 118) [P.L. 87–508, C.B. 1962–3, page 58]]

PAR. 2. Section 48.6421(b)–1 is amended by revising paragraph (a)(1)(ii) [and] the last two sentences of paragraph (a)(1), by revising paragraph (b)(2) and the last sentence of paragraph (b), and by

adding a note at the end of paragraph (d). These amended provisions read as follows:

§ 48.6421(b)–1 PAYMENTS TO ULTIMATE PURCHASER OF GASOLINE USED BY LOCAL TRANSIT SYSTEMS.—(a) *In general.*—(1) * * *

(ii) The percentage which the ultimate purchaser's commuter fare revenue derived from such scheduled service during such calendar quarter was of his total passenger fare revenue (not including, in the case of claims covering gasoline used before November 16, 1962, the tax imposed by section 4261 on the amount paid for the transportation of persons) derived from such scheduled service during such period.

However, payment in respect of gasoline used as provided in section 6421(b)(1) shall be made only as to gasoline purchased by an ultimate purchaser after June 30, 1956, and prior to October 1, 1972, and only if a properly executed claim is filed by the ultimate purchaser within the time prescribed in section 6421(c) (see § 48.6421(c)–1). For meaning of the terms "gasoline" and "commuter fare revenue", see paragraph (b) of § 48.4082–1 and paragraph (b) of § 48.6421(d)–1, respectively.

* * * * * * *

(b) *60-percent passenger fare revenue test.* * * *

(2) At least 60-percent of the total passenger fare revenue was commuter fare revenue.

In determining the total of such passenger fare revenue there shall not be included revenue from such sources as charter fees, rentals of property, advertising, receipts, etc., and, in the case of claims covering gasoline used before November 16, 1962, the tax imposed by section 4261.

* * * * * * *

(d) *Illustration.* * * *

NOTE: The above example and tables apply to gasoline used before November 16, 1962, as well as on and after such date. However, since the tax with respect to transportation of persons by motor vehicle which begins after November 15, 1962, has been repealed, all references in the example and tables to such transportation tax should be disregarded with respect to gasoline used by a local transit system after November 15, 1962, and where the term "tax-exempt passenger fare revenue" is referred to, there should be substituted the term "commuter fare revenue" and wherever the term "taxable passenger fare revenue" is used, it shall mean any fare revenue received by the transit system which does not constitute "commuter fare revenue."

PAR. 3. Section 48.6421(c)–1(b)(2) is amended by revising subdivision (ii) (*b*), (*c*), and (*d*) and by adding a note at the end of subdivision (iii). These amended provisions read as follows:

§ 48.6421(c)–1 CLAIMS.

* * * * * * *

(b) *Form of claim.* * * *

(2) *Supporting evidence.* * * *

(ii) *Transit systems.* * * *

(*b*) The total passenger fare revenue (not including, with respect to gasoline used before November 16, 1962, the tax imposed by section 4261) derived from the scheduled service described in (*a*) of this subdivision.

(*c*) The amount of such total passenger fare revenue derived from commuter fare revenue.

(*d*) A computation showing the percentage which the commuter fare revenue derived from the scheduled service was of the total passenger fare revenue ((*c*) divided by (*b*)).

* * * * * * *

(III) *Example.* * * *

Note: The above table applies to gasoline used both before November 16, 1962, as well as on and after such date. However, since the tax with respect to transportation of persons by motor vehicle which begins after November 15, 1962, has been repealed, all references in such table to such transportation tax should be disregarded with respect to gasoline used by a local transit system after November 15, 1962, and where the term "tax-exempt passenger fare revenue" is referred to, there should be substituted the term "commuter fare revenue".

PAR. 4. Section 48.6421(d) is amended by revising section 6421(d)(2) and by revising the historical note. These amended provisions read as follows:

§ 48.6421(d) STATUTORY PROVISIONS; GASOLINE USED FOR CERTAIN NONHIGHWAY PURPOSES OR BY LOCAL TRANSIT SYSTEMS; DEFINITIONS.

SEC. 6421. GASOLINE USED FOR CERTAIN NONHIGHWAY PURPOSES OR BY LOCAL TRANSIT SYSTEMS. * * *

(d) DEFINITIONS. * * *

(2) COMMUTER FARE REVENUE. The term "commuter fare revenue" means revenue attributable to fares derived from the transportation of persons and attributable to—

(A) amounts paid for transportation which do not exceed 60 cents,

(B) amounts paid for commutation or season tickets for single trips of less than 30 miles, or

(C) amounts paid for commutation tickets for one month or less.

[Sec. 6421(d) as added, amended, and in effect Jan. 1, 1959, and as amended by sec. 5(c)(2)(B), Tax Rate Extension Act 1962 (76 Stat. 119)]

PAR. 5. Paragraph (b) of § 48.6421(d)–1 is amended to read as follows:

§ 48.6421(d)–1 DEFINITIONS.

* * * * * * *

(b) *Commuter fare revenue.*—As used in section 6421(b) and §§ 48.6421(b)–1, 48.6421(c)–1, and 48.6421(g)–1, the term "commuter fare revenue" means revenue attributable to fares derived from the transportation of persons and attributable to (1) amounts paid for transportation which do not exceed 60 cents, (2) amounts paid for commutation or season tickets for single trips of less than 30 miles, or (3) amounts paid for commutation tickets for one month or less.

PAR. 6. Paragraph (b) (1) and (2) of § 48.6421(g)–1 is amended to read as follows:

§ 48.6421(g)–1 RECORDS TO BE KEPT.

* * * * * * *

(b) *Local transit systems.* * * *

(1) The total passenger fare revenue (not including with respect to gasoline used before November 16, 1962, the tax imposed by section 4261) derived from scheduled common carrier public passenger land transportation service along regular routes, and

(2) The commuter fare revenue derived from such scheduled service.

Facilities and Services Excise Taxes
(26 CFR Part 49)

PAR. 7. Section 49.4261 is amended by revising section 4261 and by revising the historical note. These amended provisions read as follows:

§ 49.4261 STATUTORY PROVISIONS; IMPOSITION OF TAX; AMOUNTS PAID WITHIN THE UNITED STATES; AMOUNTS PAID OUTSIDE THE UNITED STATES; SEATS, BERTHS, ETC.; BY WHOM PAID.

SEC. 4261. IMPOSITION OF TAX.

(a) AMOUNTS PAID WITHIN THE UNITED STATES.—There is hereby imposed upon the amount paid within the United States for taxable transportation (as defined in section 4262) of any person by air a tax equal to 5 percent of the amount so paid for transportation which begins after November 15, 1962, and before July 1, 1963.

(b) AMOUNTS PAID OUTSIDE THE UNITED STATES.—There is hereby imposed upon the amount paid without the United States for taxable trans-

portation (as defined in section 4262) of any person by air, but only if such transportation begins and ends in the United States, a tax equal to 5 percent of the amount so paid for transportation which begins after November 15, 1962, and before July 1, 1963.

(c) SEATS, BERTHS, ETC.—There is hereby imposed upon the amount paid for seating or sleeping accommodations in connection with transportation with respect to which a tax is imposed by subsection (a) or (b) a tax equivalent to 5 percent of the amount so paid in connection with transportation which begins after November 15, 1962, and before July 1, 1963.

(d) BY WHOM PAID.—Except as provided in section 4264, the taxes imposed by this section shall be paid by the person making the payment subject to the tax.

[Sec. 4261 as amended and in effect Jan. 1, 1959, and as further amended by sec. 4, Tax Rate Extension Act 1959 (73 Stat. 158) [P.L. 86–75, C.B. 1959–2, 679]; sec. 202(a)(3), Public Debt and Tax Rate Extension Act 1960 (74 Stat. 290) [P.L. 86–564, C.B. 1960–2, 681]; sec. 3(a)(3), Tax Rate Extension Act 1961 (75 Stat. 193) [P.L. 87–72, C.B. 1961–2, 317]; sec. 5 (a) and (b), Tax Rate Extension Act 1962 (76 Stat. 115)]

PAR. 8. Section 49.4261–1 is amended to read as follows:

§ 49.4261–1 IMPOSITION OF TAX; IN GENERAL.—(a) *Transportation beginning before November 16, 1962.*—Section 4261 imposes a tax equal to 10 percent of the amount paid for taxable transportation of persons by rail, motor vehicle, water, or air which begins before November 16, 1962. For the definition of the term "taxable transportation", see section 4262 and §§ 49.4262(a)–1 and 49.4262(b)–1. The tax accrues at the time payment is made for the transportation, irrespective of when the transportation is furnished if the transportation actually begins before November 16, 1962.

(b) *Transportation beginning after November 15, 1962.*—Section 4261 imposes a tax equal to 5 percent of the amount paid for the air portion of taxable transportation of persons which begins after November 15, 1962, and before July 1, 1963. For definition of the term "taxable transportation", see section 4262 and §§ 49.4262(a)–1 and 49.4262(b)–1. The tax accrues at the time payment is made for the transportation, irrespective of when the transportation is furnished if the transportation actually begins after November 15, 1962, and before July 1, 1963.

(c) *In general.*—The purpose of the transportation, whether business or pleasure, is immaterial. It is not necessary that the transportation be between two definite points. If not otherwise exempt, a payment for continuous transportation beginning and ending at the same point is subject to the tax. For the rate of tax with respect to amounts paid for seating and sleeping accommodations in connection with taxable transportation, see § 49.4261–9.

PAR. 9. Section 49.4261–2 is amended by revising the title, by striking out paragraph (a), by redesignating paragraph (b) as paragraph (a) and adding a new sentence at the end thereof, by redesignating paragraph (c) as paragraph (b), and by redesignating paragraph (d) as paragraph (c). These amended and added provisions read as follows:

§ 49.4261–2 APPLICATION OF TAX.—(a) *Tax on total amount paid.*—The tax is measured by the total amount paid, whether paid at one time or collected at intervals during the course of a continuous transportation, as in the case of a carrier operating under the zone system. For the application of the tax with respect to amount paid for seating or sleeping accommodations in connection with taxable transportation, see § 49.4261–9.

(b) *Tax on transportation of each person.* * * *

(c) *Charges for nontransportation services.*

PAR. 10. Paragraph (b) of § 49.4261–3 is amended to read as follows:

§ 49.4261–3 PAYMENTS MADE WITHIN THE UNITED STATES.

* * * * * * *

(b) *Other transportation.*—(1) *Transportation beginning before November 16, 1962.*—In the case of transportation beginning before November 16, 1962 (other than that described in paragraph (a) of this section), for which payment is made in the United States, the tax applies with respect to the amount paid for that portion of such transportation which is directly or indirectly from one port or station in the United States to another port or station in the United States. Transportation that (i) begins in the United States or in the 225-mile zone and ends outside such area, (ii) begins outside the United States or the 225-mile zone and ends inside such area, or (iii) begins outside the United States and ends outside such area is taxable only with respect to such portion of the transportation which is directly or indirectly from one port or station in the United States to another such port or station. Thus, on a trip from Chicago to London, England, with a stopover at New York, for which payment is made in the United States, the tax would apply to the part of the payment which is applicable to the transportation from Chicago to New York.

(2) *Transportation beginning after November 15, 1962.*—In the case of transportation beginning after November 15, 1962 (other than that described in paragraph (a) of this section), for which payment is made in the United States, the tax applies with respect to the amount paid for that portion of such transportation by air which is directly or indirectly from one port or station in the United States to another port or station in the United States, but only if such portion is not a part of "uninterrupted international air transportation" within the meaning of section 4262(c)(3) and paragraph (c) of § 49.4262(c)-(1). Transportation that

(i) begins in the United States or the 225-mile zone and ends outside such area,

(ii) begins outside the United States or the 225-mile zone and ends inside such area, or

(iii) begins outside the United States and ends outside such area

is taxable only with respect to such portion of the transportation by air which is directly or indirectly from one port or station in the United States to another port or station in the United States, but only if such portion is not a part of "uninterrupted international air transportation" within the meaning of section 4262(c)(3) and paragraph (c) of § 49.4262(c)–1. Thus, on a trip by air from Chicago to London, England, with a stopover at New York, for which payment is made in the United States, if the portion from Chicago to New York is not a part of "uninterrupted international air transportation" within the meaning of section 4262(c)(3) and paragraph (c) of § 49.4262(c)–1, the tax would apply to the part of the payment which is applicable to the transportation from Chicago to New York. However, if the portion from Chicago to New York is a part of "uninterrupted international air transportation" within the meaning of section 4262(c)(3) and paragraph (c) of § 49.4262(c)–1, the tax would not apply.

PAR. 11. Section 49.4261–4 is amended by revising paragraph (b) and by adding a new paragraph (d). These amended and added provisions read as follows:

§ 49.4261–4 PAYMENTS MADE WITHIN THE UNITED STATES; EVIDENCE OF NONTAXABILITY.

* * * * * * *

(b) *Through tickets.*—In the case of transportation which is wholly or in part not taxable transportation, the issuance of one ticket (commonly known as a "through ticket") covering such transportation will be sufficient to establish that the amount paid for such transportation is wholly or in part not subject to tax. Thus, if A purchases a through ticket in the United States for transportation by air which begins before November 16, 1962, from Chicago to Edmonton, Canada, with a stopover at Minneapolis, no further evidence will be required to establish that no tax applies with respect to the amount paid for the portion of transportation between Minneapolis and Edmonton. A similar result will be reached if a through ticket is purchased for the same air transportation which begins after November 15, 1962, and the trip is not "uninterrupted international air transportation" within the meaning of section 4262(c)(3) and paragraph (c) of § 49.4262(c)–1. See paragraph (d) of this section for the information to be inscribed on all tickets issued for uninterrupted international air transportation.

* * * * * * *

(d) *Tickets issued for uninterrupted international air transportation.*—All tickets issued for "uninterrupted international air transportation" within the meaning of section 4262(c)(3) and paragraph (c) of § 49.4262(c)-1, whether through tickets or separate tickets, must have inscribed thereon, in addition to the other information required in the regulations in this subpart, sufficient information from which may be ascertained the scheduled arrival and departure time at each stopover to which the six-hour scheduled interval requirement of section 4262(c)(3) applies. It will be sufficient, for example, if the airline ticket or tickets show the trip number and the date and time of departure of the aircraft from each such stopover point, provided the published airline schedules show the scheduled time of arrival at each such stopover point.

PAR. 12. Section 49.4261–7 is amended by revising paragraphs (g), (h)(1), and (i). These amended provisions read as follows:

§ 49.4261–7 EXAMPLES OF PAYMENTS SUBJECT TO TAX.

* * * * * * *

(g) *Combinations of rail, motor vehicle, water, or air transportation.*—The tax applies to the total amount paid for transportation over the lines of a number of connecting carriers; and also with respect to transportation beginning before November 16, 1962, to the total amount paid for any combination of rail, motor vehicle, water, or air transportation, such as rail-air line, air line-motor bus, or motor bus-steamship, etc. For transportation beginning after November 15, 1962, the tax will apply only to any portion of such transportation that is by air.

(h) *Chartered conveyances.*—(1) An amount paid for the charter

(i) of a special car, train, motor vehicle, aircraft, or boat for transportation which begins before November 16, 1962, or

(ii) of an aircraft for transportation which begins after November 15, 1962, provided no charge is made by the charterer to the persons transported, is subject to tax if the amount paid for the charter represents a per capita charge of more than 60 cents for each person actually transported.

* * * * * * *

(i) *All-expense tours.*—Amounts paid for all-expense tours are subject to tax with respect to that portion representing transportation which is subject to tax. See paragraph (c) of § 49.4261–2 and paragraph (f)(4) of § 49.4261–8.

PAR. 13. Section 49.4261–8 is amended by revising paragraphs (c) and (d), and subparagraphs (3) and (5) of paragraph (f). These amended provisions read as follows:

§ 49.4261–8 EXAMPLES OF PAYMENTS NOT SUBJECT TO TAX.

* * * * * * *

(c) *Special baggage transportation equipment.*—An amount paid for special baggage transportation equipment is not subject to the tax on the transportation of persons if separable from the payment for transportation of persons and if shown in the exact amount of the charge on the records covering the taxable transportation payment.

(d) *Circus or show conveyances.*—The amount paid pursuant to a contract for the movement of a circus or show conveyance where the amount covers only the transportation of the performers, laborers, animals, equipment, etc., by such conveyances is not subject to the tax on the transportation of persons imposed by section 4261. However, if the contract payment also covers the issuance to advance agents, bill posters, etc., of circus or show scrip books, or other evidence of the right to transportation, for use on regular passenger conveyances, that portion of the contract payment properly allocable to such scrip books or other evidence is subject to the tax on the transportation of persons.

* * * * * * *

(f) *Miscellaneous charges.* * * *

(3) Charges for bridge or road toll, or a ferry charge of 60 cents or less, made in connection with the transportation beginning before November 16, 1962, of a person by bus. Charges incurred by the carrier which are part of its costs of operation, such as bridge tolls, road tolls, or ferry charges, paid by the carrier on account of the bus and driver, cannot be deducted from the charge made to the passenger in determining the taxable charges for transportation.

* * * * * * *

(5) Charges in connection with the charter of a land, water, or air conveyance for the transportation of persons beginning before November 16, 1962, or an air conveyance for transportation of persons which begins after November 15, 1962, such as for parking, icing, sanitation, "layover" or "waiting time", movement of equipment in deadhead service, dockage, wharfage, etc.

PAR. 14. Section 49.4261–9 is amended by revising paragraph (b) to read as follows:

§ 49.4261–9 SEATS AND BERTHS; RATE AND APPLICATION OF TAX.

* * * * * * *

(b) *Rate of tax.*—The tax is imposed under section 4261(c) upon the amount paid for seating or sleeping accommodations at the following rates:

(1) 10 percent with respect to amounts paid in connection with taxable transportation by rail, motor vehicle, water, or air which begins before November 16, 1962.

(2) 5 percent with respect to amounts paid in connection with the air portion of any transportation which begins after November 15, 1962.

PAR. 15. Section 49.4262(a) is amended by revising section 4262(a) and by revising the historical note. These amended provisions read as follows:

SEC. 4262(a) STATUTORY PROVISIONS; DEFINITION OF TAXABLE TRANSPORTATION; TAXABLE TRANSPORTATION; IN GENERAL.

SEC. 4262. DEFINITION OF TAXABLE TRANSPORTATION.

(a) TAXABLE TRANSPORTATION; IN GENERAL.—For purposes of this subchapter, except as provided in subsection (b), the term "taxable transportation" means—

(1) Transportation which begins in the United States or in the 225-mile zone and ends in the United States or in the 225-mile zone; and

(2) In the case of transportation other than transportation described in paragraph (1), that portion of such transportation which is directly or indirectly from one port or station in the United States to another port or station in the United States, but only if such portion is not a part of uninterrupted international air transportation (within the meaning of subsection (c)(3)).

[Sec. 4262(a) as added and in effect Jan. 1, 1959, and as amended by sec. 5(b), Tax Rate Extension Act 1962 (76 Stat. 116)]

PAR. 16. Section 49.4262(a)–1 is amended by revising subparagraph (2) of paragraph (a), by adding a new sentence at the end of paragraph (a), by changing the title of paragraph (c), and amending so much of paragraph (c) as precedes Example (1) thereof, by redesignating paragraph (d) as paragraph (e) and revising it, and by adding a new paragraph (d). These amended and added provisions read as follows:

§ 49.4262(a)–1 TAXABLE TRANSPORTATION.—(a) *In general.*—Unless excluded under section 4262(b) (see § 49.4262(b)–1), taxable transportation means—

(1) Transportation which begins in the United States or in that portion of Canada or Mexico which is not more than 225 miles from the nearest point in the continental United States (the "225-mile zone") and ends in the United States or in the 225-mile zone; and

(2) In the case of any other transportation, that portion of such transportation which is directly or indirectly from one port or station in the United States to another port or station in the United States but, with respect to transportation which begins after November 15, 1962, only if such portion is not part of "uninterrupted international air transportation" within the meaning of section 4262(c)(3) and paragraph (c) of § 49.4262(c)–1. Transportation from one port or station in the United States to another port or station in the United States occurs whenever a carrier, after leaving any port or station in the United States, makes a regularly scheduled stop at another port or station in the United States

irrespective of whether stopovers are permitted or whether passengers disembark.

The provisions of this paragraph are applicable whether the transportation is by rail, motor vehicle, water, or air, or any combination thereof, except that with respect to transportation which begins after November 15, 1962, the tax, if applicable, applies only to the amount paid for that portion of the transportation which is by air.

* * * * * * *

(c) *Illustrations of taxable transportation under section 4262(a)(2) beginning before November 16, 1962.*—The following examples will illustrate the application of section 4262(a)(2) with respect to transportation beginning before November 16, 1962:

* * * * * * *

(d) *Illustrations of taxable transportation under section 4262(a)(2) beginning after November 15, 1962.*—The following examples will illustrate the application of section 4262(a)(2) with respect to transportation beginning after November 16, 1962:

Example (1). A purchases in New York a round-trip ticket for transportation by air from New York to Nassau with a scheduled stopover of 10 hours in Miami on both the going and return trip. The amount paid for that part of the transportation from New York to Miami on the going trip is subject to tax, since such transportation is from one station in the United States to another station in the United States and the trip is not uninterrupted international air transportation because the scheduled stopover interval in Miami is greater than six hours. The amount paid for the return trip from Miami to New York is subject to tax for the same reason.

Example (2). A purchases a ticket in San Francisco for transportation to London with a stopover in New York. He is to travel by air from San Francisco to New York and from New York to London by water. He is scheduled to stopover in New York for 4 hours. That portion of the total amount paid by A for his transportation applicable to the air transportation between San Francisco and New York is subject to tax since such transportation is from one station in the United States to another station in the United States and is not a part of uninterrupted international air transportation since the complete trip from San Francisco to London is not entirely by air.

Example (3). A purchases a through ticket for air transportation from San Francisco to London with stopovers at Denver, Chicago, Philadelphia, and New York. At each stopover the air carrier has scheduled his arrival and departure within 6 hours. After arriving in Philadelphia A, for his own convenience, decides to stopover for more than 6 hours. The total amount paid by A for his transportation from San Francisco to New York is subject to tax since the scheduled interval between the beginning or end and the end or beginning of any two segments of the domestic portion of international air transportation exceeded 6 hours. If the stopover interval in Philadelphia is extended for more than 6 hours by the carrier solely for its own convenience such as making repairs to the aircraft, the domestic portion of A's trip will not become taxable, provided A continues his international air transportation no later than on the first available flight offered by the carrier.

Example (4). A purchases a through ticket for transportation by air from Los Angeles to Barbados with stopovers at Houston, Mexico City, Mexico, and Miami. At each stopover, except Mexico City, A's scheduled time of arrival and departure is within six hours. At Mexico City, A's scheduled time of arrival and departure exceeds six hours. The total amount paid by A for his transportation from Los Angeles to Miami, including that part of the transportation to and from Mexico City, is subject to tax since the transportation includes a portion which is indirectly from one port or station in the United States to another port or station in the United States (Houston to Miami via Mexico City) and the scheduled interval in Mexico City between two segments of such portion exceeds six hours. If A's scheduled arrival and departure at each stopover of his transportation which is directly or indirectly between ports or stations in the United States, including that at Mexico City, had been within a six hour interval and A had arrived and departed at each such stopover within that period, the transportation would have qualified as uninterrupted international air transportation and no part of the amount paid for the transportation by air from Los Angeles to Barbados would be subject to tax.

(e) *Illustrations of transportation which is not taxable transportation.*—The following examples will illustrate transportation which is not taxable transportation:

(1) New York to Trinidad with no intervening stops;

(2) Minneapolis to Edmonton, Canada, with a stop at Winnipeg, Canada;

(3) Los Angeles to Mexico City, Mexico, with stops at Tia Juana and Guadalajara, Mexico;

(4) New York to Whitehorse, Yukon Territory, Canada, after November 15, 1962, by air with a scheduled stopover in Chicago of five hours.

Amounts paid for the transportation referred to in examples set forth in subparagraphs (1), (2), and (3) of this paragraph are not subject to the tax regardless of where payment is made, since none of the trips (i) begin in the United States or in the 225-mile zone and end in the United States or in the 225-mile zone, nor (ii) contain a portion of transportation which is directly or indirectly from one port or station in the United States to another port or station in the United States. The amount paid within the United States for the transportation referred to in the example set forth in subparagraph (4) is not subject to tax since the entire trip (including the domestic portion thereof) is "uninterrupted international air transportation" within the meaning of section 4262(c)(3) and paragraph (c) of § 49.4262(c)-1. In the event the transportation is paid for outside the United States, no tax is due since the transportation does not begin and end in the United States.

PAR. 17. Section 49.4262(b) is amended by revising section 4262(b) and by revising the historical note. These amended provisions read as follows:

§ 49.4262(b) STATUTORY PROVISIONS; EXCLUSION OF CERTAIN TRAVEL.

SEC. 4262. DEFINITION OF TAXABLE TRANSPORTATION. * * *

(b) EXCLUSION OF CERTAIN TRAVEL.—For purposes of this subchapter, the term "taxable transportation" does not include that portion of any transportation which meets all 4 of the following requirements:

(1) Such portion is outside the United States;

(2) Neither such portion nor any segment thereof is directly or indirectly—

(A) Between (i) a point where the route of the transportation leaves or enters the continental United States, or (ii) a port or station in the 225-mile zone, and

(B) A port or station in the 225-mile zone;

(3) Such portion—

(A) Begins at either (i) the point where the route of the transportation leaves the United States, or (ii) a port or station in the 225-mile zone, and

(B) Ends at either (i) the point where the route of the transportation enters the United States, or (ii) a port or station in the 225-mile zone; and

(4) A direct line from the point (or the port or station) specified in paragraph (3)(A), to the point (or the port or station) specified in paragraph (3)(B), passes through or over a point which is not within 225 miles of the United States.

[Sec. 4262(b) as added and in effect Jan. 1, 1959, and as amended by sec. 5(b), Tax Rate Extension Act 1962 (76 Stat. 116)]

PAR. 18. Section 49.4262(b)-1 is amended by revising example (2) of paragraph (b)(2) and by revising the material set forth in the parentheses at the end of the example in paragraph (d). These amended provisions read as follows:

§ 49.4262(b)-1 EXCLUSION OF CERTAIN TRAVEL.

* * * * * * *

(b) *Transportation to or from Alaska or Hawaii.* * * *

(2) * * *

Example (2). B purchased combination rail-water transportation beginning before November 16, 1962, from Chicago to Juneau, Alaska, by way of Vancouver,

Canada. The portion of the transportation from Vancouver to the point where the route of the transportation enters the three-mile limit off the coast of Alaska is not subject to tax.

* * * * * * *

(d) *Illustration.* * * *

Example. * * *

(All distances and fares assumed for purposes of this example. If transportation begins after November 15, 1962, the tax applies only to the amount paid for transportation by air and should be computed at the rate of 5 percent.)

PAR. 19. Section 49.4262(c) is amended by adding paragraph (3) to section 4262(c) and by revising the historical note. These amended and added provisions read as follows:

§ 49.4262(c) STATUTORY PROVISIONS; DEFINITIONS; CONTINENTAL UNITED STATES; 225-MILE ZONE; UNINTERRUPTED INTERNATIONAL AIR TRANSPORTATION.

SEC. 4262. DEFINITION OF TAXABLE TRANSPORTATION. * * *

(c) DEFINITIONS. * * *

(3) UNINTERRUPTED INTERNATIONAL AIR TRANSPORTATION.—The term "uninterrupted international air transportation" means any transportation by air which is not transportation described in subsection (a)(1) and in which—

(A) The scheduled interval between (i) the beginning or end of the portion of such transportation which is directly or indirectly from one port or station in the United States to another port or station in the United States and (ii) the end or beginning of the other portion of such transportation is not more than 6 hours, and

(B) The scheduled interval between the beginning or end and the end or beginning of any two segments of the portion of such transportation referred to in subparagraph (A)(i) is not more than 6 hours.

[Sec. 4262(c) as added and in effect Jan. 1, 1959, and as further amended by sec. 22(b), Alaska Omnibus Act (73 Stat. 146) [P.L. 86–70, C.B. 1959–2, 678]; sec. 18(a), Hawaii Omnibus Act (74 Stat. 416) [P.L. 86–624, C.B. 1960–2, 686]; sec. 5(b), Tax Rate Extension Act 1962 (76 Stat. 117) [P.L. 87–508, C.B. 1962–3, page 58]]

PAR. 20. Section 49.4262(c)–1 is amended by adding a paragraph (c). The added provision reads as follows:

§ 49.4262(c)–1 DEFINITIONS.

* * * * * * *

(c) *Uninterrupted international air transportation.*—(1) For the purpose of the regulations in this subpart, the term "uninterrupted international air transportation" means transportation entirely by air which does not begin in the United States or in the 225-mile zone and end in the United States or in the 225-mile zone provided that

(i) Where the transportation within the United States involves one stop, the scheduled interval between the beginning or end of the United States portion of such air transportation and the end or beginning of the remainder of the air transportation, and

(ii) Where the United States portion of such transportation involves two or more stops, the scheduled interval between the beginning or end of one segment and the end or beginning of the continuing segment of such portion

does not exceed six hours. The transportation is considered to be entirely by air even though the passenger may use other means of transportation between two airports provided the scheduled six-hour limitation for his continuing air transportation is compiled with. Transportation which otherwise is uninterrupted international air transportation does not cease to be such because of the use of non-air transportation between ports or stations which are outside the United States, provided the non-air transportation is not a part of transportation which is indirectly from one port or station in the United States to another port or station in the United States.

(2) Where the interval between the arrival and departure time at any stopover point in the United States exceeds six hours, such transportation is not uninterrupted international air transportation even though the schedules of the air lines do not make possible a scheduling within the six hour limit. Where any interval scheduled for six hours or less is increased to exceed six hours, the transportation will continue to be uninterrupted international air transportation if the increase in time is attributable to delays in the arrival or departure of the scheduled air transportation. In such case the transportation shall continue to be uninterrupted international air transportation if the passenger continues his transportation no later than on the first available flight offered by the continuing carrier which affords the passenger substantially the same accommodations as originally purchased. However, if for any other reason such interval at any stopover is increased to more than six hours, the transportation will lose its classification of uninterrupted international air transportation. The tax applicable in such case shall be paid as provided in paragraph (a) (2) of § 49.4264(c)-1. The transportation from the point of origin in the United States to a port or station outside the United States and the 225-mile zone, with a stopover in the United States, must be scheduled before the time the initial transportation commences in order for the United States portion of such transportation to qualify as uninterrupted international air transportation. For example, where transportation by air from Chicago to New York only is scheduled in Chicago and transportation by air from New York to London, England, is scheduled by the passenger after his arrival in New York, the Chicago to New York trip does not qualify as uninterrupted international air transportation even though the passenger may depart on the London flight within six hours after arrival in New York.

PAR. 21. Section 49.4263(a) and the historical note are deleted and in lieu thereof there is inserted the following new section and historical note:

§ 49.4263 STATUTORY PROVISIONS; EXEMPTIONS.

SEC. 4263. EXEMPTIONS.

(a) COMMUTATION TRAVEL, ETC.—The tax imposed by section 4261 shall not apply to amounts paid for transportation which do not exceed 60 cents, to amounts paid for commutation or season tickets for single trips of less than 30 miles, or to amounts paid for commutation tickets for one month or less.

(b) CERTAIN ORGANIZATIONS.—The tax imposed by section 4261 shall not apply to the payment for transportation or facilities furnished to an international organization, or any corporation created by Act of Congress to act in matters of relief under the treaty of Geneva of August 22, 1864.

(c) MEMBERS OF THE ARMED FORCES.—The tax imposed by section 4261 shall not apply to the payment for transportation or facilities furnished under special tariffs providing for fares of not more than 2.5 cents per mile applicable to round-trip tickets sold to personnel of the United States Army, Air Force, Navy, Marine Corps, and Coast Guard traveling in uniform of the United States at their own expense when on official leave, furlough, or pass, including cadets and midshipmen, issued on presentation of properly executed certificate.

(d) SMALL AIRCRAFT ON NONESTABLISHED LINES.—The tax imposed by section 4261 shall not apply to transportation by aircraft having—

(1) A gross weight (as determined under regulations prescribed by the Secretary or his delegate) of less than 12,500 pounds, and

(2) A passenger seating capacity of less than ten adult passengers, including the pilot, except when such aircraft is operated on an established line.

[Sec. 4263 as redesignated and as amended and in effect Jan. 1, 1959, and as further amended by sec. 5(b), Tax Rate Extension Act 1962 (76 Stat. 117)]

PAR. 22. Section 49.4263(a)-1 is redesignated § 49.4263-1. The redesignated provision reads as follows:

§ 49.4263-1 COMMUTATION TICKETS.

PAR. 23 Section 49.4263(a)–2 is redesignated § 49.4263–2 and paragraph (c) of the section as so redesignated is amended. The redesignated and amended provisions read as follows:

§ 49.4263–2 CHARGES NOT EXCEEDING 60 CENTS.

* * * * * * *

(c) *Charters.*—An amount paid for the charter of a car, train, motor vehicle, aircraft, or boat with respect to transportation beginning before November 16, 1962, or of an aircraft with respect to transportation beginning after November 15, 1962, is exempt from the tax, if the payment represents a per capita charge of sixty cents or less for each person actually transported.

PAR. 24. Section 49.4263(b) is deleted.

PAR. 25. Section 49.4263(b)–1 is deleted.

PAR. 26. Section 49.4263(c) is deleted.

PAR. 27. Section 49.4263(c)–1 is deleted.

PAR. 28. Section 49.4263(d) is deleted.

PAR. 29. Section 49.4263(d)–1 is redesignated § 49.4263–3 and paragraph (c) of the section as so redesignated is amended. These redesignated and amended provisions read as follows:

§ 49.4263–3 TRANSPORTATION FURNISHED TO CERTAIN ORGANIZATIONS.

* * * * * * *

(c) *Evidence of right to exemption.*—The right to exemption under section 4263(b) (and under former section 4263(d)) shall be established by the use of exemption certificate, Form 731. See section 4292 and the regulations thereunder for the rules applicable when the right to exemption is evidenced by exemption certificates.

PAR. 30. Section 49.4263(e) is deleted.

PAR. 31. Section 49.4263(e)–1 is redesignated § 49.4263–4. The redesignated provision reads as follows:

§ 49.4263–4 Members of the armed forces.

PAR. 32. Section 49.4263(f) is deleted.

PAR. 33. Section 49.4263(f)–1 is redesignated § 49.4263–5. The redesignated provision reads as follows:

§ 49.4263–5 Small aircraft on nonestablished lines.

PAR. 34. Immediately after § 49.4263–5 the following new section is inserted.

§ 49.4263–6 EXEMPTIONS APPLICABLE WITH RESPECT TO TRANSPORTATION BEGINNING BEFORE NOVEMBER 16, 1962.—Section 5(b) of the Tax Rate Extension Act of 1962 repealed the exemptions contained in former section 4263(b) for motor vehicles with seating capacity of less than ten and in former section 4263(c) for fishing trips by boat effective with respect to transportation beginning after November 15, 1962. With respect to transportation which began before November 16, 1962, the tax imposed by section 4261 does not apply with respect to any amount paid for transportation

(a) By a motor vehicle having a seating capacity of less than ten adult passengers, including the driver, unless such vehicle is operated on an established line, or

(b) By boat where the transportation is for the purpose of fishing from such boat.

In the case of the exemption with respect to a motor vehicle having a seating capacity of less than ten adult passengers, the term "operated on an established line" means operated with some degree of regularity between definite points. It does not necessarily mean that strict regularity of schedule is maintained; that the full run is always made; that a particular route is followed; or that intermediate stops are restricted. The term implies that the person rendering the service maintains and exercises control over the direction, route, time, number of passengers carried, etc.

PAR. 35. Section 49.4264(c) is amended by revising subsection (c)(3) of section 4264, and by revising the historical note. These amended provisions read as follows:

§ 49.4264(c) STATUTORY PROVISIONS; SPECIAL RULES; PAYMENT OF TAX.

SEC. 4264. SPECIAL RULES. * * *

(c) PAYMENT OF TAX. * * *

(3) Payment of such tax shall be made to the Secretary or his delegate, to the person to whom the payment for transportation was made, or, in the case of transportation other than transportation described in section 4262(a)(1), to any person furnishing any portion of such transportation.

[Sec. 4264(c) as added and in effect Jan. 1, 1959, and as amended by sec. 5(b), Tax Rate Extension Act 1962 (76 Stat. 118)]

PAR. 36. Section 49.4264(c)-1 is amended by revising paragraphs (a) and (c). These amended provisions read as follows:

§ 49.4264(c)-1 SPECIAL RULE FOR THE PAYMENT OF TAX.—(a) *Rule.*—(1) *In general.*—Except as provided in subparagraph (2) of this paragraph, when any tax imposed by section 4261 is not paid at the time payment for the transportation is made, then to the extent that such tax is not collected under any other provision of law, such tax shall be paid by the person paying for the transportation or by the person using the transportation. The provisions of section 4264(c) apply where the amount paid for transportation is (i) subject to tax at the time such payment is made, but no tax is paid at that time, or (ii) not subject to tax at the time such payment is made, but because of some subsequent event the payment becomes subject to tax. The payment of tax shall be made to the district director of internal revenue for the district in which the taxpayer resides, or to the person from whom the transportation was purchased, within 30 days after whichever of the following first occurs: (*a*) The rights to the transportation expire, or (*b*) the transportation becomes subject to tax. Such payment shall be accompanied with an explanation that it is being made in accordance with section 4264(c).

(2) *Transportation no longer qualifying as uninterrupted international air transportation.* In the case of a payment for transportation beginning after November 15, 1962, which qualifies as "uninterrupted international air transportation" within the meaning of section 4262(c)(3) and paragraph (c) of § 49.4262(c)-1 on the date such payment was made and which because of some subsequent event ceases to be uninterrupted international air transportation, to the extent that the tax due is not collected under any other provision of law, such tax shall be paid by the person paying for the transportation or by the person using the transportation. The payment of the tax shall be made to the air carrier which provides the next continuing portion of the transportation following the occurrence of the event which caused the transportation to cease to be uninterrupted international air transportation and such carrier shall collect the tax at the time the flight is rescheduled or before furnishing the continuing transportation to the passenger, whichever is earlier, unless the carrier has evidence, in writing, that the tax has already been paid to (i) a district director, or (ii) the person to whom the payment for the international air transportation was originally made, or (iii) any person furnishing any portion of such transportation. The provisions of this subparagraph with respect to the responsibility of the continuing carrier to collect the tax due are applicable only if the passenger uses his original ticket or is issued a substitute therefor for the purpose of continuing his transportation. Such provisions are not applicable if the passenger purchases a new ticket to continue his transportation.

* * * * * * *

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

Example (1). A purchases in New York a round trip ticket for transportation between New York and London, England, with a stopover in Montreal, Canada. After arriving in Montreal A decides not to continue his trip to London and returns to New York. A is liable for tax with respect to the amount paid for his transportation from New York to Montreal and return. The amount paid for A's transportation became subject to tax at the time he began his return

trip to New York, and within 30 days thereafter A must pay the tax to either the person from whom he purchased the ticket or his district director of internal revenue.

Example (2). A purchases in Chicago a ticket for air transportation to begin after November 15, 1962, from Chicago to London with a stopover in New York. A is scheduled to arrive in New York at 4:30 p.m. and depart from New York on the international portion at 7:30 p.m. A arrives in New York on schedule but for his own convenience reschedules his departure on a flight departing at 11:00 p.m. Since A lengthened the interval between the end of the United States portion and the beginning of the international portion beyond the 6 hour limitation, that portion of his international air transportation between Chicago and New York became subject to tax. The carrier furnishing A's transportation from New York to London shall, before furnishing him with any transportation or at the time he reschedules the remaining portion of his trip, whichever is earlier, collect the tax due on the Chicago to New York portion from A unless the carrier has written evidence that such tax has been paid to (i) a district director of internal revenue, or (ii) the person to whom the payment for the international air transportation was originally made, or (iii) any person furnishing any other portion of the international air transportation.

PAR. 37. Section 49.4264(e) is amended by revising section 4264(e) and by revising the historical note. The amended provisions read as follows:

§ 49.4264(e) STATUTORY PROVISIONS; SPECIAL RULES; ROUND TRIPS.

SEC. 4264. SPECIAL RULES. * * *

(e) ROUND TRIPS.—In applying this subchapter to a round trip, such round trip shall be considered to consist of transportation from the point of departure to the destination, and of separate transportation thereafter.

[Sec. 4264(e) as added and in effect Jan. 1, 1959, and as amended by sec. 5(b), Tax Rate Extension Act 1962 (76 Stat. 116)]

PAR. 38. Section 49.4264(f) is amended by revising section 4264(f) and by revising the historical note. These amended provisions read as follows:

§ 49.4264(f) STATUTORY PROVISIONS; SPECIAL RULES; TRANSPORTATION OUTSIDE THE NORTHERN PORTION OF THE WESTERN HEMISPHERE.

SEC. 4264. SPECIAL RULES. * * *

(f) TRANSPORTATION OUTSIDE THE NORTHERN PORTION OF THE WESTERN HEMISPHERE.—In applying this subchapter to transportation any part of which is outside the northern portion of the Western Hemisphere, if the route of such transportation leaves and reenters the northern portion of the Western Hemisphere, such transportation shall be considered to consist of transportation to a point outside such northern portion, and of separate transportation thereafter. For purposes of this subsection, the term "northern portion of the Western Hemisphere" means the area lying west of the 30th meridian west of Greenwich, east of the international dateline, and north of the Equator, but not including any country of South America.

[Sec. 4264(f) as added and in effect Jan. 1, 1959, and as amended by sec. 5(b), Tax Rate Extension Act 1962 (76 Stat. 118)]

PAR. 39. Paragraph (b)(1) of § 49.4264(f)-1 is amended to read as follows:

§ 49.4264(f)-1 TRANSPORTATION OUTSIDE THE NORTHERN PORTION OF THE WESTERN HEMISPHERE.

* * * * * * *

(b) *Transportation beginning before November 16, 1962, by water on a vessel.*—(1) *Special rule.*—Section 4264(f)(2) prior to its amendment by section 5(b) of the Tax Rate Extension Act of 1962 provided a special rule in the case of transportation which begins before November 16, 1962, any part of which is outside the northern portion of the Western Hemisphere, by water

on a vessel which makes one or more intermediate stops at ports within the United States on a voyage which (i) begins or ends in the United States, and (ii) ends or begins outside the northern portion of the Western Hemisphere. In such a case, a stop at an intermediate port within the United States at which such vessel is not authorized both to discharge and to take on passengers shall not be considered to be a stop at a port within the United States. A vessel is considered to be authorized both to discharge and to take on passengers at an intermediate port unless there is a legal or other authoritative prohibition of such traffic. For purposes of the preceding sentence, an order issued by the owner or operator of a vessel prohibiting such vessel from either discharging or taking on passengers at the intermediate port is not a legal or other authoritative prohibition of such traffic.

PAR. 40. There is inserted immediately after § 49.6109–1 the following:

Tax Rate Extension Act of 1962

§ 49.9000 STATUTORY PROVISIONS; TAX RATE EXTENSION ACT OF 1962; SPECIAL CREDIT OR REFUND OF TRANSPORTATION TAX.

Section 5(e) of the Tax Rate Extension Act of 1962 (76 Stat. 119) provides as follows:

> SEC. 5. Extension Through November 15, 1962, of Tax on Transportation of Persons, and Further Extension of Tax on Transportation of Persons by Air at 5-percent Rate for Period November 16, 1962, Through June 30, 1963.
>
> * * * * * * *
>
> (e) SPECIAL CREDIT OR REFUND OF TRANSPORTATION TAX.—Notwithstanding any other provision of law, in any case in which tax has been collected—
>
> (1) Before November 16, 1962, for or in connection with the transportation of persons which begins on or after November 16, 1962, or
>
> (2) After November 15, 1962, and before July 1, 1963, for or in connection with the transportation of persons by air which begins on or after July 1, 1963,
>
> the person who collected the tax shall pay the same over to the United States; but credit or refund (without interest) of the tax collected in excess of that applicable (by reason of the amendments made by this section) shall be allowed to the person who collected the tax as if such credit or refund were a credit or refund under the applicable provision of the Internal Revenue Code of 1954, but only to the extent that, before the time such transportation has begun, he has repaid the amount of such excess to the person from whom he collected the tax, or has obtained the consent of such person to the allowance of the credit or refund. For the purpose of this subsection, transportation shall not be considered to have begun on or after November 16, 1962, or on or after July 1, 1963, as the case may be, if any part of the transportation paid for (or for which payment has been obligated) commenced before such date.

§ 49.9000–1 SPECIAL CREDIT OR REFUND PROVIDED BY SECTION 5(e) OF THE TAX RATE EXTENSION ACT OF 1962.—(a) *In general.*—Section 5(e) of the Tax Rate Extension Act of 1962 provides that a credit or refund shall be allowed (as if such credit or refund were a credit or refund under the applicable provisions of the Internal Revenue Code of 1954) to any person who (1) prior to November 16, 1962, collected tax at the rate of 10 percent of the amount paid for the transportation of persons by rail, water, motor vehicle, or air (including seating or sleeping accommodations) which begins on or after November 16, 1962, or (2) after November 15, 1962, and before July 1, 1963, collected tax at the rate of 5 percent on amounts paid for the transportation of persons by air (including seating or sleeping accommodations) which begins on or after July 1, 1963.

(b) *Amount of credit or refund.*—The amount to be credited or refunded shall be (1) the tax collected in the case of transportation by rail, water, or motor vehicle which begins on or after November 16, 1962, (2) the excess of

the tax collected over the rate of 5 percent in the case of transportation by air which begins on or after November 16, 1962, or (3) the tax collected on or after November 16, 1962, in the case of transportation of persons by air which begins on or after July 1, 1963.

(c) *Where and how to file claim or take a credit.*—A claim for refund may be filed on Form 843 with the district director for the internal revenue district in which the amount claimed was paid. A credit for such amount may be taken against the tax shown to be due on a subsequent return.

(d) *Conditions precedent to the allowance of a claim or credit.*—The credit or refund will be allowed only if all the following conditions are met:

(1) The tax has been collected at the higher rate (10 percent or 5 percent);

(2) Such tax actually has been paid over to the United States by the person claiming the credit or refund; and

(3) Prior to the time the transportation has begun, such person either (i) has reimbursed the person from whom the tax was collected for the amount representing the difference between the tax computed at the higher rate (10 percent or 5 percent) and the tax which would have been applicable (5 percent or no tax), or (ii) has obtained the written consent of the person from whom the tax was collected to the allowance of the credit or refund of such amount.

(e) *Evidence required.*—In order to obtain a refund or credit under this section, the claimant must have satisfactory evidence to substantiate his right to such credit or refund, such as a signed, dated statement from the person from whom the tax was collected showing his name and address and the fact that such person has received payment of such excess or has consented to the allowance of the credit or refund to the claimant. The credit or refund may not be allowed if any part of the transportation paid for, or for which payment was obligated, commenced prior to November 16, 1962, or prior to July 1, 1963, as the case may be. Section 4264(e) and § 49.4264(e)-1 provide that a round trip shall be considered to consist of transportation from the point of departure to the destination and of separate transportation thereafter. Accordingly, in the case of a round-trip ticket if the transportation from the point of origin commenced before November 16, 1962, or July 1, 1963, credit or refund as provided in this section of tax collected with respect to the amount paid for the return portion of such ticket may be allowed if the transportation authorized by the return portion is begun after November 15, 1962, or June 30, 1963, as the case may be.

(f) *Interest.*—No interest shall be allowed with respect to any amount of tax refunded or credited under the provisions of this section.

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

MORTIMER M. CAPLIN,
Commissioner of Internal Revenue.

Approved November 9, 1962.

STANLEY S. SURREY,
Assistant Secretary of the Treasury.

(Filed by the Division of the Federal Register on November 13, 1962, 8:38 a.m., and published in the issue of the Federal Register for November 14, 1962, 27 F.R. 11221)

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26 CFR 49.4261–1: Imposition of tax; in general. Rev. Rul. 62–110

A steamship company offers a cruise from New York into the Gulf Stream beyond the territorial waters of the United States. The cruise ship returns to New York without making an intermediate stop at a port of call en route. *Held*, since there is no point en route which may be regarded as the destination of the cruise for purposes of applying the special rule provided by section 4264(e)

of the Internal Revenue Code of 1954 for "round trips," the cruise is considered to be "taxable transportation" which begins and ends in the United States. Accordingly, the tax on the transportation of persons, imposed by section 4261(a) of the Code, applies to amounts paid to the steamship company for the cruise.

Advice has been requested concerning the applicability of the excise tax on the transportation of persons to amounts paid to a steamship company for the cruise described below.

A steamship company offers a cruise from New York into the Gulf Stream beyond the territorial waters of the United States. The cruise ship returns to New York without making an intermediate stop at a port of call en route. The cruise does not come within the exclusion from the term "taxable transportation" as set forth in section 4262(b) of the Internal Revenue Code of 1954. Nor does the route of the transportation leave "the northern portion of the Western Hemisphere," so as to come within the special rule provided by section 4264(f) of the Code.

The specific question is whether the cruise qualifies as a "round trip," to be treated as consisting of two separate trips, under the special rule provided by section 4264(e) of the Code, an outgoing trip from New York to a point outside the United States and a return trip from a point outside the United States.

Section 4261(a) of the Code imposes a tax upon the amount paid within the United States for taxable transportation of any person by rail, motor vehicle, water, or air.

In accordance with the provisions of section 4262(a) of the Code, the term "taxable transportation" means, insofar as material here, transportation which begins in the United States and ends in the United States.

Section 49.4261–1 of the Facilities and Services Excise Tax Regulations provides that for the tax to apply it is not necessary that transportation be between two definite points. If not otherwise exempt, a payment for continuous transportation beginning and ending at the same point is subject to the tax.

In setting forth certain special rules for the tax on the transportation of persons, section 4264(e) of the Code provides that in applying the tax provisions to a round trip, such round trip shall be considered to consist of transportation from the point of departure to the destination, and of separate transportation thereafter.

Section 49.4264(e)–1(a) of the regulations provides, in part, that a round trip shall be considered to consist of two separate trips, that is, one trip from the point of departure to the destination and a second trip in returning from the destination. In the case of a cruise or tour (that is, transportation to no set destination but with one or more intermediate stops en route), the point farthest from the point of departure will be regarded as the destination for purposes of applying the term "round trip."

Although the cruise in the instant case is partly in waters outside the United States, it does not include an intermediate stop at a port of call en route. For that reason, there is no point en route which may

be regarded as the destination of the cruise for purposes of applying the special rule for round trips as set forth in section 4264(e) of the Code and section 49.4264(e)–1(a) of the regulations. Therefore, the cruise is not considered to be a "round trip" consisting of two separate trips. Instead, it is considered to be one continuous trip which begins and ends in the United States and, as such, is taxable transportation within the purview of section 4262(a) of the Code.

Accordingly, it is held that the tax on the transportation of persons, imposed by section 4261(a) of the Code, applies to amounts paid to the steamship company for the cruise described above.

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26 CFR 49.4261–7: Examples of payments subject to tax.

Whether travel agencies, which sell guided tours to be taken on a carrier's buses, are required to file returns and pay to the Government the excise tax on the transportation of persons. See Rev. Rul. 62–105, page 277.

SECTION 4263.—EXEMPTIONS

26 CFR 49.4263(a)–1: Commutation tickets. Rev. Rul. 62–104

Annual payments made by parents pursuant to a contract with a carrier for the daily transportation of children to and from school (when the transportation for a single trip is less than thirty miles) are exempt, under the provisions of section 4263(a) of the Internal Revenue Code of 1954, from the excise tax on amounts paid for the transportation of persons, even though the carrier does not actually issue "tickets" as evidence of the right to transportation.

Advice has been requested whether the excise tax on the transportation of persons applies to amounts paid for transportation service furnished under the following circumstances.

An operator of buses furnishes daily transportation of children to and from school. Tickets are not issued, but the carrier, in accordance with a contract with the parents of each child, agrees to provide such transportation upon the payment of a flat charge per year. The length of the trip for each child transported is less than ten miles.

Section 4261(a) of the Internal Revenue Code of 1954 imposes a tax upon the amounts paid within the United States for taxable transportation (as defined in section 4262 of the Code) of any person by rail, motor vehicle, water, or air.

Section 4263(a) of the Code provides, in part, that the tax imposed by section 4261 shall not apply to amounts paid for commutation or season tickets for single trips of less than 30 miles.

Although the circumstances of this case are such that the carrier does not actually issue "tickets" as evidence of the right to transportation, the annual payments made by the parents of each child transported are considered to be payments for "commutation or season tickets" within the meaning of section 4263(a) of the Code. There-

fore, it is held that the tax imposed by section 4261(a) of the Code on the transportation of persons does not apply to the annual payments made to the carrier under the circumstances described above.

SUBCHAPTER E.—SPECIAL PROVISIONS APPLICABLE TO SERVICES AND FACILITIES TAXES

SECTION 4291.—CASES WHERE PERSONS RECEIVING PAYMENT MUST COLLECT TAX

26 CFR 42.4291–1: Duty to collect tax. Rev. Rul. 62–105
(Also Section 4261; 49.4261–7.)

Travel agencies must collect any excise tax on the transportation of persons which may be due on amounts paid to them for guided tours to be taken on buses furnished by a carrier. However, whether the travel agencies should file returns and pay the tax to the Government, rather than to remit the tax to the bus company, depends upon whether the travel agencies are acting as principals rather than as agents of the bus company.

The Internal Revenue Service has been asked whether, under the circumstances described below, the travel agencies are required to file returns and pay to the Government the excise tax on transportation of persons, imposed under section 4261 of the Internal Revenue Code of 1954, collected on amounts paid to the travel agencies for guided tours.

A carrier, which owns and operates buses, has interstate and local franchise rights to operate its vehicles over certain routes. The company has contractual arrangements to furnish special bus service to two types of travel agencies which sell guided tours. Under these arrangements, the carrier controls, operates, and maintains the buses, supplies the fuel and oil, and furnishes the drivers.

Travel agencies of the first type are independent brokers which are licensed by the Interstate Commerce Commission. They sell guided tours to individuals and to groups. They charter buses for such tours from any bus company which has the required franchise rights to operate the buses. These travel agencies are not under the supervision or control of any bus company or operator.

Travel agencies of the second type are not licensed as brokers by the Interstate Commerce Commission. They represent the bus companies and are under their supervision and control. They sell guided tours, and they remit all monies to the bus company, after retaining a commission.

Section 4261(a) of the Code imposes a tax upon the amount paid within the United States for taxable transportation of any person by rail, motor vehicle, water, or air. This tax is imposed upon the person making the payment subject to the tax.

Under the provisions of section 4291 of the Code, every person receiving any payment for facilities or services on which a tax is imposed upon the payor by section 4261 of the Code must collect the amount of the tax from the person making such payment.

The question in the instant case is whether the travel agencies, which collect the transportation tax from the persons who are liable therefor, should file returns and pay the tax to the Government or remit the tax to the bus company for payment to the Government. That depends upon whether, in selling the taxable transportation, the travel agencies are acting as principals or are acting as the agents of the bus company.

Where independent travel agencies, such as the independent broker type first described above, sell taxable guided tours to be taken on buses chartered from a carrier, the travel agencies are acting as principals in such transactions. Therefore, it is held that these travel agencies are required to collect the transportation tax, file tax returns, and pay the tax to the Government.

However, where travel agencies, such as the second type described above, sell taxable guided tours as representatives of the bus company, such travel agencies are acting as agents of the bus company. Although required to collect the transportation tax, such travel agencies should remit the tax to the bus company, which is required to file returns and pay the tax to the Government.

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 47.4301–1: Imposition of the tax on original issue of stock.

Whether, under the provisions of section 6501(a) of the Internal Revenue Code of 1954, as amended, documentary stamp taxes incurred on transactions occurring before January 1, 1959, may be assessed more than three years after the taxes became due. See Rev. Rul. 62–130, page 342.

PART II.—ISSUANCE OF CERTIFICATES OF INDEBTEDNESS

SECTION 4311.—IMPOSITION OF TAX

26 CFR 47.4311–1: Imposition of tax on issuance of certificates of indebtedness.

Whether, under the provisions of section 6501(a) of the Internal Revenue Code of 1954, as amended, documentary stamp taxes incurred on transactions occurring before January 1, 1959, may be assessed more than three years after the taxes became due. See Rev. Rul. 62–130, page 342.

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 47.4321–1: Imposition of tax.

Whether, under the provisions of section 6501(a) of the Internal Revenue Code of 1954, as amended, documentary stamp taxes incurred on transactions occurring before January 1, 1959, may be assessed more than three years after the taxes became due. See Rev. Rul. 62–130, page 342.

PART II.—SALES OR TRANSFERS OF CERTIFICATES OF INDEBTEDNESS

SECTION 4331.—IMPOSITION OF TAX

26 CFR 47.4331–1: Imposition of tax.

Whether, under the provisions of section 6501(a) of the Internal Revenue Code of 1954, as amended, documentary stamp taxes incurred on transactions occurring before January 1, 1959, may be assessed more than three years after the taxes became due. See Rev. Rul. 62–130, page 342.

SUBCHAPTER C.—CONVEYANCES

SECTION 4361.—IMPOSITION OF TAX

26 CFR 47.4361–1: Imposition of tax.

Whether, under the provisions of section 6501(a) of the Internal Revenue Code of 1954, as amended, documentary stamp taxes incurred on transactions occurring before January 1, 1959, may be assessed more than three years after the taxes became due. See Rev. Rul. 62–130, page 342.

Rev. Rul. 62–186

A company adopted a pension plan for the benefit of its employees and created a trust fund to pay the benefits under the plan. To fund the past service costs, the company transferred to the trustee certain income-producing real property. *Held*, this conveyance of realty is subject to the documentary stamp tax imposed by section 4361 of the Internal Revenue Code of 1954.

Advice has been requested whether the documentary stamp tax on conveyances of realty sold, imposed by section 4361 of the Internal Revenue Code of 1954, applies to the conveyance of real property under the circumstances described below.

A company adopted a pension plan for the benefit of its employees. To carry out the provisions of this plan, a trust has been created and a trustee has been selected to administer the fund created to pay the

benefits under the plan. For Federal income tax purposes, this is a "qualified" trust under the requirements set forth in section 401(a) of the Code. Therefore, the company's contributions to the trust are deductible for income tax purposes under the provisions of section 404(a) of the Code.

Under the plan adopted by the company, no contributions are required from the employees; the entire cost of the plan is to be borne by the company. The retirement benefits to be obtained by the employees are geared to each employee's years of service and average monthly earnings. Although not contractualy required to do so, the company desired to reward the past services of the participants. To fund the past service costs, the company transferred to the trustee certain income-producing real property, which had a fair market value of approximately $4 million. The deed specified that the property was being transferred "in consideration of the sum of ten dollars." However, subject to the limitations of section 404(a) of the Code, the company claimed an income tax deduction in an amount equal to the fair market value of the property.

The issue presented here is whether the documentary stamp tax imposed by section 4361 of the Code applies to the transfer of real property from the company to the trustee. The company contends that the tax does not apply for the reason that the property was not transferred for a "valuable consideration" for purposes of the documentary stamp tax. The basis for this contention is the claim that the transfer was not in satisfaction of a legal obligation of the company and that no significant tangible benefit was received by the company.

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 47.4361–1(a)(2) of the Documentary Stamp Tax Regulations provides, in part, that the tax is limited to conveyances of realty sold and does not apply to other conveyances. Section 47.4361–1(a)(4)(ii) of the regulations provides that the term "sold" imports transfer of an interest for a valuable consideration, which may involve money or anything of value.

Among several examples of conveyances not subject to the tax, as set forth in section 47.4361–2(b) of the regulations, are 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," etc.

Whether the realty in the instant case was "sold" for purposes of determining the applicability of the documentary stamp tax depends, therefore, upon whether the company transferred its interest in that property for a "valuable consideration." The transfer of the property by the company to the trustee is not comparable to a gift of realty to a charitable foundation, such as that involved in the case of *Murray* v. *Hoey*, 32 F. Supp. 1008 (1940). Furthermore, the transfer in this case is not a mere conveyance of a naked legal title from a principal to

an agent for the purpose of managing, conserving, and liquidating the real estate, such as that involved in the decision of the United States Circuit Court of Appeals, Sixth Circuit, in the case of *Berry* v. *Kavanaugh*, 137 Fed. (2d) 574 (1943).

In determining the applicability of the documentary stamp tax to the situation described in the instant case, consideration has been given to the decision of the United States Court of Appeals for the Sixth Circuit in the case of *United States* v. *General Shoe Corporation*, 282 Fed. (2d) 9 (1959), certiorari denied, 365 U.S. 843 (1961), and to the other cases cited in that decision.

Although that decision relates to an income tax issue, the rationale of the court there is applicable to the instant case. In that case, as here, the company contributed real property to a pension trust which had been created to carry out the provisions of a pension plan adopted by the company for the benefit of its employees. The issue there was whether the company realized a taxable gain because the value of the property contributed to the trust exceeded the company's basis of the property for income tax purposes.

In holding that the company did realize a taxable capital gain, the court stated that the disposition of the real estate by the taxpayer resulted in an "amount realized" within the meaning of the income tax statute. The court further stated, as follows:

> The theory of economic gain comes into play. To argue, as the taxpayer does here, that there can be no gain because nothing is realized, is unrealistic. Literally the taxpayer is correct in its contention that it did not receive a tangible benefit * * * however, we do not conceive that in this day and age we are restricted to tangibles in tax matters where there is actual recognizable benefit, albeit intangible, the taxation of which is implicit in the statutory scheme and where such benefit is clearly capable of being evaluated on an objective basis. * * *
>
> * * * The value of what was given up here bears a direct relationship to the fair value of the "property" received. The "property" received is an economic gain to the taxpayer of exactly the market or assessed valuation which the taxpayer used as a deduction on its income tax returns. * * * This is an arm's length situation. Emotional factors are not involved. The measurement of the intangible benefits is easily reduced to dollars and cents. * * *

Among the cases cited in support of its decision in the *General Shoe Corporation* case, the court referred particularly to the decision of the United States Circuit Court of Appeals, Second Circuit, in the case of *International Freighting Corporation* v. *Commissioner of Internal Revenue*, 135 Fed. (2d) 310 (1943). In holding, in that case, that the delivery of stock by a corporation to its employees as a bonus constituted a disposition for a consideration equal to the market value when delivered, the court stated, as follows:

> But, as the delivery of the shares here constituted a disposition for a valid consideration, it resulted in a closed transaction with a consequent realized gain. It is of no relevance here that the taxpayer had not been legally obligated to award any shares or pay any additional compensation to the employees; bonus payments by corporations are recognized as proper even if there was no previous obligation to make them; although then not obligatory, they are regarded as made for a sufficient consideration. Since the bonuses would be invalid to the extent that what was delivered to the employees exceeded what the services of the employees were worth, it follows that the consideration received by the taxpayer from the employees must be deemed to be equal at least to the value of the shares in 1936. Here then, as there was no gift but a disposition of shares for a valid consideration equal to at least the market value of the shares when delivered, there was taxable gain equal to the difference between the cost of the shares and that market value.

As indicated in the cases referred to above, the courts recognize intangible benefits in connection with contributions of property for purposes of the Federal income tax, particularly where employers and employees are involved. It follows that those intangible benefits, measured by the fair market value of the property contributed, represent "valuable consideration" for purposes of the documentary stamp tax.

In the instant case, the company received the intangible benefit of improved employer-employee relations when it set up the pension fund and contributed income-producing property to it. In addition, the company received the readily recognized economic benefit of having its capital contribution used to sustain the pension fund, so that its future contributions to the fund would be minimized. It is assumed that a company which sets up a self-sustaining employees' pension fund receives its "money's worth" for its capital contribution. Realistically, the company is receiving consideration measured by the value of the property contributed.

Accordingly, it is held that the conveyance of real property in the instant case is a conveyance of realty "sold" within the meaning of section 4361 of the Code and the applicable regulations. Therefore, the conveyance is subject to the documentary stamp tax imposed by that section of the Code.

SUBCHAPTER D.—POLICIES ISSUED BY FOREIGN INSURERS

SECTION 4371—IMPOSITION OF TAX

26 CFR 47.4371-1: Imposition of tax on policies issued by foreign insurers; scope of tax.

Whether, under the provisions of section 6501(a) of the Internal Revenue Code of 1954, as amended, documentary stamp taxes incurred on transactions occuring before January 1, 1959, may be assessed more than three years after the taxes became due. See Rev. Rul. 62-130, page 342.

CHAPTER 36.—CERTAIN OTHER EXCISE TAXES

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 device. Rev. Rul. 62-135

For purposes of the occupational tax on coin-operated devices, a so-called "horoscope machine" which by application of the element of chance may entitle the person playing the machine to receive a cash award if he has a horoscope card with a winning number printed thereon is a coin-operated gaming device within the meaning of paragraph (2) of section 4462(a) of the Internal Revenue Code

of 1954. Therefore, every person who maintains for use or permits the use of such a gaming device on any place or premises occupied by him is required by section 4461(a) of the Code to pay the special tax of $250 a year with respect to each gaming device.

Advice has been requested whether the coin-operated machine described below is considered to be a gaming device for purposes of the occupational tax on coin-operated devices.

A person maintains a so-called "horoscope machine" at his place of business for use by his customers. When a coin is inserted in the machine, the machine dispenses a small card on which is printed a horoscope reading for a particular date. The part of the card on which the horoscope reading is printed has perforated edges. That portion of the card can be lifted to reveal a number printed underneath. If the card has a certain number printed on it, the player receives a cash award from the person who maintains the "horoscope machine." The amount of the cash award depends upon the number printed on the card.

Section 4461 of the Internal Revenue Code of 1954 imposes a special tax to be paid by every person who maintains for use or permits the use of, on any place or premises occupied by him, a coin-operated amusement or gaming device. This tax is imposed at the rate of ten dollars a year in the case of a device defined in paragraph (1) of section 4462(a) and $250 a year in the case of a device defined in paragraph (2) of section 4462(a).

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 the subsection. As defined in paragraph (2) of that subsection, a "coin-operated gaming device" includes any machine which is a so-called "slot" machine which operates by means of the insertion of a coin, token, or similar object and which, by application of the element of chance, may deliver, or entitle a person playing or operating the machine to receive, cash, premiums, merchandise, or tokens.

Section 4462(b) of the Code provides that the term "coin-operated amusement or gaming device" does not include bona fide vending machines in which are not incorporated gaming or amusement features.

Generally, coin-operated horoscope or fortune telling machines, which dispense cards bearing printed matter predicting future actions, events, or personal characteristics and which do not have amusement or gaming features incorporated therein, are considered to be bona fide vending machines. Under the provisions of section 4462(b) of the Code, such machines are not coin-operated amusement or gaming devices.

However, in the instant case, a gaming feature is present in the operation of the so-called "horoscope machine." By application of the element of chance, a player operating the "horoscope machine" may be entitled to receive a cash award if he has a horoscope card with a winning number printed thereon. Since the number printed on the card determines whether a player wins and also determines the amount of the cash award he is entitled to receive, it is the number, rather than the horoscope reading, which is significant to the player.

Revenue Ruling 56–309, C.B. 1956–2, 893, holds that a coin-operated machine which, upon the insertion of a coin, delivers a ticket that entitles the player to a prize if the poker hand symbols on the ticket constitute a winning hand, is considered to be a coin-operated gaming device. In the instant case, the operation of the machine is similar to the one described in Revenue Ruling 56–309, except that the subject machine delivers a card with a winning number instead of a ticket with playing card symbols.

In accordance with the foregoing, it is held that the so-called "horoscope machine" described above is a coin-operated gaming device within the meaning of paragraph (2) of section 4462(a) of the Code. Therefore, every person who maintains for use or permits the use of such a gaming device on any place or premises occupied by him is required by section 4461(a) of the Code to pay the special tax of $250 a year with respect to each gaming device.

Under the provisions of section 4462(a)(2)(B) of the Code, the same conclusion would apply to machines which are similar to the "horoscope machine" described above, but which are operated without the insertion of a coin, token, or similar object.

CHAPTER 37.—SUGAR, COCONUT AND PALM OIL

SUBCHAPTER A.—SUGAR

SECTION 4501.—IMPOSITION OF TAX

26 CFR 46.4501: Statutory provisions; imposition of tax. (Also Section 6412; 46.6412(d).) T. D. 6611[1]

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER D, PART 46.—REGULATIONS RELATING TO MISCELLANEOUS EXCISE TAXES PAYABLE BY RETURN

Amendments to excise tax regulations relating to the tax on sugar.

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 Regulations Relating to Miscellaneous Excise Taxes Payable by Return (26 CFR Part 46) to the appropriate sections of the Sugar Act Amendments of 1962 (76 Stat. 166) [P.L. 87–535, C.B. 1962–3, 65], such regulations are amended as follows:

PARAGRAPH 1. Section 46.4501 is amended by revising section 4501(c), and the historical note, to read as follows:

[1] 27 F.R. 9556.

§ 46.4501 STATUTORY PROVISIONS; IMPOSITION OF TAX.

SEC. 4501. IMPOSITION OF TAX. * * *

(c) TERMINATION OF TAX.—No tax shall be imposed under this subchapter on the manufacture, use, or importation of sugar or articles composed in chief value of sugar after June 30, 1967. Notwithstanding the provisions of subsection (a) or (b), no tax shall be imposed under this subchapter with respect to unsold sugar held by a manufacturer on June 30, 1967, or with respect to sugar or articles composed in chief value of sugar held in customs custody or control on such date.

[Sec. 4501 as amended by sec. 19, Act of May 29, 1956 (Pub. Law 545, 84th Cong., 70 Stat. 221 [C.B. 1956–1, 887]); sec. 162(b), Excise Tax Technical Changes Act 1958 (72 Stat. 1306) [P.L. 85–859, C.B. 1958–3, 92]; sec. 2, Act of July 6, 1960 (Pub. Law 86–592, 74 Stat. 330 [C.B. 1960–2, 685]); sec. 2(a), Act of March 31, 1961 (Pub. Law 87–15, 75 Stat. 40 [C.B. 1961–1, 855]); sec. 18(a), Sugar Act Amendments of 1962 (76 Stat. 166) [P.L. 87–535, C.B. 1962–3, 65]]

PAR. 2. Section 46.6412(d) is amended by revising section 6412(d), and the historical note, to read as follows:

§ 46.6412(d) STATUTORY PROVISIONS; FLOOR STOCKS REFUNDS.

SEC. 6412. FLOOR STOCKS REFUNDS. * * *

(d) SUGAR.—With respect to any sugar or articles composed in chief value of sugar upon which tax imposed under section 4501(b) has been paid and which, on June 30, 1967, are held by the importer and intended for sale or other disposition, there shall be refunded (without interest) to such importer, subject to such regulations as may be prescribed by the Secretary or his delegate, an amount equal to the tax paid with respect to such sugar or articles composed in chief value of sugar, if claim for such refund is filed with the Secretary or his delegate on or before September 30, 1967.

[Sec. 6412(d) as amended by sec. 19, Act of May 29, 1956 (Pub. Law 545, 84th Cong., 70 Stat. 221); sec. 162(a), Excise Tax Technical Changes Act 1958 (72 Stat. 1306); sec. 2, Act of July 6, 1960 (Pub. Law 86–592, 74 Stat. 330); sec. 2(b), Act of March 31, 1961 (Pub. Law 87–15, 75 Stat. 40); sec. 18(b), Sugar Act Amendments 1962 (76 Stat. 166)]

Because this Treasury decision makes only the necessary technical changes in the statutory provisions to reflect the amendments to the Internal Revenue Code contained in the Sugar Act Amendments of 1962, 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.

(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.

Approved September 20, 1962.

STANLEY S. SURREY,
Assistant Secretary of the Treasury.

(Filed by the Division of the Federal Register on September 26, 1962, 8:49 a.m., and published in the issue of the Federal Register for September 27, 1962, 27 F.R. 9556)

CHAPTER 39.—REGULATORY TAXES

SUBCHAPTER A.—NARCOTIC DRUGS AND MARIHUANA

PART I.—NARCOTIC DRUGS

Subpart A.—Tax on Opium, Isonipecaine, Opiates, and Coca Leaves

SECTION 4702.—EXEMPTIONS

REGULATIONS 5, 26 CFR 151.211: When forms not required. T.D. 69 (Narcotics)

TITLE 26—INTERNAL REVENUE—CHAPTER I—INTERNAL REVENUE SERVICE, PART 151.—REGULATORY TAXES ON NARCOTIC DRUGS

Exceptions to use of order forms

Paragraph (d) of § 151.211, Part 151, Chapter I of the Code of Federal Regulations is amended to conform to the provisions of §§ 151.421–151.428, designating two general classes of exempt narcotic preparations. Sections 151.421–151.428 were issued as a result of the amendment of section 4702 of the Internal Revenue Code of 1954 by section 4(c) of the Narcotics Manufacturing Act of 1960 [Public Law 86–429, C.B. 1960–1, 789].

As amended, § 151.211(d) reads as follows:

§ 151.211 WHEN FORMS NOT REQUIRED.
The use of order forms is not required—

* * * * * * *

(d) For the sale, distribution, giving away, dispensing, or possession of exempt narcotic pharmaceutical preparations designated as Class "X" or Class "M" and listed in § 151.428, providing the conditions of exemption set forth in § 151.424 and § 151.425 are met.

Because this amendment conforms § 151.211(d) with the regulations in § 151.421–151.428, 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.

Effective date.—This Treasury Decision shall become effective upon publication in the Federal Register.

(26 U.S.C. 4702 as amended by sec. 4(c), Pub. Law 86–429 (74 Stat. 58) [C.B. 1960–1, 789]; sec. 17, Pub. Law 86–429 (74 Stat. 67))

[SEAL] HENRY L. GIORDANO,
Acting Commissioner of Narcotics.

Approved June 26, 1962.

JAMES A. REED
Assistant Secretary of the Treasury.

(Filed by the Division of the Federal Register on July 3, 1962, 8:49 a.m., and published in the issue of the Federal Register for July 4, 1962, 27 F.R. 6328.)

CHAPTER 52.—TOBACCO, CIGARS, CIGARETTES, AND CIGARETTE PAPERS AND TUBES

SUBCHAPTER A.—DEFINITIONS; RATE AND PAYMENT OF TAX; EXEMPTION FROM TAX; AND REFUND AND DRAWBACK OF TAX

SECTION 5704.—EXEMPTION FROM TAX

26 CFR 290.198: Preparation.

Preparation of Form 2149 regarding shipments to replace tobacco products lost, damaged, or destroyed in transit for exportation. See Rev. Proc. 62–22, page 486.

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 1.6001–1: Records.

Reproduction of certain Federal tax return forms and schedules. See Rev. Proc. 62–26, page 492.

PART II.—TAX RETURNS OR STATEMENTS

Subpart A.—General Requirement

SECTION 6011.—GENERAL REQUIREMENT OF RETURN, STATEMENT OR LIST

26 CFR 1.6011–1: General requirement of return, statement, or list.

Reproduction of certain Federal tax return forms and schedules. See Rev. Proc. 62–26, page 492.

26 CFR 31.6011(a)-1: Returns under Federal Insurance Contributions Act.

Substitutes for Form 941c, Statement to Correct Information Previously Reported Under the Federal Insurance Contributions Act. See Rev. Proc. 62–35, page 535.

26 CFR 31.6011(b)–1: Employers' identification numbers.

Application for identification numbers by employers who pay wages subject to taxes imposed by the Federal Insurance Contributions Act and who are subject to income tax withholding. See T.D. 6606, page 311.

Subpart C.—Estate and Gift Tax Returns

SECTION 6018.—ESTATE TAX RETURNS

26 CFR 20.6018–1: Returns.

Reproduction of certain Federal tax return forms and schedules. See Rev. Proc. 62–26, page 492.

SECTION 6019.—GIFT TAX RETURNS

26 CFR 25.6019–1: Persons required to file returns.

Reproduction of certain Federal tax return forms and schedules. See Rev. Proc. 62–26, page 492.

PART III.—INFORMATION RETURNS

Subpart A.—Information Concerning Persons Subject to Special Provisions

SECTION 6038.—INFORMATION WITH RESPECT TO CERTAIN FOREIGN CORPORATIONS

26 CFR 1.6038: Statutory provisions; information with respect to certain foreign corporations. (Also Section 318, 1.318.) T. D. 6621[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 to reflect the amendments made by section 20 (a) and (d) of the Revenue Act of 1962 (relating to information with respect to certain foreign entities).

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 October 30, 1962, notice of proposed rulemaking with respect to the amendment of the Income Tax Regulations (26 CFR Part 1) under sections 318 and 6038 of the Internal Revenue Code of 1954 was

[1] The publication of this Treasury Decision in 27 F.R. 11877, dated December 1, 1962, contains (1) instructions for modifying the notice of proposed rulemaking published in 27 F.R. 10544, dated October 30, 1962, 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.

published in the Federal Register (27 F.R. 10544). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the following amendment of the regulations is hereby adopted:

PARAGRAPH 1. Section 1.318 is amended by revising section 318(b)(5) and (6), by adding section 318(b)(7), and by revising the historical note. These revised and added provisions read as follows:

§ 1.318 STATUTORY PROVISIONS; CONSTRUCTIVE OWNERSHIP OF STOCK.

SEC. 318. CONSTRUCTIVE OWNERSHIP OF STOCK.

(a) GENERAL RULE. * * *

(b) CROSS REFERENCES. * * *

(5) Section 382(a)(3) (relating to special limitations on net operating loss carryovers);

(6) Section 856(d) (relating to definition of rents from real property in the case of real estate investment trusts); and

(7) Section 6038(d)(1) (relating to information with respect to certain foreign corporations).

[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], and sec. 20(d), Revenue Act 1962 (Pub. Law 87-834, 76 Stat. 960) [C.B. 1962-3, 111]]

PAR. 2. Section 1.318-1 is amended by revising subparagraphs (5) and (6) of paragraph (a), by adding a new subparagraph (7) to paragraph (a), by revising subparagraphs (3) and (4) of paragraph (b), and by adding a new subparagraph (5) to paragraph (b). These revised and added provisions read as follows:

§ 1.318-1 CONSTRUCTIVE OWNERSHIP OF STOCK; INTRODUCTION.—(a) * * *

(5) Section 382(a)(3) (relating to special limitations on net operating loss carryovers);

(6) Section 856(d) (relating to definition of rents from real property in the case of real estate investment trusts); and

(7) Section 6038(d)(1) (relating to information with respect to certain foreign corporations).

* * * * * * *

(b) * * *

(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;

(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; and

(5) Under section 6038(d)(1) (relating to information with respect to certain foreign corporations)—

(i) The second sentence of subparagraphs (A) and (B), and clause (ii) of subparagraph (C), of section 318(a)(2) shall not be applied so as to consider a United States person as owning stock which is owned by a person who is not a United States person, and

(ii) In applying clause (i) of subparagraph (C) of section 318(a)(2), the phrase "10 percent" shall be substituted for the phrase "50 percent" used in subparagraph (C).

PAR. 3. Section 1.6038 and the historical note at the end thereof are amended to read as follows:

§ 1.6038 STATUTORY PROVISIONS; INFORMATION WITH RESPECT TO CERTAIN FOREIGN CORPORATIONS.

SEC. 6038. INFORMATION WITH RESPECT TO CERTAIN FOREIGN CORPORATIONS.

(a) REQUIREMENT.—

(1) IN GENERAL.—Every United States person shall furnish, with respect to any foreign corporation which such person controls (within the meaning of subsection (d)(1)), such information as

the Secretary or his delegate may prescribe by regulations relating to—

(A) The name, the principal place of business, and the nature of business of such foreign corporation, and the country under whose laws incorporated;

(B) The accumulated profits (as defined in section 902(c)) of such foreign corporation, including the items of income (whether or not included in gross income under chapter 1), deductions (whether or not allowed in computing taxable income under chapter 1), and any other items taken into account in computing such accumulated profits;

(C) A balance sheet for such foreign corporation listing assets, liabilities, and capital;

(D) Transactions between such foreign corporation and—

(i) Such person,

(ii) Any other corporation which such person controls, and

(iii) Any United States person owning, at the time the transaction takes place, 10 percent or more of the value of any class of stock outstanding of such foreign corporation; and

(E) A description of the various classes of stock outstanding, and a list showing the name and address of, and number of shares held by, each United States person who is a shareholder of record owning at any time during the annual accounting period 5 percent or more in value of any class of stock outstanding of such foreign corporation.

The Secretary or his delegate may also require the furnishing of any other information which is similar or related in nature to that specified in the preceding sentence.

(2) PERIOD FOR WHICH INFORMATION IS TO BE FURNISHED, ETC.—The information required under paragraph (1) shall be furnished for the annual accounting period of the foreign corporation ending with or within the United States person's taxable year. The information so required shall be furnished at such time and in such manner as the Secretary or his delegate shall by regulations prescribe.

(3) LIMITATION.—No information shall be required to be furnished under this subsection with respect to any foreign corporation for any annual accounting period unless such information was required to be furnished under regulations in effect on the first day of such annual accounting period.

(b) EFFECT OF FAILURE TO FURNISH INFORMATION.—

(1) IN GENERAL.—If a United States person fails to furnish, within the time prescribed under paragraph (2) of subsection (a), any information with respect to any foreign corporation required under paragraph (1) of subsection (a), then—

(A) In applying section 901 (relating to taxes of foreign countries and possessions of the United States) to such United States person for the taxable year, the amount of taxes (other than taxes reduced under subparagraph (B)) paid or deemed paid (other than those deemed paid under section 904(d)) to any foreign country or possession of the United States for the taxable year shall be reduced by 10 percent, and

(B) In applying sections 902 (relating to foreign tax credit for corporate stockholder in foreign corporation) and 960 (relating to special rules for foreign tax credit) to any such United States person which is a corporation (or to any person who acquires from any other person any portion of the interest of such other person in any such foreign corporation, but only to the extent of such portion) for any taxable year, the amount of taxes paid or deemed paid by each foreign corporation with respect to which such person is required to furnish information during the annual accounting period or periods with re-

spect to which such information is required under paragraph (2) of subsection (a) shall be reduced by 10 percent. If such failure continues 90 days or more after notice by the Secretary or his delegate to the United States person, then the amount of the reduction under this paragraph shall be 10 percent plus an additional 5 percent for each 3-month period, or fraction thereof, during which such failure to furnish information continues after the expiration of such 90-day period.

(2) LIMITATION.—The amount of the reduction under paragraph (1) for each failure to furnish information with respect to a foreign corporation required under subsection (a)(1) shall not exceed whichever of the following amounts is the greater:

(A) $10,000, or

(B) The income of the foreign corporation for its annual accounting period with respect to which the failure occurs.

(3) SPECIAL RULES.—

(A) No taxes shall be reduced under this subsection more than once for the same failure.

(B) For purposes of this subsection, the time prescribed under paragraph (2) of subsection (a) to furnish information (and the beginning of the 90-day period after notice by the Secretary) shall be treated as being not earlier than the last day on which (as shown to the satisfaction of the Secretary or his delegate) reasonable cause existed for failure to furnish such information.

(C) In applying subsections (a) and (b) of section 902, and in applying subsection (a) of section 960, the reduction provided by this subsection shall not apply for purposes of determining the amount of accumulated profits in excess of income, war profits, and excess profits taxes.

(c) TWO OR MORE PERSONS REQUIRED TO FURNISH INFORMATION WITH RESPECT TO SAME FOREIGN CORPORATION.—Where, but for this subsection, two or more United States persons would be required to furnish information under subsection (a) with respect to the same foreign corporation for the same period, the Secretary or his delegate may by regulations provide that such information shall be required only from one person. To the extent practicable, the determination of which person shall furnish the information shall be made on the basis of actual ownership of stock.

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

(1) CONTROL.—A person is in control of a corporation if such person owns stock possessing more than 50 percent of the total combined voting power of all classes of stock entitled to vote, or more than 50 percent of the total value of shares of all classes of stock, of a corporation. If a person is in control (within the meaning of the preceding sentence) of a corporation which in turn owns more than 50 percent of the total combined voting power of all classes of stock entitled to vote of another corporation, or owns more than 50 percent of the total value of the shares of all classes of stock of another corporation, then such person shall be treated as in control of such other corporation. For purposes of this paragraph, the rules prescribed by section 318(a) for determining ownership of stock shall apply; except that—

(A) The second sentence of subparagraphs (A) and (B), and clause (ii) of subparagraph (C), of section 318(a)(2) shall not be applied so as to consider a United States person as owning stock which is owned by a person who is not a United States person, and

(B) In applying clause (i) of subparagraph (C) of section 318(a)(2), the phrase "10 percent" shall be substituted for the phrase "50 percent" used in subparagraph (C).

(2) ANNUAL ACCOUNTING PERIOD.—The annual accounting period of a foreign corporation is the annual period on the basis of which

such corporation regularly computes its income in keeping its books.

(e) CROSS REFERENCES.—

(1) For provisions relating to penalties for violations of this section, see section 7203.

(2) For definition of the term "United States person", see section 7701(a)(30).

[Sec. 6038 as added by sec. 6, Act of Sept. 14, 1960 (Pub. Law 86-780, 74 Stat. 1014) [C.B. 1960-2, 720] and amended by sec. 20(a), Rev. Act 1962 (Pub. Law 87-834, 76 Stat. 960) [C.B. 1962-3, 111]]

PAR. 4. Paragraph (a) of § 1.6038-1 is amended to read as follows:

§ 1.6038-1 INFORMATION RETURNS REQUIRED OF DOMESTIC CORPORATIONS WITH RESPECT TO ANNUAL ACCOUNTING PERIODS OF CERTAIN FOREIGN CORPORATIONS BEGINNING BEFORE JANUARY 1, 1963.—(a) *Requirement of return.*—For taxable years beginning after December 31, 1960, every domestic corporation shall make a separate annual information return on Form 2952, in duplicate, with respect to each foreign corporation which it controls, as defined in paragraph (b) of this section, and with respect to each foreign subsidiary, as defined in paragraph (c) of this section, for each annual accounting period (described in paragraph (d) of this section) of each such controlled foreign corporation or foreign subsidiary beginning after December 31, 1960, and before January 1, 1963. Such information shall not be required to be furnished, however, with respect to a corporation defined in section 1504(d) of the Code which makes a consolidated return for the taxable year. For annual accounting periods beginning after December 31, 1962, see § 1.6038-2.

PAR. 5. Section 1.6038-2 is added after § 1.6038-1 and reads as follows:

§ 1.6038-2 INFORMATION RETURNS REQUIRED OF UNITED STATES PERSONS WITH RESPECT TO ANNUAL ACCOUNTING PERIODS OF CERTAIN FOREIGN CORPORATIONS BEGINNING AFTER DECEMBER 31, 1962.—(a) *Requirement of return.*—Every United States person shall make a separate annual information return on Form 2952, in duplicate, with respect to each annual accounting period (described in paragraph (e) of this section) beginning after December 31, 1962, of each foreign corporation which that person controls, as defined in paragraph (b) of this section, for an uninterrupted period of 30 days or more during such annual accounting period. Such information shall not be required to be furnished, however, with respect to a corporation defined in section 1504(d) of the Code which makes a consolidated return for the taxable year.

(b) *Control.*—A person shall be deemed to be in control of a foreign corporation if at any time during that person's taxable year it owns stock possessing more than 50 percent of the total combined voting power of all classes of stock entitled to vote, or more than 50 percent of the total value of shares of all classes of stock of the foreign corporation. A person in control of a corporation which, in turn, owns more than 50 percent of the combined voting power, or of the value, of all classes of stock of another corporation is also treated as being in control of such other corporation. The provisions of this paragraph may be illustrated by the following example:

Example. Corporation A owns 51 percent of the voting stock in Corporation B. Corporation B owns 51 percent of the voting stock in Corporation C. Corporation C in turn owns 51 percent of the voting stock in Corporation D. Corporation D is controlled by Corporation A.

(c) *Attribution rules.*—For the purpose of determining control of domestic or foreign corporations the constructive ownership rules of section 318(a) shall apply, except that:

(1) Stock owned by or for a partner or a beneficiary of an estate or trust shall not be considered owned by the partnership, estate, or trust when the effect is to consider a United States person as owning stock owned by a person who is not a United States person;

(2) A corporation will not be considered as owning stock owned by or for a 50 percent or more shareholder when the effect is to consider a United States person as owning stock owned by a person who is not a United States person; and

(3) If 10 percent or more in value of the stock in a corporation is owned, directly or indirectly, by or for any person, subparagraph (C)(i) of section 318(a)(2) shall apply.

The constructive ownership rules of section 318(a) apply only for purposes of determining control as defined in paragraph (b) of this section.

(d) *United States person.*—For the definition of United States person, see section 7701(a)(30) of the Code and the regulations thereunder.

(e) *Period covered by return.*—The information required under paragraphs (f) and (g) of this section with respect to a foreign corporation shall be furnished for the annual accounting period of the foreign corporation ending with or within the United States person's taxable year. For purposes of this section, the annual accounting period of a foreign corporation is the annual period on the basis of which that corporation regularly computes its income in keeping its books. The term "annual accounting period" may refer to a period of less than one year, where, for example, the foreign income, war profits, and excess profits taxes are determined on the basis of an accounting period of less than one year as described in section 902(c)(2). If more than one annual accounting period ends with or within the United States person's taxable year, separate annual information returns shall be submitted for each annual accounting period.

(f) *Contents of return.*—The return on Form 2952 shall contain the following information with respect to each foreign corporation:

(1) The name, address, and employer identification number, if any, of the corporation;

(2) The principal place of business of the corporation;

(3) The date of incorporation and the country under whose laws incorporated;

(4) The name and address of the foreign corporation's statutory or resident agent in the country of incorporation;

(5) The name, address, and identifying number of any branch office or agent of the foreign corporation located in the United States;

(6) The name, address, and identifying number, if any, of the person (or persons) having custody of the books of account and records of the foreign corporation, and the location of such books and records if different from such address;

(7) The nature of the corporation's business and the principal places where conducted;

(8) As regards the outstanding stock of the corporation—

(i) A description of each class of the corporation's stock, and

(ii) The number of shares of each class outstanding at the beginning and end of the annual accounting period;

(9) A list showing the name, address, and identifying number of, and the number of shares of each class of the corporation's stock held by, each United States person who is a shareholder owning at any time during the annual accounting period 5 percent or more in value of any class of the corporation's outstanding stock;

(10) For the annual accounting period, the amount of the corporation's:

(i) Current earnings and profits;

(ii) Foreign income, war profits, and excess profits taxes paid or accured;

(iii) Distributions out of current earnings and profits for the period;

(iv) Distributions other than those described in subdivision (iii) of this subparagraph and the source thereof.

(11) A summary showing the total amount of each of the following types of transactions of the corporation, which took place during the annual accounting period, with the person required to file this return, any other corporation controlled by that person, or any United States person owning at the time of the transaction 10 percent or more in value of any class of stock outstanding of the foreign corporation, or of any corporation controlling that foreign corporation:

(i) Sales and purchases of stock in trade, except in the ordinary course of business where neither party to the transaction is a United States person;

(ii) Purchases of tangible property other than stock in trade, except where neither party to the transaction is a United States person;

(iii) Sales and purchases of patents, inventions, models, or designs (whether or not patented), copyrights, trademarks, secret formulas or processes, or any other similar property rights;

(iv) Compensation paid and compensation received for the rendition of technical, managerial, engineering, construction, scientific, or like services;

(v) Commissions paid and commissions received;
(vi) Rents and royalties paid and rents and royalties received;
(vii) Amounts loaned and amounts borrowed (other than open accounts which arise and are collected in the ordinary course of business);
(viii) Dividends paid and dividends received;
(ix) Interest paid and interest received;
(x) Premiums received for insurance or reinsurance.

If the United States person is a bank, as defined in section 581, or is controlled within the meaning of section 368(c) by a bank, the term "transactions" shall not, as to a corporation with respect to which a return is filed, include banking transactions entered into on behalf of customers; in any event, however, deposits in accounts between a foreign corporation, controlled (within the meaning of paragraph (b) of this section) by a United States person, and a person described in this subparagraph and withdrawals from such accounts shall be summarized by reporting end-of-month balances.

(g) *Financial statements.*—The following information with respect to the foreign corporation shall be attached to and filed as part of the return required by this section:

(1) A statement of the corporation's profit and loss for the annual accounting period;

(2) A balance sheet as of the end of the annual accounting period of the corporation showing—
(i) The corporation's assets,
(ii) The corporation's liabilities,
(iii) The corporation's net worth;

(3) An analysis of changes in the corporation's surplus accounts during the annual accounting period including both opening and closing balances.

The statements listed in subparagraphs (1), (2), and (3) of this paragraph shall be prepared in conformity with generally accepted accounting principles, and in such form and detail as is customary for the corporation's accounting records.

(h) *Method of reporting.*—All amounts furnished under paragraphs (f) and (g) of this section shall be expressed in United States currency with a statement of the exchange rates used. All statements submitted on or with the return required under this section shall be rendered in the English language.

(i) *Time and place for filing return.*—Returns on Form 2952 required under paragraph (a) of this section shall be filed with the United States person's income tax return on or before the date required by law for the filing of that person's income tax return.

(j) *Extension of time for filing.*—District directors are authorized to grant reasonable extensions of time for filing returns on Form 2952 in accordance with the applicable provisions of § 1.6081–1 of this chapter. An application for an extension of time for filing a return of income shall also be considered as an application for an extension of time for filing returns on Form 2952.

(k) *Two or more persons required to submit the same information.*—(1) *Return jointly made.*—If two or more persons are required to furnish information with respect to the same foreign corporation for the same period, such persons may, in lieu of making separate returns, jointly make one return. Such joint return shall be filed with the income tax return of any one of the persons making such joint return.

(2) *Persons excepted from furnishing information.*—Any person required to furnish information under this section with respect to a foreign corporation need not furnish that information provided all of the following conditions are met:

(i) Such person does not directly own an interest in the foreign corporation;

(ii) Such person is required to furnish the information solely by reason of attribution of stock ownership from a United States person under paragraph (c) of this section;

(iii) The person from whom the stock ownership is attributed furnishes all of the information required under this section of the person to whom the stock ownership is attributed.

The rule of this subparagraph may be illustrated by the following examples:

Example (1). A, a United States person (as defined in section 7701(a)(30)), owns 100 percent of the stock of M, a domestic corporation. A also owns 100 percent of the stock of N, a foreign corporation. A, in filing the information return required by this section with respect to N Corporation, in fact furnishes all of the information required of M Corporation with respect to N Corporation. M Corporation need not file the information.

Example (2). X, a domestic corporation, owns 100 percent of the stock of Y, a domestic corporation. Y Corporation owns 100 percent of the stock of Z, a foreign corporation. X Corporation is not excused by this subparagraph from filing information with respect to Z Corporation because X Corporation is deemed to control Z Corporation under the provisions of paragraph (b) of this section without recourse to the attribution rules in paragraph (c).

(3) *Statement required.*—Any United States person required to furnish information under this section with his return who does not do so by reason of the provisions of subparagraph (1) or (2) of this paragraph shall file a statement with his return indicating that such liability has been (or, in the case of a joint return made under subparagraph (1) of this paragraph, will be) satisfied and identifying the return with which the information was or will be filed and the place of filing.

(l) *Failure to furnish information.*—(1) *Effect on foreign tax credit.*—(i) Failure of a United States person to furnish, in accordance with the provisions of this section, any return or any information in any return, required to be filed for a taxable year under authority of section 6038 on or before the date prescribed in paragraph (i) of this section (determined with regard to any extension of time for such filing) shall affect the application of section 901 as provided in subparagraph (2) of this paragraph and shall affect the application of sections 902 and 960 as provided in subparagraph (3) of this paragraph. Such failure shall affect the application of sections 902 and 960 to any such United States person which is a corporation or to any person who acquires from any other person any portion (but only to the extent of such portion) of the interest of such other person in any such foreign corporation.

(ii) Where a United States person, having filed the return required by this section except for an omission of, or error with respect to, some of the information referred to in paragraphs (f) and (g) of this section, establishes to the satisfaction of the Commissioner that such omission or error was inadvertent or for reasonable cause and that such person has substantially complied with this section, such omission or error shall not constitute a failure under this section.

(2) *Application of section 901.*—In the application of section 901 to a United States person referred to in subdivision (i) of subparagraph (1) of this paragraph, the amount of taxes paid or deemed paid by such person for any taxable year, with or within which the annual accounting period of a foreign corporation for which such person failed to furnish information required under this section ended, shall be reduced by 10 percent. However, no tax reduced under subparagraph (3) of this paragraph or deemed paid under section 904(d) shall be reduced under the provisions of this subparagraph.

(3) *Application of sections 902 and 960.*—In the application of sections 902 and 960 to a United States person referred to in subdivision (i) of subparagraph (1) of this paragraph for any taxable year, the amount of taxes paid or deemed paid by each foreign corporation for the accounting period or periods for which such person was required for the taxable year of the failure to furnish information under this section shall be reduced by 10 percent. The 10-percent reduction is not limited to the taxes paid or deemed paid by the foreign corporation with respect to which there is a failure to file information but shall apply to the taxes paid or deemed paid by all foreign corporations controlled by that person. In applying subsections (a) and (b) of section 902, and in applying subsection (a) of section 960, the reduction provided by this paragraph shall not apply for purposes of determining the amount of accumulated profits in excess of income, war profits, and excess profits taxes.

(4) *Reduction for continued failure.*—(i) If the failure referred to in subdivision (i) of subparagraph (1) of this paragraph continues for 90 days or more after date of written notice by the district director to such United States person, then the amount of the reduction referred to in subparagraphs (2) and (3) of this paragraph shall be 10 percent plus an additional 5 percent for each 3-month

period, or fraction thereof, during which such failure continues after the expiration of such 90-day period.

(ii) No taxes shall be reduced under this paragraph more than once for the same failure. Taxes paid by a foreign corporation when once reduced for a failure shall not be reduced again for the same failure in their status as taxes deemed paid by a corporate shareholder. Where a failure continues, each additional periodic 5-percent reduction, referred to in subdivision (i) of this subparagraph, shall be considered as part of the one reduction.

(iii) The effects of section 6038(b) and of this paragraph on the computation of foreign tax credit under section 902(a) of the Code and, where applicable, on the computation of the amount equal to taxes deemed paid which is includible in gross income under section 78 of the Code, may be illustrated by the following examples:

Example (1). M, a domestic corporation, owns 100 percent of the stock of N, a foreign corporation which is a less developed country corporation within the meaning of section 902(d) of the Code. Both M and N use the calendar year as a taxable year and all of the following events occur after January 1, 1965. The dividend from N Corporation is the only dividend from a foreign corporation received by M Corporation during the taxable year.

(a) Gains, profits, and income of N Corporation. $100,000

(b) Foreign tax paid with respect to such gains, profits, and income by N Corporation. 40,000

(c) Reduction of foreign tax paid by N Corporation resulting from M Corporation's failure to file information with respect to N Corporation as required under section 6038(a): 90-day failure to file, 10-percent reduction; additional 3 months failure to file, 5-percent reduction; total reduction, 15 percent. ($40,000 times 15 percent) 6,000

(d) Foreign tax paid by N Corporation after section 6038(b)(1)(B) reduction. 34,000

(e) Dividend paid by N Corporation to M Corporation. 45,000

(f) Accumulated profits of N Corporation as defined in section 902(c)(1)(B) (determined without regard to the section 6038(a)(1)(B) reduction). 60,000

(g) M Corporation is deemed to have paid the same proportion of foreign taxes paid (reduced as provided under section 6038(b)) on or with respect to the accumulated profits (determined without regard to the reduction provided under section 6038(b) as the amount of dividends bears to the amount of such accumulated profits. 15,300

$$\frac{60,000}{100,000} \times \frac{45,000}{60,000} \times 34,000$$

The above example illustrates that the reduction in foreign taxes paid by the foreign corporation provided under section 6038(b) and this paragraph are not taken into account in computing accumulated profits for purposes of determining the amount of foreign taxes deemed paid with respect to a particular dividend.

Example (2). The facts are the same as in example (1) except that N Corporation is not a less developed country corporation within the meaning of section 902(d) of the Code.

(a) Gains, profits, and income of N Corporation. $100,000

(b) Foreign tax paid by N Corporation with respect to such gains, profits, and income. 40,000

(c) Reduction of foreign tax paid by N Corporation resulting from M Corporation's failure to file information with respect to N Corporation as required under section 6038(a): 90-day failure to file, 10-percent reduction; additional 3 months failure to file, 5-percent reduction; total reduction, 15 percent. ($40,000 times 15 percent) 6,000

(d) Foreign tax paid by N Corporation after section 6038(b)(1)(B) reduction. 34,000

(e) Dividend paid by N Corporation to M Corporation 45,000

(f) Accumulated profits of N Corporation as defined in section 902(c)(1)(A) (determined without regard to the section 6038(b)(1)(B) reduction). 100,000

(g) Accumulated profits of N Corporation as described in section 902 (a)(1) (determined without regard to the section 6038(b)(1)(B) reduction). 60,000

(h) M Corporation is deemed to have paid the same proportion of foreign taxes paid (reduced as provided under section 6038(b)) with respect to the accumulated profits (determined without regard to the reduction provided under section 6038(b)) as amount of the dividend (determined without regard to section 78) bears to such amount of accumulated profits. 25,500

$$\frac{45,000}{60,000} \times 34,000$$

M Corporation must include $25,500 in gross income as a dividend under the provisions of section 78 of the Code. The above example illustrates that the reductions in foreign taxes paid by the foreign corporation provided under section 6038(b) are taken into account in determining the amount included in gross income of the domestic corporation as foreign taxes deemed paid under section 78 of the Code but such reductions are not taken into account in computing accumulated profits for purposes of determining the amount of foreign taxes deemed paid with respect to a particular dividend.

(5) *Limitation on reduction.*—The amount of the reduction under this paragraph for each failure to furnish information with respect to a foreign corporation as required under this section shall not exceed the greater of:

(i) $10,000, or

(ii) The income of the foreign corporation for its annual accounting period with respect to which the failure occurs.

For purposes of this section if a person is required to furnish information with respect to more than one foreign corporation, controlled (within the meaning of paragraph (b) of this section) by that person, each failure to submit information for each such corporation constitutes a separate failure.

(6) *Reasonable cause.*—For purposes of subsection (b) of section 6038 and this section, the time prescribed for furnishing information under this paragraph, and the beginning of the 90-day period after notice by the district director, shall be treated as being not earlier than the last day on which (as shown to the satisfaction of the district director) reasonable cause existed for failure to furnish such information.

(7) A person, who wishes to avoid the reductions provided in subparagraphs (2), (3), and (4) of this paragraph for failure to furnish information in accordance with this section, must make an affirmative showing under subparagraph (1)(ii) or (6) of this paragraph of all facts alleged as a reasonable cause for such failure in the form of a written statement containing a declaration that it is made under the penalties of perjury.

(8) *Penalties.*—The information required by section 6038 of the Code must be furnished even though there are no foreign taxes which would be reduced under the provisions of this section. For criminal penalties for failure to file a return and filing a false or fraudulent return, see sections 7203, 7206, and 7207 of the Code.

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

BERTRAND M. HARDING,
Acting Commissioner of Internal Revenue.

Approved November 29, 1962.

STANLEY S. SURREY,
Assistant Secretary of the Treasury.

(Filed by the Division of the Federal Register on November 30, 1962, 8:51 a.m., and published in the issue of the Federal Register for December 1, 1962, 27 F.R. 11877)

Subpart B.—Information Concerning Transactions With Other Persons

SECTION 6042.—RETURNS REGARDING PAYMENTS OF DIVIDENDS AND CORPORATE EARNINGS AND PROFITS

26 CFR 1.6042–1: Return of information as to payment of dividends. (Also Section 61; 1.61–9.) Rev. Rul. 62–201[1]

The following guidelines are set forth as an aid in determining the liability for income tax on dividend payments and for the reporting of dividend payments by the payors.

The general rule is that dividends on stock are presumptively the income of the record owner of the stock and, unless otherwise shown, the record owner is considered to be the actual owner for the purpose of determining the liability for any tax attributable to dividends on the stock whether payment of the dividend is made to him or to someone else at his direction.

A record owner who claims that he is not the actual owner of stock and, consequently, not liable for income tax on the dividends, must, with respect to dividends paid on such stock, file a Form 1087, Ownership Certificate—Dividends on Stock, for the calendar year disclosing the name and address of the actual owner, the name of the issuing corporation, the number of shares, and the amount of dividends. Unless such disclosure is made, it will be assumed that the record owner is the actual owner and appropriate steps will be taken to require the inclusion of the dividends in his income.

Generally, a separate Form 1087 must be filed by the record owner for each of the stockholdings of each actual owner for whom he acts as nominee. However, where the record owner is a banking institution, trust company, or brokerage firm, it may, provided it maintains such records as will permit a prompt substantiation of each payment of dividends made to the actual owner, file one Form 1087 for each actual owner for whom it acts as nominee and report thereon the total amount of dividends paid to such actual owner (without itemization as to the issuing company, class of stock, etc.). For a listing of special circumstances in which no Form 1087 is required to be filed, see section 1.6042–1(c)(2) of the Income Tax Regulations.

Consistent with the above, a Form 1099, U.S. Information Return for Calendar Year ——, filed by a payor of dividends who is asked by the record owner to pay the dividend to another person, should show the distribution of the dividend to the record owner.

[1] Based on Technical Information Release 394, dated August 2, 1962.

SECTION 6046.—RETURNS AS TO ORGANIZATION OR REORGANIZATION OF FOREIGN CORPORATIONS AND AS TO ACQUISITIONS OF THEIR STOCK

26 CFR 1.6046: Statutory provisions; returns as to organization or reorganization of foreign corporations and as to acquisitions of their stock.
(Also Section 6679; 301.6679)

T. D. 6623 [1]

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

Regulations amended with respect to returns as to organization or reorganization of foreign corporations and as to acquisitions of their stock.

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 October 30, 1962, notice of proposed rulemaking was published in the Federal Register (27 F.R. 10547) regarding the amendment of the Income Tax Regulations (26 CFR Part 1) and the Regulations on Procedure and Administration (26 CFR Part 301) under section 6046 of the Internal Revenue Code of 1954 as amended by section 20(b) of the Revenue Act of 1962 (Public Law 87-834, 76 Stat. 1061) [C.B. 1962-3, 111], and section 6679 of such Code as added by section 20(c) of such Act (76 Stat. 1062). 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. Section 1.6046 is amended to read as follows:

§ 1.6046 STATUTORY PROVISIONS; RETURNS AS TO ORGANIZATION OR REORGANIZATION OF FOREIGN CORPORATIONS AND AS TO ACQUISITIONS OF THEIR STOCK.

SEC. 6046. RETURNS AS TO ORGANIZATION OR REORGANIZATION OF FOREIGN CORPORATIONS AND AS TO ACQUISITIONS OF THEIR STOCK.

(a) REQUIREMENT OF RETURN.—A return complying with the requirements of subsection (b) shall be made by—

(1) Each United States citizen or resident who is on January 1, 1963, an officer or director of a foreign corporation, 5 percent or more in value of the stock of which is owned by a United States person (as defined in section 7701(a)(30)), or who becomes such an officer or director at any time after such date.

(2) Each United States person who on January 1, 1963, owns 5 percent or more in value of the stock of a foreign corporation, or who, at any time after such date—

(A) Acquires stock which, when added to any stock owned on January 1, 1963, has a value equal to 5 percent or more of the value of the stock of a foreign corporation, or

(B) Acquires an additional 5 percent or more in value of the stock of a foreign corporation, and

[1] The publication of this Treasury Decision in 27 F.R. 11881, dated December 1, 1962, contains (1) instructions for modifying the notice of proposed rulemaking in 27 F.R. 10547, dated October 30, 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.

(3) Each person who at any time after January 1, 1963, becomes a United States person while owning 5 percent or more in value of the stock of a foreign corporation.

(b) FORM AND CONTENTS OF RETURNS.—The returns required by subsection (a) shall be in such form and shall set forth, in respect of the foreign corporation, such information as the Secretary or his delegate prescribes by forms or regulations as necessary for carrying out the provisions of the income tax laws, except that in the case of persons described only in subsection (a)(1) the information required shall be limited to the names and addresses of persons described in subsection (a)(2).

(c) OWNERSHIP OF STOCK.—For purposes of subsection (a), stock owned directly or indirectly by a person (including, in the case of an individual, stock owned by members of his family) shall be taken into account. For purposes of the preceding sentence, the family of an individual shall be considered as including only his brothers and sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendants.

(d) TIME FOR FILING.—Any return required by subsection (a), shall be filed on or before the 90th day after the day on which, under any provision of subsection (a), the United States citizen, resident, or person becomes liable to file such return.

(e) LIMITATION.—

(1) GENERAL RULE.—Except as provided in paragraph (2), no information shall be required to be furnished under this section with respect to any foreign corporation unless such information was required to be furnished under regulations which have been in effect for at least 90 days before the date on which the United States citizen, resident, or person becomes liable to file a return required under subsection (a).

(2) EXCEPTION.—In the case of liability to file a return under subsection (a) arising on or after January 1, 1963, and before June 1, 1963—

(A) No information shall be required to be furnished under this section with respect to any foreign corporation unless such information was required to be furnished under regulations in effect on or before March 1, 1963, and

(B) If the date on which such regulations become effective is later than the day on which such liability arose, any return required by subsection (a) shall (in lieu of the time prescribed by subsection (d)) be filed on or before the 90th day after such date.

(f) CROSS REFERENCE.—For provisions relating to penalties for violations of this section, see sections 6679 and 7203.

[Sec. 6046 as amended by sec. 7(a), Act of Sept. 14, 1960 (Pub. Law 86-780, 74 Stat. 1016) [C.B. 1960-2, 720]; sec. 20(b) Revenue Act 1962 (76 Stat. 1061) [C.B. 1962-3, 111]]

PAR. 2. Section 1.6046-1 is redesignated § 1.6046-3 and is amended by revising the heading and paragraphs (a), (c), and (e) thereof to read as follows:

§ 1.6046-3 RETURNS AS TO FORMATION OR REORGANIZATION OF FOREIGN CORPORATIONS PRIOR TO SEPTEMBER 15, 1960.—(a) *Requirement of returns.*—Every attorney, accountant, fiduciary, bank, trust company, financial institution, or other person, who, on or before September 14, 1960, aids, assists, counsels, or advises in, or with respect to, the formation, organization, or reorganization of any foreign corporation shall file an information return on Form 959 (as in use prior to the October 1960 revision). The return must be filed in every such case regardless of—

* * * * * * *

(c) *Information required to be shown on return.*—The return required by section 6046, prior to its amendment by section 7(a) of the Act of September 14, 1960, and this section shall set forth the following information to the extent the

information is within the possession or knowledge, or under the control, of the person filing the return:

* * * * * * *

(e) *Time and place for filing return.*—(1) *Time for filing.*—Returns required by section 6046, prior to its amendment by section 7(a) of the Act of September 14, 1960, and this section shall be filed within 30 days after the first performance of any of the functions referred to in paragraph (a) of this section. If in a particular case, the aid, assistance, counsel, or advice given by any person extends over a period of more than one day, such person, to avoid multiple filing of returns, shall file a return within 30 days after either of the following events:

PAR. 3. Immediately preceding § 1.6046–3 as redesignated there is inserted the following new section:

§ 1.6046–2 RETURNS AS TO FOREIGN CORPORATIONS WHICH ARE CREATED OR ORGANIZED, OR REORGANIZED, ON OR AFTER SEPTEMBER 15, 1960, AND BEFORE JANUARY 1, 1963.—(a) *Requirement of returns.*—In the case of any foreign corporation which is created or organized, or reorganized, on or after September 15, 1960, and before January 1, 1963—

(1) Each United States citizen or resident who was an officer or director of such corporation at any time within 60 days after such creation or organization, or reorganization, and

(2) Each United States shareholder of such corporation by or for whom, at any time within 60 days after such creation or organization, or reorganization, 5 percent or more in value of such corporation's then outstanding stock was owned directly or indirectly (including, in the case of an individual stock owned by members of his family),

shall file a return on Form 959 (Rev. Oct. 1960), United States Information Return With Respect to the Creation or Organization, or Reorganization, of a Foreign Corporation.

(b) *Information required to be shown on return.*—The return required by section 6046, prior to its amendment by section 20(b) of the Revenue Act of 1962, and this section shall set forth the following information:

(1) The name and address of the person (or persons) filing the return, and an indication that he is a United States shareholder, officer, or director;

(2) The name and business address of the foreign corporation;

(3) The name of the country under the laws of which the foreign corporation was created or organized, or reorganized;

(4) The name and address of the foreign corporation's statutory or resident agent in the country of incorporation;

(5) The date of the foreign corporation's creation or organization, or reorganization;

(6) A statement of the manner in which the creation or organization, or reorganization, of the foreign corporation was effected;

(7) A complete statement of the reasons for, and the purposes sought to be accomplished by, the creation or organization, or reorganization, of the foreign corporation;

(8) A statement showing the classes and kinds of assets transferred to the foreign corporation in connection with its creation or organization, or reorganization, including a list completely describing each asset or group of assets, its value, date of transfer, and the name and address of person (or persons) owning such asset or group immediately prior to the transfer;

(9) A statement showing the assets transferred and the securities issued by the foreign corporation in its creation or organization or reorganization, as well as the name and address of each person to whom such a transfer or issuance was made;

(10) A statement specifying the amount and type of any indebtedness due from the foreign corporation to each of its shareholders and the name of each such shareholder;

(11) The names and addresses of the shareholders of the foreign corporation at the time of its creation or organization, or reorganization, and the classes of stock and number of shares held by each;

(12) The names and addresses of subscribers to the stock of the foreign corporation, and the number of shares subscribed to by each; and

(13) The name and address of the person (or persons) having custody of the books of account and records of the foreign corporation, and the location of such books and records if different from such address.

(c) *Time and place for filing return.*—The return required by section 6046, prior to its amendment by section 20(b) of the Revenue Act of 1962, and this section shall be filed with the Director of International Operations, Internal Revenue Service, Washington 25, D.C., on or before the 90th day after such foreign corporation is created or organized, or reorganized.

PAR. 4. Immediately preceding § 1.6046–2 there is inserted the following new section:

§ 1.6046–1 RETURNS AS TO ORGANIZATION OR REORGANIZATION OF FOREIGN CORPORATIONS AND AS TO ACQUISITIONS OF THEIR STOCK, ON OR AFTER JANUARY 1, 1963.—(a) *Officers or directors.*—(1) *When liability arises on January 1, 1963.*—Each United States citizen or resident who is on January 1, 1963, an officer or director of a foreign corporation shall make a return on Form 959 (Rev. Jan. 1963) showing the name, address, and identifying number of each United States person (as defined in section 7701(a)(30)) who, on January 1, 1963, owns 5 percent or more in value of the outstanding stock of such foreign corporation.

(2) *When liability arises after January 1, 1963.*—(i) *Requirement of return.*—Each United States citizen or resident who is at any time after January 1, 1963, an officer or director of a foreign corporation shall make a return on Form 959 (Rev. Jan. 1963) setting forth the informtaion described in subdivision (ii) of this subparagraph with respect to each United States person (as defined in section 7701(a)(30)) who, during the time such citizen or resident is such an officer or director—

(*a*) Acquires (whether in one or more transactions) outstanding stock of such corporation which has, or which when added to any such stock then owned by him (excluding any stock owned by him on January 1, 1963, if on that date he owned 5 percent or more in value of such stock) has, a value equal to 5 percent or more in value of the outstanding stock of such foreign corporation, or

(*b*) Acquires (whether in one or more transactions) an additional 5 percent or more in value of the outstanding stock of such foreign corporation.

(ii) *Information required to be shown on return.*—The return required under subdivision (i) of this subparagraph shall contain the following information:

(*a*) Name, address, and identifying number of each shareholder with respect to whom the return is filed;

(*b*) A statement showing that the shareholder is either described in subdivision (i) (*a*) or (i) (*b*) of this subparagraph; and

(*c*) The date on which the shareholder became a person described in subdivision (i) (*a*) or (i) (*b*) of this subparagraph.

(3) *Application of rules.*—The provisions of this paragraph may be illustrated by the following examples:

Example (1). A, a United States citizen, is, on January 1, 1963, a director of M, a foreign corporation. X, on January 1, 1963, is a United States person owning 5 percent in value of the outstanding stock of M Corporation. A must file a return under the provisions of subparagraph (1) of this paragraph.

Example (2). The facts are the same as in Example (1) except that X owns only 2 percent in value of the outstanding stock of M Corporation on January 1, 1963. On July 1, 1963, X acquires 2 percent in value of the outstanding stock of M Corporation and on September 1, 1963, he acquires an additional 2 percent in value of such stock. The July 1, 1963, transaction does not give rise to liability to file a return; however, A must file a return as a result of the September 1, 1963, transaction because X's holdings now exceed 5 percent.

Example (3). The facts are the same as in Example (2) and, on September 15, 1963, X acquires an additional 4 percent in value of the outstanding stock of M Corporation (X's total holdings are now 10 percent). On November 1, 1963, X acquires an additional 2 percent in value of the outstanding stock of M Corporation. The September 15, 1963, transaction does not give rise to liability to file a return since X has not acquired 5 percent in value of the outstanding stock of M Corporation since A last became liable to file a return. However, A must file a return as a result of the November 1, 1963, transaction because X has now acquired an additional 5 percent in value of the outstanding stock of M Corporation.

Example (4). The facts are the same as in Examples (2) and (3) and, in addition, B, a United States citizen, becomes an officer of M Corporation on October 1, 1963. B is not required to file a return either as a result of the facts set forth in Example (2) or as a result of the September 15, 1963, transaction described in Example (3). However, B is required to file a return as a result of the November 1, 1963, transaction described in Example (3) because X has acquired an additional 5 percent in value of the outstanding stock of M Corporation while B is an officer or director.

(b) *Returns required of United States persons when liability to file arises on January 1, 1963.*—Each United States person, as defined in section 7701(a)(30), who, on January 1, 1963, owns 5 percent or more in value of the outstanding stock of a foreign corporation, shall make a return on Form 959 (Rev. Jan. 1963) with respect to such foreign corporation setting forth the following information:

(1) The name, address, and identifying number of the shareholder (or shareholders) filing the return, and the internal revenue district in which such shareholder filed his most recent United States income tax return;

(2) The name, business address, and employer identification number, if any, of the foreign corporation and the name of the country under the laws of which it is incorporated;

(3) The date of organization and, if any, of each reorganization of the foreign corporation if such reorganization occurred on or after January 1, 1960, while the shareholder owned 5 percent or more in value of the outstanding stock of such corporation;

(4) The name and address of the foreign corporation's statutory or resident agent in the country of incorporation;

(5) The name, address, and identifying number of any branch office or agent of the foreign corporation located in the United States;

(6) If the foreign corporation has filed a United States income tax return, or participated in the filing of a consolidated return, for any of its last three calendar or fiscal years immediately preceding January 1, 1963, state each year for which a return was filed (including, in the case of a consolidated return, the name of the corporation filing such return), the type of form used, the internal revenue office to which it was sent, and the amount of tax, if any, paid;

(7) The name and address of the person (or persons) having custody of the books of account and records of the foreign corporation, and the location of such books and records if different from such address;

(8) The names, addresses, and identifying numbers of all United States persons who are principal officers (for example, president, vice president, secretary, treasurer, and comptroller) or members of the board of directors of the foreign corporation as of January 1, 1963;

(9) A complete description of the principal business activities in which the foreign corporation is actually engaged and, if the foreign corporation is a member of a group constituting a chain of ownership with respect to each unit of which the shareholder owns 5 percent or more in value of the outstanding stock, a chart showing the foreign corporation's position in the chain of ownership and the percentages of ownership;

(10) A copy of the following statements prepared in accordance with generally accepted accounting principles and in such form and detail as is customary for the corporation's accounting records:

(i) The corporation's profit and loss statement for the most recent complete annual accounting period; and

(ii) The corporation's balance sheet as of the end of the most recent complete annual accounting period;

(11) A statement showing as of January 1, 1963, the amount and type of any indebtedness of the foreign corporation—

(i) To any United States person owning 5 percent or more in value of its stock, or

(ii) To any other foreign corporation owning 5 percent or more in value of the outstanding stock of the foreign corporation with respect to which the return is filed provided that the shareholder filing the return owns 5 percent or more in value of the outstanding stock of such other foreign corporation,

together with the name, address, and identifying number, if any, of each such shareholder or entity;

(12) A statement, as of January 1, 1963, showing the name, address, and identifying number, if any, of each person who is, on January 1, 1963, a subscriber to the stock of the foreign corporation, and the number of shares subscribed to by each;

(13) A statement showing the number of shares of each class of stock of the foreign corporation owned by each shareholder filing the return and—

(i) If such stock was acquired after December 31, 1953, the dates of acquisition, the amounts paid or value given therefor, the method of acquisition, i.e., by original issue, purchase on open market, direct purchase, gift, inheritance, etc., and from whom acquired; or

(ii) If such stock was acquired before January 1, 1954, a statement that such stock was acquired before such date, and the value at which such stock is carried on the books of such shareholder;

(14) A statement showing as of January 1, 1963, the name, address, and identifying number of each United States person who owns 5 percent or more in value of the outstanding stock of the foreign corporation, the classes of stock held, the number of shares of each class held, including the name, address, and identifying number, if any, of each actual owner if such person is different from the shareholder of record and a statement of the nature and amount of the interests of each such actual owner; and

(15) The total number of shares of each class of outstanding stock of the foreign corporation (or other data indicating the shareholder's percentage of ownership).

(c) *Returns required of United States persons when liability to file arises after January 1, 1963.*—(1) *United States persons required to file.*—A return on Form 959 (Rev. Jan. 1963), relating to the organization or reorganization of a foreign corporation and to the acquisition of its stock, containing the information required by subparagraph (3) of this paragraph, shall be made by each United States person, as defined in section 7701(a)(30), when at any time after January 1, 1963—

(i) Such person acquires (whether in one or more transactions) outstanding stock of such foreign corporation which has, or which when added to any such stock then owned by him (excluding any stock owned by him on January 1, 1963, if on that date he owned 5 percent or more in value of such stock) has, a value equal to 5 percent or more in value of the outstanding stock of such foreign corporation, or

(ii) Such person, having already acquired the interest referred to in paragraph (b) of this section or in subdivision (i) of this subparagraph—

(*a*) Acquires (whether in one or more transactions) an additional 5 percent or more in value of the outstanding stock of such foreign corporation,

(*b*) Owns 5 percent or more in value of the outstanding stock of such foreign corporation when such foreign corporation is reorganized (as defined in paragraph (f)), or

(*c*) Disposes of sufficient stock in such foreign corporation to reduce his interest to less than 5 percent in value of the outstanding stock of such foreign corporation.

The provisions of this subparagraph may be illustrated by the following examples:

Example (1). On January 15, 1963, A, a United States person, acquires 5 percent in value of the outstanding stock of M, a foreign corporation. A must file a return under the provisions of this subparagraph.

Example (2). On January 1, 1963, B, a United States person, owns 2 percent in value of the outstanding stock of M, a foreign corporation. B is not required to file a return under the provisions of this section because he does not own 5 percent or more in value of the outstanding stock of M Corporation. On February 1, 1963, B acquires an additional 3 percent in value of the outstanding stock of M Corporation. B must file a return under the provisions of this subparagraph.

Example (3). On January 1, 1963, C, a United States person, owns 6 percent in value of the outstanding stock of M, a foreign corporation. C must file a return under the provisions of paragraph (b) of this section. On February 1, 1963, C acquires an additional 2 percent in value of the outstanding stock of M Corporation in a transaction not involving a reorganization. C is not required to file a return under the provisions of this subparagraph.

Example (*4*). The facts are the same as in Example (3) except that, in addition, on April 1, 1963, C acquires 2 percent in value of the outstanding stock of M Corporation in a transaction not involving a reorganization. (C's total holdings are now 10 percent.) C is not required to file a return under the provisions of this subparagraph because he has not acquired 5 percent or more in value of the outstanding stock of M Corporation since he last became liable to file a return. On May 1, 1963, C acquires 1 percent in value of the outstanding stock of M Corporation. C must file a return under the provisions of this subparagraph.

Example (*5*). On June 1, 1963, D, a United States person, owns 12 percent in value of the outstanding stock of M, a foreign corporation. Also, on June 1, 1963, M Corporation is reorganized and, as a result of such reorganization, D owns only 6 percent of the outstanding stock of such foreign corporation. D must file a return under the provisions of this subparagraph.

Example (*6*). The facts are the same as in Example (5) except that, in addition, on November 1, 1970, D donates 2 percent of the outstanding stock of M Corporation to a charity. Since D has disposed of sufficient stock to reduce his interest in M Corporation to less than 5 percent in value of the outstanding stock of such corporation, D must file a return under the provisions of this subparagraph.

(2) *Shareholders who become United States persons.*—A return on Form 959 (Rev. Jan. 1963), relating to the organization or reorganization of a foreign corporation and to the acquisition of its stock, containing the information required by subparagraph (3) of this paragraph, shall also be made by each person who at any time after January 1, 1963, becomes a United States person while owning 5 percent or more in value of the outstanding stock of such foreign corporation.

(3) *Information required to be shown on return.*—(i) *In general.*—The return on Form 959 (Rev. Jan. 1963), required to be filed by persons described in subparagraphs (1) and (2) of this paragraph, shall set forth the same information as is required by the provisions of paragraph (b) of this section except that where such provisions require information with respect to January 1, 1963, such information shall be furnished with respect to the date on which liability arises to file the return required under this paragraph.

(ii) *Additional information.*—In addition to the information required under subdivision (i) of this subparagraph, the following information shall also be furnished in the return required under this paragraph:

(*a*) The date on or after January 1, 1963, if any, on which such shareholder (or shareholders) last filed a return under this section with respect to the corporation;

(*b*) If a return is filed by reason of becoming a United States person, the date the shareholder became a United States person;

(*c*) If a return is filed by reason of the disposition of stock, the date and method of such disposition and the person to whom such disposition was made; and

(*d*) If a return is filed by reason of the organization or reorganization of the foreign corporation on or after January 1, 1963, the following information:

(*1*) A statement showing a detailed list of the classes and kinds of assets transferred to the foreign corporation including a description of the assets (such as a list of patents, copyrights, stock, securities, etc.), the fair market value of each asset transferred (and, if such asset is tranferred by a United States person, its adjusted basis), the date of transfer, the name, address, and identifying number, if any, of the owner immediately prior to the transfer, and the consideration paid by the foreign corporation for such transfer;

(*2*) A statement showing the assets transferred and the notes or securities issued by the foreign corporation, the name, address, and identifying number, if any, of each person to whom such transfer or issue was made, and the consideration paid to the foreign corporation for such transfer or issue; and

(*3*) An analysis of the changes in the corporation's surplus accounts occurring on or after January 1, 1963.

(iii) *Exclusion of information previously furnished.*—In any case where any identical item of information required to be filed under this paragraph by a shareholder with respect to a foreign corporation has previously been furnished by such shareholder in any return made in accordance with the provisions of this section, such shareholder may satisfy the requirements of this paragraph by filing Form 959 (Rev. Jan. 1963), identifying such item of information, the date furnished, and stating that it is unchanged.

(d) *Associations, etc.*—Returns are required to be filed in accordance with the provisions of this section with respect to any foreign association, foreign joint-stock company, or foreign insurance company, etc., which would be considered to be a corporation under § 301.7701–2 of this chapter (Regulations on Procedure and Administration). Persons who would qualify by the nature of their functions and ownership in such associations, etc., as officers, directors, or shareholders thereof will be treated as such for purposes of this section without regard to their designations under local law.

(e) *Special provisions.*—(1) *Return jointly made.*—Any two or more persons required under paragraph (a) of this section to make a return with respect to one or more shareholders of the same corporation, or under paragraph (b) or (c) of this section to make a return with respect to the same corporation, may in lieu of making several returns, jointly make one return.

(2) *Separate return for each corporation.*—When returns are required with respect to more than one foreign corporation, a separate return must be made for each corporation.

(3) *Use of power of attorney by officers or directors.*—(i) *In general.*—Any two or more persons required under paragraph (a) of this section to make a return with respect to one or more shareholders of the same corporation may, by means of one or more duly executed powers of attorney, constitute one of their number as attorney in fact for the purpose of making such returns or for the purpose of making a joint return under subparagraph (1) of this paragraph.

(ii) *Nature of power of attorney.*—The power of attorney referred to in subdivision (i) of this subparagraph shall be limited to the making of returns required under paragraph (a) of this section and shall be limited to a single calendar year with respect to which such returns are required.

(iii) *Manner of execution of power of attorney.*—The use of technical language in the preparation of the power of attorney referred to in subdivision (i) of this subparagraph is not necessary. Such power of attorney shall be signed by the individual United States citizen or resident required to file a return or returns under paragraph (a) of this section. Such power of attorney must be acknowledged before a notary public or, in lieu thereof, witnessed by two disinterested persons. The notarial seal must be affixed unless such seal is not required under the laws of the state or country wherein such power of attorney is executed.

(iv) *Manner of execution of return under authority of power of attorney.*—A return made under authority of one or more powers of attorney referred to in subdivision (i) of this subparagraph shall be signed by the attorney in fact for each principal for which such attorney in fact is acting. A copy of such one or more powers of attorney shall be kept at a convenient and safe location accessible to internal revenue officers, and shall at all times be available for inspection by such officers.

(v) *Effect on penalties.*—The fact that a return is made under authority of a power of attorney referred to in subdivision (i) of this subparagraph shall not affect the principal's liability for penalties provided for failure to file a return required under paragraph (a) of this section or for filing a false or fraudulent return.

(4) *Persons excepted from filing returns.*—Any person required to make a return under paragraph (b) or (c) of this section with respect to a foreign corporation need not make such return provided all of the following conditions are met:

(i) Such person does not directly own an interest in the foreign corporation;

(ii) Such person is required to furnish the information solely by reason of attribution of stock ownership from a United States person under paragraph (i) of this section; and

(iii) The person from whom the stock ownership is attributed furnishes all of the information required under paragraph (b) or (c) of this section of the person to whom such stock ownership is attributed.

(5) *Persons excepted from furnishing items of information.*—Any person required to furnish any item of information under paragraph (b) or (c) of this section with respect to a foreign corporation may, if such item of information is furnished by another person having an equal or greater stock interest (measured in terms of value of such stock) in such foreign corporation, satisfy such requirement by filing a statement with his return on Form 959 (Rev. Jan. 1963) indicating that such liability has been satisfied and identifying the return in which such item of information was included.

(f) *Meaning of terms.*—For purposes of this section—

(1) *Acquisition.*—Stock in a foreign corporation shall be considered acquired when a person has an unqualified right to receive such stock, even though such stock is not actually issued. For example, when under the law of a foreign country, all the necessary steps for incorporation are completed but stock in the corporation will not be issued within 30 days, every United States citizen or resident who is an officer or a director of such corporation, provided a United States person has an interest of 5 percent or more in such corporation, and every such United States persons shall, within 90 days of the date of incorporation, file the returns required under section 6046 and this section. In the case of a reorganization, new stock may be acquired, depending on the type of reorganization, whether or not any stock certificates are surrendered or exchanged or the designation of such stock is altered.

(2) *Reorganization.*—With respect to a foreign corporation, the term "reorganization" shall mean not only a transaction described in section 368(a)(1) and the regulations thereunder but also any other transaction or series of transactions which has the same effect.

(g) *Method of reporting.*—All amounts furnished in returns prescribed under this section shall be expressed in United States currency with a statement of the exchange rates used. All statements required to be submitted on or with returns under this section shall be rendered in the English language.

(h) *Actual ownership of stock.*—If any shareholder, referred to in this section, is not the actual owner of the stock of the foreign corporation, the information required under this section shall be furnished in the name of and by such actual owner. For example, in the case of stock held by a nominee, the information required under this section shall be furnished by the actual owner of such stock.

(i) *Constructive ownership of stock.*—(1) *In general.*—Stock owned directly or indirectly by or for a foreign corporation or a foreign partnership shall be considered as being owned proportionately by its shareholders or partners. Thus, any United States person who is a member of a nonresident foreign partnership which becomes a shareholder in a foreign corporation shall be considered to be a shareholder in such foreign corporation to the extent of his proportionate share in such partnership.

(2) *Members of family.*—An individual shall be considered as owning the stock owned directly or indirectly by or for his brothers and sisters (whether by the whole or half blood), his spouse, his ancestors, and his lineal descendants. However, when stock is treated as owned by an individual under the rule provided in this subparagraph, it shall not be treated as owned by him for the purpose of again applying such rule in order to make another the constructive owner of such stock. The provisions of this subparagraph may be illustrated by the following example:

Example. H, W, and HF are United States citizens. W, wife of H, owns 20 percent of the value of the outstanding stock of X, a foreign corporation. X Corporation owns 90 percent of the value of the outstanding stock of Y, a foreign corporation. Y Corporation becomes the owner of 50 percent of the value of the outstanding stock of each of two newly organized foreign corporations, M and N. In applying the "members of family" rule, H is considered to own 20 percent of the value of the outstanding stock of X Corporation, and 18 percent of the value of the outstanding stock of Y Corporation, and 9 percent of M Corporation and N Corporation. However, HF, the father of H, is not considered to own stock of X, Y, M, or N since his son, H, is not treated as the owner of such stock for purposes of again applying the "members of family" rule.

(j) *Time and place for filing return.*—(1) *Time for filing.*—Any return required by section 6046 and this section shall be filed on or before the 90th day after the day on which a United States citizen, resident, or person becomes liable to file such return under any provision of section 6046(a) and of paragraph (a), (b), or (c) of this section. The Director of International Operations is authorized to grant reasonable extensions of time for filing returns under section 6046 and this section in accordance with the applicable provisions of section 6081(a) and § 1.6081–1.

(2) *Place for filing.*—Returns required by section 6046 and this section shall be filed with the Director of International Operations, Internal Revenue Service, Washington 25, D.C.

(k) *Penalties.*—(1) For criminal penalties for failure to file a return and filing a false or fraudulent return, see sections 7203, 7206, and 7207.

(2) For civil penalty for failure to file return, or failure to show information required on a return, under this section, see section 6679.

PAR. 5. At the end of the regulations in Part 301 relating to Additions to the Tax, Additional Amounts, and Assessable Penalties, there are inserted the following new sections:

§ 301.6679 STATUTORY PROVISIONS; FAILURE TO FILE RETURNS AS TO ORGANIZATION OR REORGANIZATION OF FOREIGN CORPORATIONS AND AS TO ACQUISITIONS OF THEIR STOCK.

SEC. 6679. FAILURE TO FILE RETURNS AS TO ORGANIZATION OR REORGANIZATION OF FOREIGN CORPORATIONS AND AS TO ACQUISITIONS OF THEIR STOCK.

(a) CIVIL PENALTY.—In addition to any criminal penalty provided by law, any person required to file a return under section 6046 who fails to file such return at the time provided in such section, or who files a return which does not show the information required pursuant to such section, shall pay a penalty of $1,000, unless it is shown that such failure is due to reasonable cause.

(b) DEFICIENCY PROCEDURES NOT TO APPLY.—Subchapter B of chapter 63 (relating to deficiency procedure for income, estate, and gift taxes) shall not apply in respect of the assessment or collection of any penalty imposed by subsection (a).

[Sec. 6679 as added by sec. 20(c), Revenue Act 1962 (76 Stat. 1062)]

§ 301.6679–1 FAILURE TO FILE RETURNS AS TO ORGANIZATION OR REORGANIZATION OF FOREIGN CORPORATIONS AND AS TO ACQUISITIONS OF THEIR STOCK.—(a) *Civil penalty.*—(1) *In general.*—In addition to any criminal penalty provided by law, each person required to file a return under section 6046, and the regulations thereunder, who fails to file such a return within the time provided, or who files a return which does not show the required information, shall pay a penalty of $1,000, unless such failure is shown to be due to reasonable cause.

(2) *Joint return.*—The penalty imposed by section 6679 and this section shall apply to each United States citizen, resident, or person filing a joint return pursuant to the provisions of section 6046 and § 1.6046–1, which does not show the required information.

(3) *Showing of reasonable cause.*—The penalty imposed by section 6679 shall not apply if it is established to the satisfaction of the Director of International Operations that such failure was due to a reasonable cause. 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. If the taxpayer exercises ordinary business care and prudence and is nevertheless unable to furnish any item of information required under section 6046, and the regulations thereunder, such failure shall be considered due to a reasonable cause. In determining the extent of a taxpayer's ability to obtain information, the percentage of stock owned by such taxpayer and the nature of the other interests in the foreign corporation will be considered.

(b) *Deficiency procedures not to apply.*—The penalty imposed by section 6679 may be assessed and collected without regard to the deficiency procedures provided by subchapter B of chapter 63 of the Code.

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

BERTRAND M. HARDING,
Acting Commissioner of Internal Revenue.

Approved November 29, 1962.

STANLEY S. SURREY,
Assistant Secretary of the Treasury.

(Filed by the Division of the Federal Register on November 30, 1962, 8:52 a.m., and published in the issue of the Federal Register for December 1, 1962, 27 F.R. 11881)

Subpart C.—Information Regarding Wages Paid Employees

SECTION 6051.—RECEIPTS FOR EMPLOYEES

26 CFR 31.6051–1: Statements for employees.

Printing of substitutes for Form W–2, Withholding Tax Statement—1963. See Rev. Proc. 62–25, page 490.

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, by State governments and the furnishing of copies of such returns and abstract data. See Rev. Proc. 62–18, page 408.

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. 11055
(Also Part II, Section 55; 458.324)

Inspection of income tax returns by the House Select Committee on Small Business.

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 tax return for the years 1950 to 1962, inclusive, made by an organization exempt from income tax under section 101 or 165(a) of the 1939 Code, as amended (53 Stat. 33, 67, 876; 56 Stat. 836, 862, 872; 64 Stat. 953, 959; 65 Stat. 490; 26 U.S.C. (1952 Ed.) 101, 165(a)), or section 501(a) or 521 of the 1954 Code (68A Stat. 163, 176; 26 U.S.C. 501(a), 521), shall, during the Eighty-seventh Congress, be open to inspection by the Select Committee on Small Business, House of Representatives, or any duly authorized subcommittee thereof, in connection with its study of the impact of the activities of tax-exempt organizations on small business, pursuant to House Resolution 46, 87th Congress, agreed to February 6, 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 become effective upon its filing for publication in the Federal Register.

JOHN F. KENNEDY.

THE WHITE HOUSE,
October 9, 1962.

(Filed by the Division of the Federal Register on October 10, 1962, 11:08 a.m., and published in the issue of the Federal Register for October 11, 1962. 27 F.R. 9981)

(Also Part II, Section 55; 458.324) E.O. 11065

Inspection of income, excess-profits, estate, and gift tax returns by the Senate Committee on Foreign Relations.

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 1962, inclusive, shall, during the Eighty-seventh Congress, be open to inspection by the Senate Committee on Foreign Relations or any duly authorized subcommittee thereof, in connection with its study of all nondiplomatic activities of representatives of foreign governments, and their contractors and agents, in promoting the interests of those governments, and the extent to which such representatives attempt to influence the policies of the United States and affect the national interest, pursuant to Senate Resolution 362, 87th Congress, agreed to July 12, 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,
November 21, 1962.

(Filed by the Division of the Federal Register on November 23, 1962, 3:39 p.m., and published in the issue of the Federal Register for November 27, 1962, 27 F.R. 11581)

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26 CFR 301.6103(b)–1: Inspection by States.

Inspection of Federal tax returns filed under the Internal Revenue Code of 1954, by State governments and the furnishing of copies of such returns and abstract data. See Rev. Proc. 62–18, page 408.

SECTION 6106.—PUBLICITY OF UNEMPLOYMENT TAX RETURNS

26 CFR 301.6106–1: Publicity of unemployment tax returns.

Inspection of Federal tax returns filed under the Internal Revenue Code of 1954, by State governments and the furnishing of copies of such returns and abstract data. See Rev. Proc. 62–18, page 408.

SECTION 6109.—IDENTIFYING NUMBERS

26 CFR 1.6109: Statutory provisions; identifying numbers. T.D. 6606 [1]
(Also 31.6109–1, 41.6109–1, 45.6109–1, 46.6109–1, 48.6109–1, 49.6109–1, 179.52a.)
(Also Sections 6011, 6676; 31.6011(b)–1, 301.6676.)
(Also Part III–A, Section 6109; 194.106a, 196.34a, 197.29a, 201.32a, 245.76a.)

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PARTS 1, 31, 41, 45, 46, 48, AND 49
SUBCHAPTER E, PARTS 179, 194, 196, 197, 201, AND 245
SUBCHAPTER F, PART 301

Regulations relating to the use of identifying numbers

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

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

On February 24, 1962, notice of proposed rulemaking was published in the Federal Register (27 F.R. 1761) regarding the amendments of the Income Tax Regulations (26 CFR Part 1), the Employment Tax Regulations (26 CFR Part 31), the Highway Motor Vehicle Use Tax Regulations (26 CFR Part 41), the Miscellaneous Stamp Tax Regulations (26 CFR Part 45), the Regulations Relating to Miscellaneous Excise Taxes Payable by Return (26 CFR Part 46), the Manufacturers and Retailers Excise Tax Regulations (26 CFR Part 48), the Facilities and Services Excise Tax Regulations (26 CFR Part 49), the regulations relating to Machine Guns and Certain other Firearms (26 CFR Part 179), the regulations relating to Liquor Dealers (26 CFR Part 194), the regulations relating to Stills (26 CFR Part 196), the regulations relating to Drawback on Distilled Spirits Used in Manufacturing Nonbeverage Products (26 CFR Part 197), the regulations relating to Distilled Spirits Plants (26 CFR Part

[1] The publication of this Treasury Decision in 27 F.R. 8513, dated August 25, 1962, contains (1) instructions for modifying the notice of proposed rulemaking in 27 F.R. 1761, dated February 24, 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.

201), the regulations relating to Beer (26 CFR Part 245), and the Regulations on Procedure and Administration (26 CFR Part 301), prescribing regulations under sections 6109 and 6676 of the Internal Revenue Code of 1954 as added by the Act of October 5, 1961 (Public Law 87-397, 75 Stat. 828 [C.B. 1961-2, 348]). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the following regulations are hereby adopted.

Income Tax
(26 CFR Part 1)

PARAGRAPH 1. Immediately after § 1.6102-1 there are inserted the following new sections:

§ 1.6109 STATUTORY PROVISIONS; IDENTIFYING NUMBERS.

SEC. 6109. IDENTIFYING NUMBERS.

(a) SUPPLYING OF IDENTIFYING NUMBERS.—When required by regulations prescribed by the Secretary or his delegate:

(1) INCLUSION IN RETURNS.—Any person required under the authority of this title to make a return, statement, or other document shall include in such return, statement, or other document such identifying number as may be prescribed for securing proper identification of such person.

(2) FURNISHING NUMBER TO OTHER PERSONS.—Any person with respect to whom a return, statement, or other document is required under the authority of this title to be made by another person shall furnish to such other person such identifying number as may be prescribed for securing his proper identification.

(3) FURNISHING NUMBER OF ANOTHER PERSON.—Any person required under the authority of this title to make a return, statement, or other document with respect to another person shall request from such other person, and shall include in any such return, statement, or other document, such identifying number as may be prescribed for securing proper identification of such other person.

(b) LIMITATION.

(1) Except as provided in paragraph (2), a return of any person with respect to his liability for tax, or any statement or other document in support thereof, shall not be considered for purposes of paragraphs (2) and (3) of subsection (a) as a return, statement, or other document with respect to another person.

(2) For purposes of paragraphs (2) and (3) of subsection (a), a return of an estate or trust with respect to its liability for tax, and any statement or other document in support thereof, shall be considered as a return, statement, or other document with respect to each beneficiary of such estate or trust.

(c) REQUIREMENT OF INFORMATION.—For purposes of this section, the Secretary or his delegate is authorized to require such information as may be necessary to assign an identifying number to any person.

[Sec. 6109 as added by sec. 1(a), Act of Oct. 5, 1961 (Pub. Law 87-397, 75 Stat. 828) [C.B. 1961-2, 348]]

§ 1.6109-1 IDENTIFYING NUMBERS.—(a) *In general.*—(1) *Designations.*—The identifying number prescribed by this section for use by an individual is termed an "account number". However, the identifying number prescribed for use by an individual engaged in a trade or business within the meaning of subparagraph (2) of this paragraph, with respect to any trade or business, is termed an "employer identification number". The identifying number prescribed for use by a person other than an individual is termed an "employer identification number". For definition of the term "account number", see § 301.7701-11 of this chapter (Regulations on Procedure and Administration). For definition of the term "employer identification number", see § 301.7701-12 of this chapter (Regulations on Procedure and Administration). For purposes of this section, an estate or trust is considered to be a person other than an individual.

(2) *Trade or business.*—For purposes of this section, an individual shall be considered to be engaged in a trade or business if any return is required to be filed by him with respect to his liability for any tax imposed by subtitle C, D, or E of the Code (other than a household employer's return on Form 942 or an employee representative's return on Form CT–2 required pursuant to § 31.6011(e)–1 or § 31.6011(a)–2, respectively, of this chapter (Employment Tax Regulations)).

(b) *Use of numbers.*—(1) *Number of maker of return.*—(i) *Return with respect to tax liability.*—Every person required to make a return, statement, or other document for any period commencing after December 31, 1961, with respect to his liability, or to matters relating to or dealing with his liability, for any tax imposed by subtitle A shall include his account number or his employer identification number, as the case may be, in any such return, statement, or other document filed after September 30, 1962. If such person is an individual engaged in a trade or business within the meaning of this section, he shall include his account number in the return, statement, or other document, and shall also include his employer identification number in any Schedule C (Profit (or loss) from Business or Profession) or Schedule F (Schedule of Farm Income and Expenses) filed as part of his individual income tax return. A fiduciary or agent making a return, statement, or other document for another person shall include therein the identifying number of such other person but not the identifying number of the person acting as fiduciary or agent. An income tax return or a declaration of estimated income tax filed jointly by a husband and wife need include the identifying number of only the husband except that the identifying number of the wife shall also be shown if, for the taxable year covered by the return or declaration, the wife has—

(*a*) Separate gross income of $600 or more, or $1,200 or more if she has attained the age of 65 before the close of the taxable year,

(*b*) Self-employment income, as defined in section 1402(b), or

(*c*) Income (such as wages, dividends, or interest) paid to her otherwise than with her husband which the payer thereof is required to report on a return or statement of information.

(ii) The application of subdivision (i) of this subparagraph may be illustrated by the following examples:

Example (1). A, an individual, operates a store during the year 1962 in which he employs three assistants and from which he derives net earnings from self-employment of more than $400. In making his income tax return for the calendar year 1962, A includes his account number in the return form and in his report of self-employment income on Schedule SE, and his employer identification number in Schedule C on which he computes the profit or loss from his business.

Example (2). D, an incompetent, receives in 1962, $800 of income from investments. D's guardian, E, is required to include in the income tax return filed for D on April 15, 1963, D's account number. E shall not include his own identifying number in such return.

Example (3). X, an organization exempt from taxation under section 501(a), is required to file an annual return of information on Form 990. In such return filed for the calendar year 1962, X is required to include its employer identification number.

Example (4). A, an individual engaged in a trade or business within the meaning of this section, dies on July 31, 1962. In his will, A provides that after the payment of certain specific bequests, the residue of his estate is to be held in trust for the benefit of his son, S. The administration of A's estate is completed on June 1, 1963, and the residue of the estate transferred to the trustee for S. The executor of A's estate is required to include the account number assigned to A in A's final income tax return (Form 1040) and in A's report of self-employment income on Schedule SE and is required to include A's employer identification number in Schedule C filed with the Form 1040. If the executor is required to file an income tax return (Form 1041) on behalf of the estate, he is required to obtain, and include therein, an employer identification number for the estate. If the trustee is required to file an income tax return (Form 1041) on behalf of the trust, he is required to obtain, and include therein, an employer identification number for the trust. See subparagraph (2)(iv)(*b*) of this paragraph for determining whether S's account number also should be included in the income tax return (Form 1041) of the estate or the trust.

Example (5). Brothers A, B, and C contribute the entire support of their mother in 1962. The brothers contribute the support in such a manner that any one of the brothers could claim a deduction for the exemption of the mother provided a written declaration on Form 2120 (Multiple Support Declaration) from each of his brothers is attached to his income tax return. Since Forms 2120 must be filed to enable any of the brothers to claim a deduction, the account number of each brother making a Form 2120 must be included in such form.

(iii) *Return with respect to another person.* Every person other than an individual not engaged in a trade or business within the meaning of this section, who is required to make a return, statement, or other document with respect to another person for any period commencing after December 31, 1961, shall include his employer identification number in any such return, statement, or other document filed after September 30, 1962. Every individual not engaged in a trade or business within the meaning of this section, who is required to make a return, statement, or other document with respect to another person for any period commencing after December 31, 1961, shall include his account number in any such return, statement, or other document filed after September 30, 1962. A fiduciary or agent making such a return, statement, or other document for another person shall include therein the identifying number of such other person and not his own identifying number.

(iv) The application of subdivision (iii) of this subparagraph may be illustrated by the following example:

Example. M, the estate of a decedent, paid during 1963, $700 for rental of a warehouse. The employer identification number of the estate is required to be included in the Form 1096 and Form 1099 required to be filed in 1964 with respect to such payment. However, the person acting as executor shall not include his own identifying number in such forms.

(v) *Exception.*—Notwithstanding the provisions of subdivisions (i) and (iii) of this subparagraph, an individual who does not have an account number and who has not been requested by the Internal Revenue Service to obtain one is not required to include an account number in any return, statement, or other document filed in 1962.

(2) *Number of person with respect to whom return is made by another.*—(i) *General rule.*—Except as otherwise provided in subdivision (ii) of this subparagraph, when a return, statement, or other document with respect to any person is required to be made by another person for any period commencing after December 31, 1962, the account number or the employer identification number, as the case may be, of the person with respect to whom the return, statement, or other document is required to be made shall be—

(*a*) Requested of such person by the person required to make such return, statement, or other document;

(*b*) Furnished by such person to the person required to make the return, statement, or other document; and

(*c*) Included in the return, statement, or other document by the person required to make it.

A request should state that the identifying number is required to be furnished under authority of law. An individual who receives amounts of income in respect of which a return, statement, or other document is required to be made by the payer thereof, and which is payable to the trade name of a sole proprietorship operated by him, shall furnish his employer identification number to the payer of such amounts. If such individual is not required to secure an employer identification number he shall furnish his account number to the payer. When an amount is made payable to a fiduciary or agent for a named or otherwise designated trust, estate, minor, incompetent, or other person, the identifying number of such trust, estate, etc. (clearly linked with the name of such trust, estate, etc.), and not the identifying number of the person acting as fiduciary or agent, shall be included by the payer in the return or statement of information made by him with respect to such payment. In the case of dividends on stock made payable to a person other than the record owner of the stock, the identifying number and name of the record owner shall be included by the payer in the return or statement of information made by him with respect to such dividends.

(ii) *Exception.*—The identifying number of a payee is not required to be included in any return or statement with respect to payments made to such payee

if the total amount shown on such return or statement was paid to such payee prior to October 1, 1963.

(iii) *Multiple payees.*—When an information return or statement is required to be made by any person with respect to a payment made by him to more than one person, the identifying number of only one of such payees is required to be requested of such payees by the payer, furnished to the payer by such payees, and included by the payer (clearly linked with the name of the payee to whom it belongs when the surnames are different) in the return or statement of information made by him with respect to such payment. When the multiple payees are husband and wife, the account number of the husband shall be requested and furnished and shall be included by the payer in the return or statement of information made by him with respect to the payment. When the multiple payees are an adult and a minor, the account number of the adult shall be requested and furnished and shall be included by the payer in the return or statement of information made by him with respect to the payment.

(iv) *Meaning of terms.*—(*a*) Except as provided in (*b*) of this subdivision, the return of any person with respect to his liability for any tax imposed by subtitle A, or any statement or document in support thereof, is not considered a return, statement, or other document with respect to another person for purposes of this section. If any such return or supporting statement or document contains information with respect to another person, the identifying number of such other person shall not be requested or furnished, and shall not be included in such return, statement, or other document. For example, the identifying number of the doctor to whom an individual taxpayer has made a payment for medical services shall not be requested or furnished, and shall not be included in the individual's income tax return even though the name of the doctor may be required to be furnished in support of the medical deduction. Similarly, the identifying number of a newspaper to which a manufacturing corporation has made a payment for advertising shall not be requested or furnished, and shall not be included in the corporation's income tax return.

(*b*) The return of an estate or trust with respect to its liability for any tax imposed by subtitle A, and any statement or other document in support thereof, shall be considered as a return, statement, or other document with respect to each beneficiary of such estate or trust. Accordingly, the identifying number of each beneficiary whose name is required to be included in any such return or supporting statement or document shall be requested and furnished and shall be included in such return or supporting document to identify such beneficiary. The term "beneficiary" includes heirs, devisees, and legatees.

(v) *Renewal of requests for identifying numbers.*—Where identifying numbers are requested it will not generally be necessary to renew requests for identifying numbers unless the Internal Revenue Service subsequently requires that requests be renewed.

(vi) The application of this subparagraph may be illustrated by the following examples:

Example (1). During 1963, Corporation C pays $100 in dividends to A, an individual. The identifying number to be furnished the payer is A's account number and not A's employer identification number even if A has secured the latter as the result of, for example, operating a sole proprietorship.

Example (2). During 1963, Corporation C pays $100 in dividends to A & Company, a sole proprietorship operated by A. If such operation requires A to secure an employer identification number, the identifying number to be furnished to Corporation C is that employer identification number; otherwise it is A's account number.

Example (3). A, an individual, dies February 28, 1964, owning among other income-producing property 1,000 shares of common stock of X Corporation. In his will, A provides that, after the payment of certain specific bequests, B, his executor, shall transfer the residue of his estate to C, who shall hold it in trust for the benefit of A's son, S. B qualifies as executor of the estate of A and secures an employer identification number for the estate. B notifies X Corporation of A's death, gives evidence of his qualification as executor, furnishes the employer identification number of the estate, and requests that dividends be paid to "B, executor for the estate of A". On June 3, 1964, B receives a cash dividend from X Corporation in the amount of $750. The administration of A's estate is completed on September 30, 1964, and the residue of the estate is transferred to C, trustee under the will of A. The residue of the estate includes the

cash dividend of $750 and the X Corporation stock. C is required to obtain and furnish to B, and B is required to request, the employer identification number of the trust to be used in the income tax return (Form 1041) for the period February 28, 1964 to September 30, 1964, filed by B. The X Corporation is required to include the employer identification number of the estate on a Form 1099 filed with respect to the $750 dividend payment.

Example (4). A savings account is opened in the M Bank entitled "John and Mary Clark in trust for Dennis Clark." However, under State law a legal and valid trust was not created by this arrangement nor was a gift made of the account. Therefore, John and Mary Clark who are the parents of Dennis are the owners of the account. During the calendar year 1964, the M Bank credits this account with interest in the amount of $750. The Bank should ask Mr. and Mrs. Clark for an identifying number, and John Clark should furnish the Bank with his own account number because the $750 is income to him and Mrs. Clark. The M Bank then should include this number in the Form 1099 which the Bank must file with respect to the $750 interest. If a valid trust had been created under the State law, Mr. Clark should furnish the Bank with the employer identification number for the trust.

Example (5). During calendar year 1964, Corporation Y pays dividends in the amount of $400 to "James Jones, Custodian for Mary Jones, a minor, under the Uniform Gifts to Minors Act of the State of R". The persons named are father and minor daughter. Y should ask James Jones for an identifying number and James Jones should furnish the Y Corporation with the account number of Mary Jones for inclusion in the Form 1099 which Y must file with respect to the $400 dividends paid. If Mary Jones has no account number, one must be obtained even if Mary Jones is not required to file any return in connection with this income.

Example (6). During the calendar year 1964, the X Federal Savings and Loan Association credited dividends in the amount of $600 to the savings account of "Maurice and Martha Milton, trustees for their minor son, Marvin Milton". The account is subject to the order of either trustee, but under this arrangement no taxable trust is created. The trustees are not subject to court order or any agreement. Under applicable State law, the savings account legally belongs to the child and the parents are not legally permitted to use any of the funds to satisfy their obligation to support the child. The Association should request that it be furnished an identifying number and the trustees, or one of them, should furnish the Association with the identifying number of Marvin Milton for inclusion in the Form 1099 which the Association must file with respect to the dividends in the amount of $600.

Example (7). During the calendar year 1964, the Z Corporation pays dividends in the amount of $200 to "William Stanley, trustee under deed of trust dated May 1, 1957, for the benefit of Howard Patrick", an account registered in the Corporation's records as owning 400 shares of its common stock. For income tax purposes the trust is recognized as a separate entity. The Z Corporation should request that it be furnished an identifying number, and Mr. Stanley should furnish the Corporation with the employer identification number of the trust for inclusion in the Form 1099 which the Corporation must file with respect to the $200 dividend.

Example (8). During calendar year 1964, the X Corporation pays dividends in the amount of $1,500 to the A&B Company, a Partnership which is registered in the Corporation's records as the owner of 750 shares of its preferred stock. A and B are officers of Bank Y. They were appointed by Y as nominees to hold this stock. The stock is part of the corpus of a trust being administered by Y for the benefit of Mr. C. The identifying number to be furnished to the X Corporation by A&B Company is the employer identification number of the A&B Company, and not the identifying number of Bank Y, the trust, or Mr. C.

Example (9). In 1963, Corporation C pays $100 in dividends to John Doe and Mary Doe, as joint tenants with right of survivorship. If John and Mary are husband and wife, the identifying number to be furnished to Corporation C is the account number of John. If they are not husband and wife, and both are adults, the account number of either may be furnished. If Mary is the minor daughter of John, the identifying number to be furnished is the account number of John.

Example (10). In 1963, Corporation C pays $100 in dividends to John Smith and Mary Jones (two unmarried adult individuals) as tenants in common. The identifying number to be furnished the payer is the account number of either

Mr. Smith or Miss Jones. The number furnished must be clearly linked with the name of the payee to whom it belongs.

Example (11). C Corporation, which meets all the requirements of section 1371(a) is an "electing small business corporation" within the meaning of section 1371(b). In accordance with section 6037 and the regulations thereunder, C files a return on Form 1120–S. This form is considered a return, statement, or other document made with respect to another person (C's shareholders) within the meaning of section 6109(a)(2) and (3). Accordingly the identifying numbers of C's shareholders should be requested and furnished, and included in the Form 1120–S.

(c) *Applications.*—(1) *General.*—An application for an identifying number shall be made in accordance with this paragraph by every person required under this section to include his identifying number in any return, statement, or other document required to be filed by him or to furnish his identifying number to another person for inclusion in any return, statement, or other document required to be filed by such other person. However, any person who has an identifying number, either an account number or an employer identification number, assigned to him under provisions other than the regulations in this section shall not make application for another number of the same kind under this section. A number so assigned is also prescribed for use in accordance with the requirements of this section.

(2) *Account number.*—(i) *Time for filing application.*—(a) *During 1962.*—Application forms for use in obtaining account numbers under this section will as far as possible be furnished without request during 1962 to taxpayers needing numbers. Any individual so supplied with an application form shall complete and file it in accordance with the instructions for such form. A taxpayer is not required under this section to file an application for an account number during 1962 unless furnished with an application.

(*b*) *After 1962.*—An individual needing an account number after 1962 shall file an application form in accordance with subdivision (ii) of this subparagraph far enough in advance of the first required use of such account number to permit issuance of the number in time for compliance with such requirement.

(ii) *Filing requirements.*—Application for an account number shall be made on either Form SS–5 or Form 3227. An application form may be obtained from any district director, or any district office of the Social Security Administration. The application, together with any supplementary statement, shall be prepared in accordance with the form, instructions, and regulations applicable thereto, and shall set forth fully and clearly the data therein called for. The application shall be filed in accordance with the instructions on the form. An account number will be assigned to the applicant in due course upon the basis of information reported on the application. A card showing the name and account number of the individual to whom a number has been assigned will be furnished to the individual.

(3) *Employer identification number.*—Application for an employer identification number shall be made on Form SS–4. Form SS–4 will generally be furnished only on request and may be obtained from any district director, or any district office of the Social Security Administration. The application, together with any supplementary statement, shall be prepared in accordance with the form, instructions, and regulations applicable thereto, and shall set forth fully and clearly the data therein called for. The application shall be signed by (i) the individual, if the person is an individual; (ii) the president, vice president, or other principal officer, if the person is a corporation; (iii) a responsible and duly authorized member or officer having knowledge of its affairs, if the person is a partnership or other unincorporated organization; or (iv) the fiduciary, if the person is a trust or estate. The application for an employer identification number should be filed approximately one month in advance of the first required use of the number to permit issuance of the number in time for compliance with such requirement The application shall be filed with the district director with whom the applicant is required to file his income tax return or with whom the applicant would be required to file an income tax return if such a return were required of him. An employer identification number will be assigned to the applicant in due course upon the basis of information reported on the application.

(d) *Nonresident aliens.*—This section shall not apply to nonresident aliens not engaged in trade or business within the United States or to foreign corporations not engaged in trade or business within the United States and not having an office or place of business or a fiscal or paying agent in the United States.

(e) *Penalty.*—For penalty for failure to supply identifying number, see section 6676 and § 301.6676–1 of this chapter (Regulations on Procedure and Administration).

Employment Taxes
(26 CFR Part 31)

PAR. 2. In paragraph (a) of § 31.0–2, subparagraphs (10) and (11) are amended to read as follows:

§ 31.0–2 GENERAL DEFINITIONS AND USE OF TERMS.—(a) *In general.* * * *

(10) Account number means the identifying number of an employee assigned, as the case may be, under the Internal Revenue Code of 1954, under subchapter A of chapter 9 of the Internal Revenue Code of 1939, or under title VIII of the Social Security Act. See also § 301.7701–11 of this chapter (Regulations on Procedure and Administration).

(11) Indentification number means the identifying number of an employer assigned, as the case may be, under the Internal Revenue Code of 1954, under subchapter A or D of chapter 9 of the Internal Revenue Code of 1939, or under title VIII of the Social Security Act. See also § 301.7701–12 of this chapter (Regulations on Procedure and Administration).

PAR. 3. Section 31.3402(f)(2)–1 is amended by adding paragraph (d) as follows:

§ 31.3402(f)(2)–1 WITHHOLDING EXEMPTION CERTIFICATES.

* * * * * * *

(d) *Inclusion of account number on withholding exemption certificate.*—Every individual filing a withholding exemption certificate with an employer shall include his account number on such certificate.

PAR. 4. In paragraph (a) of § 31.6001–5, subparagraph (1) is amended to read as follows:

§ 31.6001–5 ADDITIONAL RECORDS IN CONNECTION WITH COLLECTION OF INCOME TAX AT SOURCE ON WAGES.—(a) * * *

(1) The name and address of the employee, and, after December 31, 1962, the account number of the employee.

PAR. 5. In § 31.6011(a)–7 a new paragraph is added as follows:

§ 31.6011(a)–7 EXECUTION OF RETURNS.

* * * * * * *

(d) *Reporting of identifying numbers.*—For provisions relating to the reporting of identifying numbers on returns required under the regulations in this part, see § 31.6109–1.

PAR. 6. In § 31.6011(b)–1, paragraphs (a), (b), and (d) are amended to read as follows:

§ 31.6011(b)–1 EMPLOYERS' IDENTIFICATION NUMBERS.—(a) *Requirement of application.*—(1) *In general.*—(i) *Before October 1, 1962.*—Except as provided in paragraph (b) of this section, every employer who on any day after December 31, 1954, and before October 1, 1962, has in his employ one or more individuals in employment for wages subject to the taxes imposed by the Federal Insurance Contributions Act, but who prior to such day neither has been assigned an identification number nor has applied therefor, shall make an application on Form SS–4 for an identification number.

(ii) *On or after October 1, 1962.*—Except as provided in paragraph (b) of this section, every employer who on any day after September 30, 1962, has in his employ one or more individuals in employment for wages which are subject to the taxes imposed by the Federal Insurance Contributions Act or which are subject to the withholding of income tax from wages under section 3402, but who prior to such day neither has been assigned an identification number nor has applied therefor, shall make an application on Form SS–4 for an identification number.

(iii) *Method of application.*—The application, together with any supplementary statement, shall be prepared in accordance with the form, instructions, and

regulations applicable thereto, and shall set forth fully and clearly the data therein called for. Form SS–4 may be obtained from any district director, or any district office of the Social Security Administration. The application shall be filed with the district director with whom the employer will file returns pursuant to § 31.6091–1, or with the nearest district office of the Social Security Administration. The application shall be signed by (*a*) the individual, if the employer is an individual; (*b*) the president, vice president, or other principal officer, if the employer is a corporation; (*c*) a responsible and duly authorized member or officer having knowledge of its affairs, if the employer is a partnership or other unincorporated organization; or (*d*) the fiduciary, if the employer is a trust or estate. An identification number will be assigned to the employer in due course upon the basis of the information reported on the application required under this section.

(2) *Time for filing Form SS–4.*—The application for an identification number shall be filed on or before the seventh day after the first payment of wages to which reference is made in subparagraph (1) of this paragraph. For provisions relating to the time when wages are paid, see § 31.3121(a)–2 and paragraph (b) of § 31.3402(a)–1.

(b) *Employers who are assigned identification numbers without application.*—An identification number may be assigned, without application by the employer, in the case of an employer who has in his employ only employees who are engaged exclusively in the performance of domestic service in his private home not on a farm operated for profit (see § 31.3121(a)(7)–1). If an identification number is so assigned, the employer is not required to make an application on Form SS–4 for the number.

* * * * * * *

(d) *Use of identification number.*—The identification number assigned to an employer (other than a household employer referred to in paragraph (b) of this section) shall be shown in the employer's records, and shall be shown in his claims to the extent required by the applicable forms, regulations, and instructions. For provisions relating to the inclusion of identification numbers in returns, statements on Form W–2, and depositary receipts, see § 31.6109–1.

PAR. 7. In § 31.6011(b)–2, subparagraphs (1) and (2) of paragraph (a) are amended, and a new subparagraph is added to paragraph (b), as follows:

§ 31.6011(b)–2 EMPLOYEES' ACCOUNT NUMBERS.—(a) *Requirement of application.*—(1) *In general.*—(i) *Before November 1, 1962.*—Every employee who on any day after December 31, 1954, and before November 1, 1962, is in employment for wages subject to the taxes imposed by the Federal Insurance Contributions Act, but who prior to such day has neither secured an account number nor made application therefor, shall make an application on Form SS–5 for an account number.

(ii) *On or after November 1, 1962.*—Every employee who on any day after October 31, 1962, is in employment for wages which are subject to the taxes imposed by the Federal Insurance Contributions Act or which are subject to the withholding of income tax from wages under section 3402, but who prior to such day has neither secured an account number nor made application therefor, shall make an application on Form SS–5 for an account number.

(iii) *Method of application.*—The application shall be prepared in accordance with the form, instructions, and regulations applicable thereto, and shall set forth fully and clearly the data therein called for. The employee shall file the application with any district office of the Social Security Administration or, if the employee is not working within the United States, with the district office of the Social Security Administration at Baltimore, Maryland. Form SS–5 may be obtained from any district office of the Social Security Administration or from any district director. An account number will be assigned to the employee by the Social Security Administration in due course upon the basis of information reported on the application required under this section. A card showing the name and account number of the employee to whom an account number has been assigned will be furnished to the employee by the Social Security Administration.

(2) *Time for filing Form SS–5.*—The application shall be filed on or before the seventh day after the occurrence of the first day of employment to which reference is made in subparagraph (1) of this paragraph, unless the employee

leaves the employ of his employer before such seventh day, in which case the application shall be filed on or before the date on which the employee leaves the employ of his employer.

* * * * * * *

(b) *Duties of employee with respect to his account number.*— * * *

(3) *Furnishing of account number by employee to employer.*—See § 31.6109–1 for additional provisions relating to the furnishing of an account number by the employee to his employer.

PAR. 8. In § 31.6051–1, subparagraph (1)(i)(*b*) of paragraph (a) is amended, subparagraph (3) of paragraph (d) is deleted, and a new paragraph is added, as follows:

§ 31.6051–1 STATEMENTS FOR EMPLOYEES.—(a) *Requirement if wages are subject to withholding of income tax.*—(1) *General rule.*—(i) * * *

(*b*) The name and address of the employee, and his social security account number if wages as defined in section 3121(a) have been paid or if the Form W–2 is required to be furnished to the employee for a period commencing after December 31, 1962,

* * * * * * *

(e) *Cross references.*—For provisions relating to the penalties provided for the willful furnishing of a false or fraudulent statement, or for the willful failure to furnish a statement, see § 31.6674–1 and section 7204. For additional provisions relating to the inclusion of identification numbers and account numbers in statements on Form W–2, see § 31.6109–1. For provisions relating to the penalty for failure to report an identification number or an account number, as required by § 31.6109–1, see § 301.6676–1 of this chapter (Regulations on Procedure and Administration).

PAR. 9. Immediately after § 31.6101–1 there is inserted the following:

§ 31.6109 STATUTORY PROVISIONS; IDENTIFYING NUMBERS.

SEC. 6109. IDENTIFYING NUMBERS.

(a) SUPPLYING OF IDENTIFYING NUMBERS.—When required by regulations prescribed by the Secretary or his delegate:

(1) INCLUSION IN RETURNS.—Any person required under the authority of this title to make a return, statement, or other document shall include in such return, statement, or other document such identifying number as may be prescribed for securing proper identification of such person.

(2) FURNISHING NUMBER TO OTHER PERSONS.—Any person with respect to whom a return, statement, or other document is required under the authority of this title to be made by another person shall furnish to such other person such identifying number as may be prescribed for securing his proper identification.

(3) FURNISHING NUMBER OF ANOTHER PERSON.—Any person required under the authority of this title to make a return, statement, or other document with respect to another person shall request from such other person, and shall include in any such return, statement, or other document, such identifying number as may be prescribed for securing proper identification of such other person.

* * * * * * *

(c) REQUIREMENTS OF INFORMATION.—For purpose of this section, the Secretary or his delegate is authorized to require such information as may be necessary to assign an identifying number to any person.

[Sec. 6109 as added by sec. 1(a), Act of Oct. 5, 1961 (Pub. Law 87–397, 75 Stat. 828 [C.B. 1961–2, 348])]

§ 31.6109–1 SUPPLYING OF IDENTIFYING NUMBERS.—(a) *Identification number.*—The identification number assigned to an employer (other than a household employer referred to in paragraph (b) of § 31.6011(b)–1) shall be shown in returns, statements on Form W–2, and depositary receipts made by the employer, pursuant to the regulations in this part, for any period ending after September 30, 1962.

(b) *Account number.*—(1) *Employee to furnish to employer.*—An employee to whom a statement on Form W–2 is required to be furnished for any period commencing after December 31, 1962, shall furnish his account number to each employer required to furnish such statement to him. For additional provisions relating to the furnishing of account numbers by employees to employers, see paragraph (b) of § 31.6011(b)–2.

(2) *Use of account number by employer.*—Each statement required to be furnished to an employee on Form W–2 for any period commencing after December 31, 1962, shall show the account number of the employee. For additional provisions relating to requirements for furnishing a statement on Form W–2, see § 31.6051–1.

(3) *Use of account number by employee representative.*—An employee representative shall include his account number on any return on Form CT–2 made by him, pursuant to paragraph (a)(2) of § 31.6011(a)–2, for any period commencing after September 30, 1962.

(c) *Procedure for applying for identifying number.*—(1) *Identification number.*—Every employer who has not been assigned an identification number, and who is not otherwise required by § 31.6011(b)–1 to make application therefor, shall make an application on Form SS–4 for an identification number. For provisions relating to the procedure to be followed in applying for an identification number, see paragraph (a) of § 31.6011(b)–1.

(2) *Account number.*—An employee representative who has not been assigned an account number, and who is not otherwise required by § 31.6011(b)–2 to make application therefor, shall make an application on Form SS–5 for an account number. The application shall be filed on or before the last day of the first calendar quarter, beginning after September 30, 1962, for which the employee representative is required to make a return on Form CT–2. For provisions relating to the procedure to be followed in applying for an account number, see paragraph (a)(1) of § 31.6011(b)–2.

(d) *Penalty.*—For provisions relating to the penalty for failure to supply an identification number or an account number, as required by this section, see § 301.6676–1 of this chapter (Regulations on Procedure and Administration).

Excise Tax on Use of Certain Highway Motor Vehicles (26 CFR Part 41)

PAR. 10. Immediately after § 41.6101–1 there is inserted the following:

§ 41.6109 STATUTORY PROVISIONS; IDENTIFYING NUMBERS.

SEC. 6109. IDENTIFYING NUMBERS.

(a) SUPPLYING OF IDENTIFYING NUMBERS.—When required by regulations prescribed by the Secretary or his delegate:

(1) INCLUSION IN RETURNS.—Any person required under the authority of this title to make a return, statement, or other document shall include in such return, statement, or other document such identifying number as may be prescribed for securing proper identification of such person.

* * * * * * *

(c) REQUIREMENT OF INFORMATION.—For purposes of this section, the Secretary or his delegate is authorized to require such information as may be necessary to assign an identifying number to any person.

[Sec. 6109 as added by sec. 1(a), Act of Oct. 5, 1961 (Pub. Law 87–397, 75 Stat. 828 [C.B. 1961–2, 348]).]

§ 41.6109–1 EMPLOYER IDENTIFICATION NUMBERS.—(a) *Requirement of application.*—(1) *In general.*—An application on Form SS–4 for an employer identification number shall be made by every person in whose name a highway motor vehicle is registered at a time, after September 30, 1962, when a taxable use of such vehicle occurs, but who prior to such time neither has been assigned an employer identification number nor has applied therefor. The application, together with any supplementary statement, shall be prepared in accordance with the form, instructions, and regulations applicable thereto, and shall set forth fully and clearly the data therein called for. Form SS–4 may be obtained from any district director. The application shall be filed with the district director with whom returns required pursuant to § 41.6011(a)–1 will be filed

by the person who is required to make the application. The application shall be signed by (i) the individual, if the person is an individual; (ii) the president, vice president, or other principal officer, if the person is a corporation; (iii) a responsible and duly authorized member or officer having knowledge of its affairs, if the person is a partnership or other unincorporated organization; or (iv) the fiduciary, if the person is a trust or estate. An employer identification number will be assigned to the person in due course upon the basis of information reported on the application required under this section.

(2) *Time for filing Form SS–4.*—The application for an employer identification number shall be filed on or before the seventh day after the date of the first taxable use, after September 30, 1962, of a highway motor vehicle which is registered in the name of the person who is required to make the application.

(b) *Use of employer identification number.*—The employer identification number assigned to a person liable for the tax imposed by section 4481 shall be shown in any return, statement, or other document made by such person for any period commencing after June 30, 1963.

(c) *Cross references.*—For the definition of the term "employer identification number", see § 301.7701–12 of this chapter (Regulations on Procedure and Administration). For provisions relating to the penalty for failure to include the employer identification number in a return, statement, or other document, see § 301.6676–1 of this chapter (Regulations on Procedure and Administration).

Miscellaneous Stamp Taxes
(26 CFR Part 45)

PAR. 11. Immediately after § 45.6101–1 there is inserted the following:

§ 45.6109 STATUTORY PROVISIONS; IDENTIFYING NUMBERS.

SEC. 6109. IDENTIFYING NUMBERS.

(a) SUPPLYING OF IDENTIFYING NUMBERS.—When required by regulations prescribed by the Secretary or his delegate:

(1) INCLUSION IN RETURNS.—Any person required under the authority of this title to make a return, statement, or other document shall include in such return, statement, or other document such identifying number as may be prescribed for securing proper identification of such person.

* * * * * * *

(c) REQUIREMENT OF INFORMATION.—For purposes of this section, the Secretary or his delegate is authorized to require such information as may be necessary to assign an identifying number to any person.

[Sec. 6109 as added by sec. 1(a), Act of Oct. 5, 1961 (Pub. Law 87–397, 75 Stat. 828 [C.B. 1961–2, 348])]

§ 45.6109–1 EMPLOYER IDENTIFICATION NUMBERS.—(a) *Requirement of application.*—(1) *In general.*—An application on Form SS–4 for an employer identification number shall be made by every person who, at any time after September 30, 1962, performs any act with respect to which a tax is imposed by section 4461, 4471, 4821, or 4841, but who prior to such time neither has been assigned an employer identification number nor has applied therefor. The application, together with any supplementary statement, shall be prepared in accordance with the form, instructions, and regulations applicable thereto, and shall set forth fully and clearly the data therein called for. Form SS–4 may be obtained from any district director. The application shall be filed with any district director with whom a return on Form 11 or Form 11–B will be filed by the person who is required to make the application. The application shall be signed by (i) the individual, if the person is an individual; (ii) the president, vice president, or other principal officer, if the person is a corporation; (iii) a responsible and duly authorized member or officer having knowledge of its affairs, if the person is a partnership or other unincorporated organization; or (iv) the fiduciary, if the person is a trust or estate. An employer identification number will be assigned to the person in due course upon the basis of information reported on the application required under this section.

(2) *Time for filing Form SS–4.*—The application for an employer identification number shall be filed on or before the seventh day after the date of

performance, by the person who is required to make the application, of the first act after September 30, 1962, with respect to which tax is imposed by section 4461, 4471, 4821, or 4841.

(b) *Use of employer identification number.*—The employer identification number assigned to a person liable for the tax imposed by section 4461, 4471, 4821, or 4841 shall be shown in any return, statement, or other document made by such person for any period commencing after June 30, 1963.

(c) *One number per taxpayer.*—Each taxpayer shall make application for, and shall be assigned, only one employer identification number, regardless of the number of places of business for which the taxpayer is required to file Form 11 or Form 11–B.

(d) *Cross references.*—For the definition of the term "employer identification number", see § 301.7701–12 of this chapter (Regulations on Procedure and Administration). For provisions relating to the penalty for failure to include the employer identification number in a return, statement, or other document, see § 301.6676–1 of this chapter (Regulations on Procedure and Administration).

Regulations Relating to Miscellaneous Excise Taxes Payable by Return (26 CFR Part 46)

PAR. 12. Immediately after § 46.6101–1 there is inserted the following:

§ 46.6109 STATUTORY PROVISIONS; IDENTIFYING NUMBERS.

SEC. 6109. IDENTIFYING NUMBERS.

(a) SUPPLYING OF IDENTIFYING NUMBERS. When required by regulations prescribed by the Secretary or his delegate:

(1) INCLUSION IN RETURNS.—Any person required under the authority of this title to make a return, statement, or other document shall include in such return, statement, or other document such identifying number as may be prescribed for securing proper identification of such person.

* * * * * * *

(c) REQUIREMENT OF INFORMATION.—For purposes of this section, the Secretary or his delegate is authorized to require such information as may be necessary to assign an identifying number to any person.

[Sec. 6109 as added by sec. 1(a), Act of Oct. 5, 1961 (Pub. Law 87–397, 75 Stat. 828 [C.B. 1961–2, 348])]

§ 46.6109–1 EMPLOYER IDENTIFICATION NUMBERS.—(a) *Requirement of application.*—(1) *In General.*—An application on Form SS–4 for an employer identification number shall be made by every person who, at any time after September 30, 1962, performs any manufacturing or processing operation with respect to which a tax is imposed by section 4501(a) or 4511, but who prior to such time neither has been assigned an employer identification number nor has applied therefor. The application, together with any supplementary statement, shall be prepared in accordance with the form, instructions, and regulations applicable thereto, and shall set forth fully and clearly the data therein called for. Form SS–4 may be obtained from any district director. The application shall be filed with any district director with whom returns on Form 720 will be filed by the person who is required to make the application. The application shall be signed by (i) the individual, if the person is an individual; (ii) the president, vice president, or other principal officer, if the person is a corporation; (iii) a responsible and duly authorized member or officer having knowledge of its affairs, if the person is a partnership or other unincorporated organization; or (iv) the fiduciary, if the person is a trust or estate. An employer identification number will be assigned to the person in due course upon the basis of information reported on the application required under this section.

(2) *Time for filing Form SS–4.*—The application for an employer identification number shall be filed on or before the seventh day after the date of performance by the person who is required to make the application, of the first manufacturing or processing operation after September 30, 1962, with respect to which a tax is imposed by section 4501(a) or 4511.

(b) *Use of employer identification number.*—The employer identification number assigned to a person liable for the tax imposed by section 4501(a) or

4511 shall be shown in any return, statement, or other document made by such person for any period commencing after September 30, 1962.

(c) *Cross references.*—For the definition of the term "employer identification number", see § 301.7701–12 of this chapter (Regulations on Procedure and Administration). For provisions relating to the penalty for failure to include the employer identification number in a return, statement, or other document, see § 301.6676–1 of this chapter (Regulations on Procedure and Administration).

PAR. 13. In § 46.6302(c)–1, subparagraph (3) of paragraph (a) is deleted.

Manufacturers and Retailers Excise Taxes
(26 CFR Part 48)

PAR. 14. Immediately after § 48.6011(c)–1 there is inserted the following:

§ 48.6109 STATUTORY PROVISIONS; IDENTIFYING NUMBERS.

SEC. 6109. IDENTIFYING NUMBERS.

(a) SUPPLYING OF IDENTIFYING NUMBERS.—When required by regulations prescribed by the Secretary or his delegate:

(1) INCLUSION IN RETURNS.—Any person required under the authority of this title to make a return, statement, or other document shall include in such return, statement, or other document such identifying number as may be prescribed for securing proper identification of such person.

* * * * * * *

(c) REQUIREMENT OF INFORMATION.—For purposes of this section, the Secretary or his delegate is authorized to require such information as may be necessary to assign an identifying number to any person.

[Sec. 6109 as added by sec. 1(a), Act of Oct. 5, 1961 (Pub. Law 87–397, 75 Stat. 828 [C.B. 1961–2, 348])]

§ 48.6109–1 EMPLOYER IDENTIFICATION NUMBERS.—(a) *Requirement of application.*—(1) *In general.*—An application on Form SS–4 for an employer identification number shall be made by every person who, at any time after September 30, 1962, makes a sale of an article with respect to which a tax is imposed by chapter 31 or 32 of the Code, but who prior to such time neither has been assigned an employer identification number nor has applied therefor. The application, together with any supplementary statement, shall be prepared in accordance with the form, instructions, and regulations applicable thereto, and shall set forth fully and clearly the data therein called for. Form SS–4 may be obtained from any district director. The application shall be filed with the district director with whom returns on Form 720 will be filed by the person who is required to make the application. The application shall be signed by (i) the individual, if the person is an individual; (ii) the president, vice president, or other principal officer, if the person is a corporation; (iii) a responsible and duly authorized member or officer having knowledge of its affairs, if the person is a partnership or other unincorporated organization; or (iv) the fiduciary, if the person is a trust or estate. An employer identification number will be assigned to the person in due course upon the basis of information reported on the application required under this section.

(2) *Time for filing Form SS–4.*—The application for an employer identification number shall be filed on or before the seventh day after the date of the first sale of an article, after September 30, 1962, with respect to which a tax is imposed by chapter 31 or 32 of the Code.

(b) *Use of employer identification number.*—The employer identification number assigned to a person liable for a tax imposed by chapter 31 or 32 of the Code shall be shown in any return, statement, or other document made by such person for any period commencing after September 30, 1962.

(c) *Cross references.* For the definition of the term "employer identification number", see § 301.7701–12 of this chapter (Regulations on Procedure and Administration). For provisions relating to the penalty for failure to include the employer identification number in a return, statement, or other document see § 301.6676–1 of this chapter (Regulations on Procedure and Administration).

Facilities and Services Excise Taxes
(26 CFR Part 49)

PAR. 15. Immediately after § 49.4287–1 there is inserted the following:

SUBPART G—REFUNDS AND OTHER ADMINISTRATIVE PROVISIONS OF SPECIAL APPLICATION TO FACILITIES AND SERVICES TAXES

§ 49.6109 STATUTORY PROVISIONS; IDENTIFYING NUMBERS.

SEC. 6109. IDENTIFYING NUMBERS.

(a) SUPPLYING OF IDENTIFYING NUMBERS. When required by regulations prescribed by the Secretary or his delegate:

(1) INCLUSION IN RETURNS.—Any person required under the authority of this title to make a return, statement, or other document shall include in such return, statement, or other document such identifying number as may be prescribed for securing proper identification of such person.

* * * * * * *

(c) REQUIREMENT OF INFORMATION.—For purposes of this section, the Secretary or his delegate is authorized to require such information as may be necessary to assign an identifying number to any person.

[Sec. 6109 as added by sec. 1(a), Act of Oct. 5, 1961 (Pub. Law 87–397, 75 Stat. 828 [C.B. 1961–2, 348])]

§ 49.6109–1 EMPLOYER IDENTIFICATION NUMBERS.—(a) *Requirement of application.*—(1) *In general.*—An application on Form SS–4 for an employer identification number shall be made by every person who, at any time after September 30, 1962, receives a payment for a facility or service with respect to which a tax is imposed by chapter 33 of the Code, but who prior to such time neither has been assigned an employer identification number nor has applied therefor. The application, together with any supplementary statement, shall be prepared in accordance with the form, instructions, and regulations applicable thereto, and shall set forth fully and clearly the data therein called for. Form SS–4 may be obtained from any district director. The application shall be filed with the district director with whom returns on Form 720 will be filed by the person who is required to make the application. The application shall be signed by (i) the individual, if the person is an individual; (ii) the president, vice president, or other principal officer, if the person is a corporation; (iii) a responsible and duly authorized member or officer having knowledge of its affairs, if the person is a partnership or other unincorporated organization; or (iv) the fiduciary, if the person is a trust or estate. An employer identification number will be assigned to the person in due course upon the basis of information reported on the application required under this section.

(2) *Time for filing Form SS–4.*—The application for an employer identification number shall be filed on or before the seventh day after the date of the first receipt of a payment, after September 30, 1962, for a facility or service with respect to which a tax is imposed by chapter 33 of the Code.

(b) *Use of employer identification number.*—The identification number assigned to a person liable for a tax imposed by chapter 33 of the Code shall be shown in any return, statement, or other document made by such person for any period commencing after September 30, 1962.

(c) *Cross references.*—For the definition of the term "employer identification number", see § 301.7701–12 of this chapter (Regulations on Procedure and Administration). For provisions relating to the penalty for failure to include the employer identification number in a return, statement, or other document, see § 301.6676–1 of this chapter (Regulations on Procedure and Administration).

Machine Guns and Certain Other Firearms
(26 CFR Part 179)

PAR. 16. 26 CFR Part 179, Machine Guns and Certain Other Firearms, is amended by inserting immediately after § 179.52, three new sections as follows:

§ 179.52a EMPLOYER IDENTIFICATION NUMBER.—The employer identification number (defined at 26 CFR 301.7701–12) of the taxpayer who has been as-

signed such a number shall be shown on each Form 11, including amended Form 11, filed pursuant to the provisions of this part for any period commencing after September 30, 1962. Failure of the taxpayer to include his employer identification number on Form 11 may result in assertion and collection of the penalty specified in 26 CFR 301.6676–1. (75 Stat. 828; 26 U.S.C. 6109, 6676.)

§ 179.52b APPLICATION FOR EMPLOYER IDENTIFICATION NUMBER.—(a) An employer identification number will be assigned pursuant to application on Form SS–4 filed by the taxpayer. Form SS–4 may be obtained from the district director with whom the Form 11 is required to be filed.

(b) An application on Form SS–4 for an employer identification number shall be made by every taxpayer who filed a return on Form 11 before October 1, 1962, for the period ending June 30, 1963, and who has neither secured an employer identification number nor made application therefor prior to October 1, 1962. Such application on Form SS–4 shall be filed on or before October 8, 1962.

(c) An application on Form SS–4 for an employer identification number shall be made by every taxpayer whose first return on Form 11 is filed on or after October 1, 1962 but who prior to the filing of such first return on Form 11 has neither secured an employer identification number nor made application therefor. Such application on Form SS–4 shall be filed on or before the seventh day after the date on which such first return on Form 11 is filed.

(d) Each taxpayer shall make application for and shall be assigned only one employer identification number, regardless of the number of places of business for which the taxpayer is required to file Form 11. (75 Stat. 828; 26 U.S.C. 6109.)

§ 179.52c EXECUTION OF FORM SS–4.—The application on Form SS–4, together with any supplementary statement, shall be prepared in accordance with the form, instructions, and regulations applicable thereto, and shall set forth fully and clearly the data therein called for. The application shall be filed with any district director with whom a return on Form 11 will be filed by the person who is required to make the application. The application shall be signed by (a) the individual, if the person is an individual; (b) the president, vice president, or other principal officer, if the person is a corporation; (c) a responsible and duly authorized member or officer having knowledge of its affairs, if the person is a partnership or other unincorporated organization; or (d) the fiduciary, if the person is a trust or estate. (75 Stat. 828; 26 U.S.C. 6109.)

Liquor Dealers
(26 CFR Part 194)

PAR. 17. 26 CFR Part 194, Liquor Dealers, is amended as follows:

(A) Section 194.106 is amended as follows:

(1) By renumbering paragraphs (d), (e), and (f) as (e), (f), and (g), respectively;

(2) By inserting, immediately after paragraph (c), the following new paragraph: "(d) The employer identification number (see §§ 194.106a–194.106c);"; and

(3) By changing the citation at the end of the section to read "(68A Stat. 732, 846; 75 Stat. 828; 26 U.S.C. 6011, 7011, 6109)".

(B) By inserting, immediately after § 194.106, three new sections as follows:

§ 194.106a EMPLOYER IDENTIFICATION NUMBER.—The employer identification number (defined at 26 CFR 301.7701–12) of the taxpayer who has been assigned such a number shall be shown on each Form 11, including amended Form 11, filed pursuant to the provisions of this part for any period commencing after September 30, 1962. Failure of the taxpayer to include his employer identification number on Form 11 may result in assertion and collection of the penalty specified in 26 CFR 301.6676–1. (75 Stat. 828; 26 U.S.C. 6109, 6676.)

§ 194.106b APPLICATION FOR EMPLOYER IDENIFICATION NUMBER.—(a) An employer identification number will be assigned pursuant to application on Form SS–4 filed by the taxpayer. Form SS–4 may be obtained from the district director with whom the Form 11 is required to be filed.

(b) An application on Form SS–4 for an employer identification number shall be made by every taxpayer who filed a return on Form 11 before October 1, 1962, for the period ending June 30, 1963, and who has neither secured an employer identification number nor made application therefor prior to October 1, 1962. Such application on Form SS–4 shall be filed on or before October 8, 1962.

(c) An application on Form SS–4 for an employer identification number shall be made by every taxpayer whose first return on Form 11 is filed on or after October 1, 1962, but who prior to the filing of such first return on Form 11 has neither secured an employer identification number nor made application therefor. Such application on Form SS–4 shall be filed on or before the seventh day after the date on which such first return on Form 11 is filed.

(d) Each taxpayer shall make application for and shall be assigned only one employer identification number, regardless of the number of places of business for which the taxpayer is required to file Form 11. (75 Stat. 828; 26 U.S.C. 6109.)

§ 194.106c Execution of Form SS–4.—The application on Form SS–4, together with any supplementary statement, shall be prepared in accordance with the form, instructions, and regulations applicable thereto, and shall set forth fully and clearly the data therein called for. The application shall be filed with any district director with whom a return on Form 11 will be filed by the person who is required to make the application. The application shall be signed by (a) the individual, if the person is an individual; (b) the president, vice president, or other principal officer, if the person is a corporation; (c) a responsible and duly authorized member or officer having knowledge of its affairs, if the person is a partnership or other unincorporated organization; or (d) the fiduciary, if the person is a trust or estate. (75 Stat. 828; 26 U.S.C. 6109.)

Stills
(26 CFR Part 196)

Par. 18. 26 CFR Part 196, Stills, is amended as follows:

(A) Section 196.34 is amended by striking the word "form" at the end of the section, and inserting in lieu thereof the words "headings on the form and the instructions thereon or issued in respect thereto"; and

(B) By inserting, immediately after § 196.34, three new sections as follows:

§ 196.34a Employer Identification Number.—The employer identification number (defined at 26 CFR 301.7701–12) of the taxpayer who has been assigned such a number shall be shown on each Form 11, including amended Form 11, filed pursuant to the provisions of this part for any period commencing after September 30, 1962. Failure of the taxpayer to include his employer identification number on Form 11 may result in assertion and collection of the penalty specified in 26 CFR 301.6676–1. (75 Stat. 828; 26 U.S.C. 6109, 6676.)

§ 196.34b Application for Employer Identification Number.—(a) An employer identification number will be assigned pursuant to application on Form SS–4 filed by the taxpayer. Form SS–4 may be obtained from the district director with whom the Form 11 is required to be filed.

(b) An application on Form SS–4 for an employer identification number shall be made by every taxpayer who filed a return on Form 11 before October 1, 1962, for the period ending June 30, 1963, and who has neither secured an employer identification number nor made application therefor prior to October 1, 1962. Such application on Form SS–4 shall be filed on or before October 8, 1962.

(c) An application on Form SS–4 for an employer identification number shall be made by every taxpayer whose first return on Form 11 is filed on or after October 1, 1962, but who prior to the filing of such first return on Form 11 has neither secured an employer identification number nor made application therefor. Such application on Form SS–4 shall be filed on or before the seventh day after the date on which such first return on Form 11 is filed.

(d) Each taxpayer shall make application for and shall be assigned only one employer identification number, regardless of the number of places of business for which the taxpayer is required to file Form 11. (75 Stat. 828; 26 U.S.C. 6109.)

§ 196.34c EXECUTION OF FORM SS–4.—The application on Form SS–4, together with any supplementary statement, shall be prepared in accordance with the form, instructions, and regulations applicable thereto, and shall set forth fully and clearly the data therein called for. The application shall be filed with any district director with whom a return on Form 11 will be filed by the person who is required to make the application. The application shall be signed by (a) the individual, if the person is an individual; (b) the president, vice president, or other principal officer, if the person is a corporation; (c) a responsible and duly authorized member or officer having knowledge of its affairs, if the person is a partnership or other unincorporated organization; or (d) the fiduciary, if the person is a trust or estate. (75 Stat. 828; 26 U.S.C. 6109.)

Drawback on Distilled Spirits Used in Manufacturing Nonbeverage Products (26 CFR Part 197)

PAR. 19. 26 CFR Part 197. Drawback on Distilled Spirits Used in Manufacturing Nonbeverage Products, is amended as follows:

(A) Section 197.29 is amended as follows:

(1) By renumbering paragraphs (b), (c), and (d) as (c), (d), and (e), respectively; and

(2) By inserting, immediately after paragraph (a), the following new paragraph: "(b) The employer identification number (see §§ 197.29a–197.29c);".

(B) By inserting, immediately after § 197.29, three new sections as follows:

§ 197.29a EMPLOYER IDENTIFICATION NUMBER.—The employer identification number (defined at 26 CFR 301.7701–12) of the taxpayer who has been assigned such a number shall be shown on each Form 11, including amended Form 11, filed pursuant to the provisions of this part for any period commencing after September 30, 1962. Failure of the taxpayer to include his employer identification number on Form 11 may result in assertion and collection of the penalty specified in 26 CFR 301.6676–1. (75 Stat. 828; 26 U.S.C. 6109, 6676.)

§ 197.29b APPLICATION FOR EMPLOYER IDENTIFICATION NUMBER.—(a) An employer identification number will be assigned pursuant to application on Form SS–4 filed by the taxpayer. Form SS–4 may be obtained from the district director with whom the Form 11 is required to be filed.

(b) An application on Form SS–4 for an employer identification number shall be made by every taxpayer who filed a return on Form 11 before October 1, 1962, for the period ending June 30, 1963, and who has neither secured an employer identification number nor made application therefor prior to October 1, 1962. Such application on Form SS–4 shall be filed on or before October 8, 1962.

(c) An application on Form SS–4 for an employer identification number shall be made by every taxpayer whose first return on Form 11 is filed on or after October 1, 1962, but who prior to the filing of such first return on Form 11 has neither secured an employer identification number nor made application therefor. Such application on Form SS–4 shall be filed on or before the seventh day after the date on which such first return on Form 11 is filed.

(d) Each taxpayer shall make application for and shall be assigned only one employer identification number, regardless of the number of places of business for which the taxpayer is required to file Form 11. (75 Stat. 828; 26 U.S.C. 6109.)

§ 197.29c EXECUTION OF FORM SS–4.—The application on Form SS–4, together with any supplementary statement, shall be prepared in accordance with the form, instructions, and regulations applicable thereto, and shall set forth fully and clearly the data therein called for. The application shall be filed with any district director with whom a return on Form 11 will be filed by the person who is required to make the application. The application shall be signed by (a) the individual, if the person is an individual; (b) the president, vice president, or other principal officer, if the person is a corporation; (c) a responsible and duly authorized member or officer having knowledge of its affairs, if the person is a partnership or other unincorporated organization; or (d) the fiduciary, if the person is a trust or estate. (75 Stat. 828; 26 U.S.C. 6109.)

Distilled Spirits Plants
(26 CFR Part 201)

PAR. 20. 26 CFR Part 201, Distilled Spirits Plants, is amended by inserting, immediately after § 201.32, five new sections as follows:

§ 201.32a DATA REQUIRED ON FORM 11.—Each return on Form 11 shall be prepared in accordance with the headings on the form and the instructions thereon or issued in respect thereto, and shall include the following:

(a) Where the rectifier is an individual or a corporation, the true name of such individual or corporation;

(b) In the case of a partnership, the true name of each and every person comprising the partnership;

(c) The employer identification number (see §§ 201.32c–201.32e);

(d) The exact location of the place of business, by name and number of building or street or, where these do not exist, by some particularization in addition to the post office address;

(e) The kind and class of tax (see § 201.31);

(f) All other information provided for on the form. (68A Stat. 732, 846; 75 Stat. 828; 26 U.S.C. 6011, 7011, 6109.)

§ 201.32b EXECUTION OF FORM 11.—The return on Form 11 of an individual proprietor shall be signed by the proprietor; the return of a partnership shall be signed by a member of the firm; and the return of a corporation shall be signed by a duly authorized officer thereof: *Provided*, That any individual, partnership, or corporation may appoint an agent to sign in his behalf. In each case, the person signing the return shall designate his capacity as "individual owner," "member of firm," "agent," "attorney-in-fact" or, in the case of a corporation, the title of the officer. Receivers, trustees, assignees, executors, administrators, and other legal representatives who continue the business of a rectifier by reason of death, insolvency, or other circumstances, shall indicate the fiduciary capacity in which they act. Returns signed by persons, as agents or attorneys-in-fact, will not be accepted unless, in each instance, the principal named on the return has executed a power of attorney authorizing such person to sign the return, and such power of attorney is filed with the district director. Form 11 shall be verified by a written declaration that the return has been executed under the penalties of perjury. (68A Stat. 748, 749; 75 Stat. 828; 26 U.S.C. 6061, 6065, 6109.)

§ 201.32c EMPLOYER IDENTIFICATION NUMBER.—The employer identification number (defined at 26 CFR 301.7701–12) of the taxpayer who has been assigned such a number shall be shown on each Form 11, including amended Form 11, filed pursuant to the provisions of this part for any period commencing after September 30, 1962. Failure of the taxpayer to include his employer identification number on Form 11 may result in assertion and collection of the penalty specified in 26 CFR 301.6676–1. (75 Stat. 828; 26 U.S.C. 6109, 6676.)

§ 201.32d APPLICATION FOR EMPLOYER IDENTIFICATION NUMBER.—(a) An employer identification number will be assigned pursuant to application on Form SS–4 filed by the taxpayer. Form SS–4 may be obtained from the district director with whom the Form 11 is required to be filed.

(b) An application on Form SS–4 for an employer identification number shall be made by every taxpayer who filed a return on Form 11 before October 1, 1962, for the period ending June 30, 1963, and who has neither secured an employer identification number nor made application therefor prior to October 1, 1962. Such application on Form SS–4 shall be filed on or before October 8, 1962.

(c) An application on Form SS–4 for an employer identification number shall be made by every taxpayer whose first return on Form 11 is filed on or after October 1, 1962, but who prior to the filing of such first return on Form 11 has neither secured an employer identification number nor made application therefor. Such application on Form SS–4 shall be filed on or before the seventh day after the date on which such first return on Form 11 is filed.

(d) Each taxpayer shall make application for and shall be assigned only one employer identification number, regardless of the number of places of business for which the taxpayer is required to file Form 11. (75 Stat. 828; 26 U.S.C. 6109.)

§ 201.32e EXECUTION OF FORM SS–4.—The application on Form SS–4, together with any supplementary statement, shall be prepared in accordance with the form, instructions, and regulations applicable thereto, and shall set forth

fully and clearly the data therein called for. The application shall be filed with any district director with whom a return on Form 11 will be filed by the person who is required to make the application. The application shall be signed by (a) the individual, if the person is an individual; (b) the president, vice president, or other principal officer, if the person is a corporation; (c) a responsible and duly authorized member or officer having knowledge of its affairs, if the person is a partnership or other unincorporated organization; or (d) the fiduciary, if the person is a trust or estate. (75 Stat. 828; 26 U.S.C. 6109.)

Beer
(26 CFR Part 245)

PAR. 21. 26 CFR Part 245, Beer, is amended by inserting, immediately after § 245.76, four new sections as follows:

§ 245.76a DATA REQUIRED ON FORM 11.—Each return on Form 11 shall be prepared in accordance with the headings on the form and the instructions thereon or issued in respect thereto, and shall include the following:

(a) Where the taxpayer is an individual or a corporation, the true name of such individual or corporation;

(b) In the case of a partnership, the true name of each and every person comprising the partnership;

(c) The employer identification number (see §§ 245.76b–245.76d);

(d) The exact location of the place of business, by name and number of building or street or, where these do not exist, by some particularization in addition to the post office address;

(e) The class of tax;

(f) All other information provided for on the form. (68A Stat. 732, 846; 75 Stat. 828; 26 U.S.C. 6011, 7011, 6109.)

§ 245.76b EMPLOYER IDENTIFICATION NUMBER.—The employer identification number (defined at 26 CFR 301.7701–12) of the taxpayer who has been assigned such a number shall be shown on each Form 11, including amended Form 11, filed pursuant to the provisions of this part for any period commencing after September 30, 1962. Failure of the taxpayer to include his employer identification number on Form 11 may result in assertion and collection of the penalty specified in 26 CFR 301.6676–1. (75 Stat. 828; 26 U.S.C. 6109, 6676.)

§ 245.76c APPLICATION FOR EMPLOYER IDENTIFICATION NUMBER.—(a) An employer identification number will be assigned pursuant to application on Form SS–4 filed by the taxpayer. Form SS–4 may be obtained from the district director with whom the Form 11 is required to be filed.

(b) An application on Form SS–4 for an employer identification number shall be made by every taxpayer who filed a return on Form 11 before October 1, 1962, for the period ending June 30, 1963, and who has neither secured an employer identification number nor made application therefor prior to October 1, 1962. Such application on Form SS–4 shall be filed on or before October 8, 1962.

(c) An application on Form SS–4 for an employer identification number shall be made by every taxpayer whose first return on Form 11 is filed on or after October 1, 1962, but who prior to the filing of such first return on Form 11 has neither secured an employer identification number nor made application therefor. Such application on Form SS–4 shall be filed on or before the seventh day after the date on which such first return on Form 11 is filed.

(d) Each taxpayer shall make application for and shall be assigned only one employer identification number regardless of the number of places of business for which the taxpayer is required to file Form 11. (75 Stat. 828; 26 U.S.C. 6109.)

§ 245.76d EXECUTION OF FORM SS–4.—The application on Form SS–4, together with any supplementary statement, shall be prepared in accordance with the form, instructions, and regulations applicable thereto, and shall set forth fully and clearly the data therein called for. The application shall be filed with any district director with whom a return on Form 11 will be filed by the person who is required to make the application. The application shall be signed by (a) the individual, if the person is an individual; (b) the president, vice president, or other principal officer, if the person is a corporation; (c) a responsible and duly

authorized member or officer having knowledge of its affairs, if the person is a partnership or other unincorporated organization; or (d) the fiduciary, if the person is a trust or estate. (75 Stat. 828; 26 U.S.C. 6109.)

Procedure and Administration
(26 CFR Part 301)

PAR. 22. Section 301.6109 is renumbered, is amended to change the number of the statute set forth therein, and a historical note is added at the end thereof, as follows:

§ 301.6110 STATUTORY PROVISIONS; CROSS REFERENCES.

SEC. 6110. CROSS REFERENCES.

(1) For reports of Secretary of Agriculture concerning cotton futures, see section 4876.

(2) For inspection of returns, order forms, and prescriptions concerning narcotics, see section 4773.

(3) For inspection of returns, order forms, and prescriptions concerning marihuana, see section 4773.

(4) For authority of Secretary or his delegate to furnish list of special taxpayers, see section 4775.

(5) For inspection of records, returns, etc., concerning gasoline or lubricating oils, see section 4102.

[Sec. 6110 as renumbered by sec. 1(a), Act of Oct. 5, 1961 (Pub. Law 87-397, 75 Stat. 828 [C.B. 1961-2, 348])]

PAR. 23. Immediately after § 301.6108-1 there are inserted the following new sections:

§ 301.6109 STATUTORY PROVISIONS; IDENTIFYING NUMBERS.

SEC. 6109. IDENTIFYING NUMBERS.

(a) SUPPLYING OF IDENTIFYING NUMBERS.—When required by regulations prescribed by the Secretary or his delegate:

(1) INCLUSION IN RETURNS.—Any person required under the authority of this title to make a return, statement, or other document shall include in such return, statement, or other document such identifying number as may be prescribed for securing proper identification of such person.

(2) FURNISHING NUMBER TO OTHER PERSONS.—Any person with respect to whom a return, statement, or other document is required under the authority of this title to be made by another person shall furnish to such other person such identifying number as may be prescribed for securing his proper identification.

(3) FURNISHING NUMBER OF ANOTHER PERSON.—Any person required under the authority of this title to make a return, statement, or other document with respect to another person shall request from such other person, and shall include in any such return, statement, or other document, such identifying number as may be prescribed for securing proper identification of such other person.

(b) LIMITATION.—

(1) Except as provided in paragraph (2), a return of any person with respect to his liability for tax, or any statement or other document in support thereof, shall not be considered for purposes of paragraphs (2) and (3) of subsection (a) as a return, statement, or other document with respect to another person.

(2) For purposes of paragraphs (2) and (3) of subsection (a), a return of an estate or trust with respect to its liability for tax, and any statement or other document in support thereof, shall be considered as a return, statement, or other document with respect to each beneficiary of such estate or trust.

(c) REQUIREMENT OF INFORMATION.—For purposes of this section, the Secretary or his delegate is authorized to require such information as may be necessary to assign an identifying number to any person.

[Sec. 6109 as added by sec. 1(a), Act of Oct. 5, 1961 (Pub. Law 87-397, 75 Stat. 828 [C.B. 1961-2, 348])]

§ 301.6109–1 IDENTIFYING NUMBERS.—For provisions concerning the requesting and furnishing of identifying numbers, and their inclusion in returns, statements, or other documents, see the regulations relating to the particular tax.

PAR. 24. Immediately after § 301.6675–1 there are inserted the following new sections:

§ 301.6676 STATUTORY PROVISIONS; FAILURE TO SUPPLY IDENTIFYING NUMBERS.

SEC. 6676. FAILURE TO SUPPLY IDENTIFYING NUMBERS.

(a) CIVIL PENALTY.—If any person who is required by regulations prescribed under section 6109—

(1) To include his identifying number in any return, statement, or other document,

(2) To furnish his identifying number to another person, or

(3) To include in any return, statement, or other document made with respect to another person the identifying number of such other person,

fails to comply with such requirement at the time prescribed by such regulations, such person shall pay a penalty of $5 for each such failure, unless it is shown that such failure is due to reasonable cause.

(b) DEFICIENCY PROCEDURES NOT TO APPLY.—Subchapter B of chapter 63 (relating to deficiency procedures for income, estate, and gift taxes) shall not apply in respect of the assessment or collection of any penalty imposed by subsection (a).

[Sec. 6676 as added by sec. 1(b), Act of Oct. 5, 1961 (Pub. Law 87–397, 75 Stat. 828 [C.B. 1961–2, 348])]

§ 301.6676–1 PENALTY FOR FAILURE TO SUPPLY IDENTIFYING NUMBER.—(a) *In general.*—Except as provided in paragraph (c) of this section, if any person who is required by the regulations under section 6109—

(1) To include his identifying number in any return, statement, or other document,

(2) To furnish his identifying number to another person, or

(3) To include in any return, statement, or other document made with respect to another person the identifying number of such other person.

fails to comply with such requirement at the time prescribed by such regulations, such person shall pay a penalty of $5 for each such failure. Such penalty shall be paid in the same manner as tax upon the issuance of a notice and demand therefor. Under § 1.6109–1(b)(2) a payer is required to request the identifying number of the payee. If, after such a request has been made, the payee does not furnish the payer with his identifying number, the penalty will not be assessed against the payer.

(b) *Deficiency procedures not to apply.*—Subchapter B, chapter 63, of the Code (deficiency procedures) shall not apply in respect of the assessment or collection of the penalty set forth in paragraph (a) of this section.

(c) *Reasonable cause.*—If any person who is required by the regulations under section 6109 to supply an identifying number fails to comply with such requirement at the time prescribed by such regulations, but establishes to the satisfaction of the district director or the director of the regional service center that such failure was due to reasonable cause, the penalty set forth in paragraph (a) of this section shall not apply.

(d) *Persons required to supply identifying numbers.*—For regulations under section 6109 relating to persons required to supply an identifying number, see the regulations relating to the particular tax.

PAR. 25. Section 301.7701–11 is renumbered and amended to read as follows:

§ 301.7701–13 OTHER TERMS.—Any terms which are defined in section 7701 and which are not defined in § 301.7701–1 to § 301.7701–12, inclusive, shall, when used in this chapter, have the meanings assigned to them in section 7701.

PAR. 26. Immediately after § 301.7701–10 there are inserted the following new sections:

§ 301.7701–11 ACCOUNT NUMBER.—For purposes of this chapter, the term "account number" means the identifying number of an individual which is assigned pursuant to section 6011(b) or corresponding provisions of prior law, or

pursuant to section 6109, and in which nine digits are separated by hyphens as follows: 000-00-0000. Such term does not include a number with a letter as a suffix which is used to identify an auxiliary beneficiary under the social security program. The terms "account number" and "social security account number" refer to the same number.

§ 301.7701–12 EMPLOYER IDENTIFICATION NUMBER.—For purposes of this chapter, the term "employer identification number" means the identifying number of an individual or other person (whether or not an employer) which is assigned pursuant to section 6011(b) or corresponding provisions of prior law, or pursuant to section 6109, and in which nine digits are separated by a hyphen, as follows: 00-0000000. The terms "employer identification number" and "identification number" (defined in § 31.0–2(a)(11) of this chapter (Employment Tax Regulations)) refer to the same number.

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

MORTIMER M. CAPLIN,
Commissioner of Internal Revenue.

Approved August 20, 1962.

STANLEY S. SURREY,
Assistant Secretary of the Treasury.

(Filed by the Division of the Federal Register on August 24, 1962, 8:45 am., and published in the issue of the Federal Register for August 25, 1962, 27 F.R. 8513)

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26 CFR 1.6109–1: Identifying numbers.

Assignment of employer identification numbers to certain estates and trusts. See Rev. Proc. 62–23, page 487.

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26 CFR 31.6109–1: Supplying of identifying numbers.

Use of identifying numbers on employment tax returns, statements or other documents. See T.D. 6606, page 311.

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26 CFR 41.6109–1: Employer identification numbers.

Use of employer identification numbers on returns, statements, or other documents, filed with respect to the use tax on certain highway motor vehicles. See T.D. 6606, page 311.

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26 CFR 45.6109–1: Employer identification numbers.

Use of employer identification numbers on returns, statements, or other documents filed with respect to miscellaneous stamp taxes. See T.D. 6606, page 311.

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26 CFR 46.6109–1: Employer identification numbers.

Use of employer identification numbers on returns, statements, or other documents filed with respect to miscellaneous excise taxes payable by return. See T.D. 6606, page 311.

26 CFR 48.6109–1 : Employer identification numbers.

Use of employer identification numbers on returns, statements, or other documents filed with respect to manufacturers and retailers excise taxes. See T.D. 6606, page 311.

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26 CFR 49.6109–1 : Employer identification numbers.

Use of employer identification numbers on returns, statements, or other documents filed with respect to facilities and services taxes. See T.D. 6606, page 311.

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26 CFR 151.30: Employer identification numbers.
(Also 152.9a.)
(Also Section 6201; 151.451.)

T. D. 6609 [1]

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER D, PARTS 151 AND 152

Regulations relating to the use of identifying numbers and providing directors of regional service centers with authority to make assessments and perform other acts.

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

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

On February 24, 1962, notice of proposed rulemaking to conform the regulations relating to Regulatory Taxes on Narcotics Drugs (26 CFR Part 151) and the Regulations Under the Marihuana Tax Act of 1937, As Amended (26 CFR Part 152) to the amendments made to the Internal Revenue Code of 1954 by the Act of October 5, 1961 (Public Law 87–397, 75 Stat. 828 [C.B. 1961–2, 348]), authorizing the requirement of identifying numbers, was published in the Federal Register (27 F.R. 1770). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the following amendments of the regulations are hereby adopted. In addition, paragraphs 2, 3, 4, and 5 below amend §§ 151.81, 151.84, 151.451, and 151.453 of the Regulatory Taxes on Narcotic Drugs to conform such sections to the provisions of T.D. 6585 [C.B. 1962–1, 290] (26 F.R. 12553) providing directors of regional service centers with authority to make assessments and to perform other acts.

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[1] The publication of this Treasury Decision in 27 F.R. 8523, dated August 25, 1962, contains (1) instructions for modifying the notice of proposed rulemaking in 27 F.R. 1770, dated February 24, 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.

Regulatory Taxes on Narcotic Drugs
(26 CFR Part 151)

PARAGRAPH 1. Immediately after § 151.29 there is inserted the following:

§ 151.30 EMPLOYER IDENTIFICATION NUMBERS.—(a) Except as provided in paragraph (b) of this section, an application on Form SS–4 for an employer identification number shall be made by every person who, at any time after September 30, 1962, performs any act with respect to which a tax is imposed by section 4721, but who prior to such time neither has been assigned an employer identification number nor has applied therefor.

(b) The provisions of this section shall not apply in respect of those employees and officials referred to in section 4772.

(c) The application on Form SS–4, together with any supplementary statement, shall be prepared in accordance with the form, instructions, and regulations applicable thereto, and shall set forth fully and clearly the data therein called for. Form SS–4 may be obtained from any district director. The application on Form SS–4 shall be filed with any district director with whom a return on Form 678 will be filed by the person who is required to make the application. The application shall be filed on or before the seventh day after the first date, after September 30, 1962, on which occurs any act with respect to which a tax is imposed by section 4721. The application shall be signed by (1) the individual, if the person is an individual; (2) the president, vice president, or other principal officer if the person is a corporation; (3) a responsible and duly authorized member or officer having knowledge of its affairs, if the person is a partnership or other unincorporated organization; or (4) the fiduciary, if the person is a trust or estate. An employer identification number will be assigned to the person in due course upon the basis of the information reported on the application required under this section.

(d) If an employer identification number has been assigned to a person liable for the tax imposed by section 4721, the number shall be shown in any return, statement, or other document made by such person for any period commencing after June 30, 1963.

(e) Each taxpayer shall make application for, and shall be assigned, only one employer identification number, regardless of the number of places of business for which the taxpayer is required to file Form 678.

(f) For the definition of the term "employer identification number", see § 301.7701–12 of this chapter (Regulations on Procedure and Administration). For provisions relating to the penalty for failure to include the employer identification number in a return, statement, or other document, see § 301.6676–1 of this chapter (Regulations on Procedure and Administration).

PAR. 2. Paragraph (b) of § 151.81 is amended to read as follows:

§ 151.81 DELINQUENT RETURNS.—

* * * * * * *

(b) A taxpayer who wishes to avoid the addition to the tax for delinquency must make an affirmative showing of all the facts alleged as reasonable cause for failure to file the return on time. Such showing should be made in the form of a written statement containing a declaration that it is made under penalties of perjury. The 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 returns within the prescribed time, then the delay is due to reasonable cause.

PAR. 3. Paragraph (c) of § 151.84 is amended to read as follows:

§ 151.84 DELINQUENT PAYMENT.—

* * * * * * *

(c) Interest 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. Interest on tax may be assessed and collected at anytime within the period of limitation on collection after assessment of the tax to which it relates.

PAR. 4. Section 151.451 is amended to read as follows:

§ 151.451 ASSESSMENT OF TAXES.—Tax due on narcotic drugs not paid by attachment of stamps to containers shall be reported for assessment. Special tax which the taxpayer refuses or fails to pay may likewise be reported for assessment. The district director is authorized and required, and the director of the regional service center is authorized, to make all assessments of all taxes imposed by the Internal Revenue Code of 1954 or any prior internal revenue law.

PAR. 5. Paragraphs (c) and (d) of § 151.453 are amended to read as follows:

§ 151.453 PAYMENT BY CHECK, ETC.

* * * * * * *

(c) If a taxpayer gives a check or money order as 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.

(d) If a check or money order is tendered in the payment for the special tax or for stamps, and such check or money order is not paid upon presentation, a penalty of 1 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. The penalty set forth in this paragraph shall not apply if the person tendered such check or money order in good faith and with reasonable cause to believe that it would be duly paid.

Regulations Under the Marihuana Tax Act of 1937, As Amended (26 CFR Part 152)

PAR. 6. Immediately after § 152.9 there is inserted the following:

§ 152.9a EMPLOYER IDENTIFICATION NUMBERS.—(a) Except as provided in paragraph (b) of this section, an application on Form SS–4 for an employer identification number shall be made by every person who, at any time after September 30, 1962, performs any act with respect to which a tax is imposed by section 4751, but who prior to such time neither has been assigned an employer identification number nor has applied therefor.

(b) The provisions of this section shall not apply in respect of those employees and officials referred to in section 4772.

(c) The application on Form SS–4, together with any supplementary statement, shall be prepared in accordance with the form, instructions, and regulations applicable thereto, and shall set forth fully and clearly the data therein called for. Form SS–4 may be obtained from any district director. The application on Form SS–4 shall be filed with any district director with whom a return on Form 678 will be filed by the person who is required to make the application. The application shall be filed on or before the seventh day after the first date, after September 30, 1962, on which occurs any act with respect to which a tax is imposed by section 4751. The application shall be signed by (1) the individual, if the person is an individual; (2) the president, vice president, or other principal officer if the person is a corporation; (3) a responsible and duly authorized member or officer having knowledge of its affairs, if the person is a partnership or other unincorporated organization; or (4) the fiduciary, if the person is a trust or estate. An employer identification number will be assigned to the person in due course upon the basis of the information reported on the application required under this section.

(d) If an employer identification number has been assigned to a person liable for the tax imposed by section 4751, the number shall be shown in any return, statement, or other document made by such person for any period commencing after June 30, 1963.

(e) Each taxpayer shall make application for, and shall be assigned, only one employer identification number, regardless of the number of places of business for which the taxpayer is required to file Form 678.

(f) For the definition of the term "employer identification number", see § 301.7701–12 of this chapter (Regulations on Procedure and Administration). For provisions relating to the penalty for failure to include the employer identification number in a return, statement, or other document, see § 301.6676–1 of this chapter (Regulations on Procedure and Administration).

Because paragraphs 2, 3, 4, and 5 of this Treasury Decision make only technical changes, it is hereby found that it is unnecessary, with respect to such changes, 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).)

WILLIAM H. LOEB,
Acting Commissioner of Internal Revenue.
CHARLES SIRAGUSA,
Acting Commissioner of Narcotics.

Approved August 20, 1962.

STANLEY S. SURREY,
Assistant Secretary of the Treasury.

(Filed by the Division of the Federal Register on August 24, 1962, 8:45 a.m., and published in the issue of the Federal Register for August 25, 1962, 27 F.R. 8523)

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26 CFR 152.9a: Employer identification numbers.

Use of employer identification numbers on returns, statements, or other documents filed with respect to the occupational tax on marihuana. See T.D. 6609, page 334.

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26 CFR 179.52a: Employer identification numbers.

Use of employers identification numbers on firearms tax returns, statements, or other documents. See T.D. 6606, page 311.

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26 CFR 270.169: Employer identification number. (Also Section 285.29.) T. D. 6608 [1]

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER E, PARTS 270 AND 285

Employer identification numbers

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 April 20, 1962, a notice of proposed rulemaking with respect to the amendment of 26 CFR Part 270, Manufacture of Tobacco Products, and 26 CFR Part 285, Manufacture of Cigarette Papers

[1] 27 F.R. 8526.

and Tubes, was published in the Federal Register (27 F.R. 3817). No objections to the rules proposed having been received within the 30-day period prescribed in the notice, the following regulations are hereby adopted.

In order to implement the amendments made to the Internal Revenue Code of 1954, by the addition of Sections 6109 and 6676 (Act of October 5, 1961, Public Law 87–397, 75 Stat. 828 [C.B. 1961–2, 348]), authorizing the requirement of employer identification numbers, the regulations relating to the Manufacture of Tobacco Products (26 CFR Part 270) and the Manufacture of Cigarette Papers and Tubes (26 CFR Part 285) are amended as set out below:

Sections 270.169 and 285.29 as contained in this document make reference to sections 301.6676–1 and 301.7701–12 as contained in a notice of proposed rulemaking published in the Federal Register February 24, 1962 (27 F.R. 1761).

PARAGRAPH 1. 26 CFR Part 270 is amended as follows:

§ 270.162 [Amendment]

Section 270.162 is amended by inserting the words "his employer identification number as required by § 270.169," in the third sentence after the word "return," appearing the first time in the sentence, and by changing the law citation at the end of the section to read "(72 Stat. 1417, 1423, 75 Stat. 828; 26 U.S.C. 5703, 5741, 6109)".

§ 270.167 [Amendment]

Section 270.167 is amended by inserting the words "show therein his employer identification number as required by § 270.169," in the second sentence after the word "year,", and by changing the law citation at the end of the section to read "(72 Stat. 1417, 1423, 75 Stat. 828; 26 U.S.C. 5703, 5741, 6109)".

Three new sections designated §§ 270.169, 270.170, and 270.171, to read as follows, are added immediately after § 270.168:

§ 270.169 EMPLOYER IDENTIFICATION NUMBER.—The employer identification number (defined at 26 CFR 301.7701–12) of a manufacturer of tobacco products who has been assigned such a number shall be shown on each semimonthly tax return, Form 3071, and on each prepayment tax return, Form 2617, filed by a manufacturer of tobacco products pursuant to the provisions of this part on or after October 1, 1962. Failure of the manufacturer to include his employer identification number on Form 3071 or Form 2617 may result in assertion and collection of the penalty specified in 26 CFR 301.6676–1. (75 Stat. 828; 26 U.S.C. 6109, 6676.)

§ 270.170 APPLICATION FOR EMPLOYER IDENTIFICATION NUMBER.—(a) An employer identification number will be assigned pursuant to application on Form SS–4 filed by a manufacturer of tobacco products. Form SS–4 may be obtained from the district director with whom the tax returns, Form 3071 and Form 2617, are required to be filed.

(b) An application on Form SS–4 for an employer identification number shall be made by every manufacturer of tobacco products who filed a return on Form 3071 or Form 2617 before October 1, 1962, and who has neither secured an employer identification number nor made application for such a number prior to October 1, 1962. Such application on Form SS–4 shall be filed on or before October 8, 1962.

(c) An application on Form SS–4 for an employer identification number shall be made by every manufacturer of tobacco products whose first return on Form 3071 or Form 2617 is filed on or after October 1, 1962, but who prior to the filing of such return has neither secured an employer identification number nor made application therefor. Such application on Form SS–4 shall be filed on or before the seventh day after the date on which such first return is filed.

(d) Each manufacturer of tobacco products shall make application for and shall be assigned only one employer identification number, regardless of the number of places of business for which the manufacturer is required to file returns pursuant to the requirements of this part. (75 Stat. 828; 26 U.S.C. 6109.)

§ 270.171 EXECUTION OF FORM SS–4.—The application on Form SS–4, together with any supplementary statement, shall be prepared in accordance with the form, instructions, and regulations applicable thereto, and shall set forth fully and clearly the data therein called for. The application shall be filed with any district director with whom the returns on Form 3071 or Form 2617 are required to be filed by the person who is required to make the application. The application shall be signed by (a) the individual, if the person is an individual; (b) the president, vice president, or other principal officer, if the person is a corporation; (c) a responsible and duly authorized member or officer having knowledge of its affairs, if the person is a partnership or other unincorporated organization; or (d) the fiduciary, if the person is a trust or estate. (75 Stat. 828; 26 U.S.C. 6109.)

PAR. 2. 26 CFR Part 285 is amended as follows:

§ 285.25 [Amendment]

Section 285.25 is amended by inserting the words "his employer identification number as required by § 285.29," in the first sentence after the word "showing", and by changing the law citation at the end of the section to read "(72 Stat. 1417, 68A Stat. 896, 75 Stat. 828; 26 U.S.C. 5703, 7503, 6109)".

Three new sections, designated §§ 285.29, 285.30 and 285.30a, to read as follows, are added immediately after § 285.28:

§ 285.29 EMPLOYER IDENTIFICATION NUMBER.—The employer identification number (defined at 26 CFR 301.7701–12) of a manufacturer of cigarette papers or tubes who has been assigned such a number shall be shown on each monthly tax return, Form 2137, filed by a manufacturer of cigarette papers or tubes pursuant to the provisions of this part on or after October 1, 1962. Failure of the manufacturer to include his employer identification number on Form 2137 may result in assertion and collection of the penalty specified in 26 CFR 301.6676–1. (75 Stat. 828; 26 U.S.C. 6109, 6676.)

§ 285.30 APPLICATION FOR EMPLOYER IDENTIFICATION NUMBER.—(a) An employer identification number will be assigned pursuant to application on Form SS–4 filed by a manufacturer of cigarette papers or tubes. Form SS–4 may be obtained from the district director with whom the Form 2137 is required to be filed.

(b) An application on Form SS–4 for an employer identification number shall be made by every manufacturer of cigarette papers or tubes who filed a return on Form 2137 before October 1, 1962, and who has neither secured an employer identification number nor made application for such a number prior to October 1, 1962. Such application on Form SS–4 shall be filed on or before October 8, 1962.

(c) An application on Form SS–4 for an employer identification number shall be made by every manufacturer of cigarette papers or tubes whose first return on Form 2137 is filed on or after October 1, 1962, but who prior to the filing of such return has neither secured an employer identification number nor made application therefor. Such application on Form SS–4 shall be filed on or before the seventh day after the date on which such first return is filed.

(d) Each manufacturer of cigarette papers or tubes shall make application for and shall be assigned only one employer identification number, regardless of the number of places of business for which the manufacturer is required to file returns, pursuant to the requirements of this part. (75 Stat. 828; 26 U.S.C. 6109.)

§ 285.30a EXECUTION OF FORM SS–4.—The application on Form SS–4, together with any supplementary statement, shall be prepared in accordance with the form, instructions, and regulations applicable thereto, and shall set forth fully and clearly the data therein called for. The application shall be filed with any district director of internal revenue with whom the return, Form 2137,

is required to be filed by the person who is required to make the application. The application shall be signed by (a) the individual, if the person is an individual; (b) the president, vice president, or other principal officer, if the person is a corporation; (c) a responsible and duly authorized member or officer having knowledge of its affairs, if the person is a partnership or other unincorporated organization; or (d) the fiduciary, if the person is a trust or estate. (75 Stat. 828; 26 U.S.C. 6109.)

This Treasury Decision shall become effective on October 1, 1962. (This Treasury Decision is issued under the authority contained in section 7805 of the Internal Revenue Code (68A Stat. 917; 26 U.S.C. 7805).)

MORTIMER M. CAPLIN,
Commissioner of Internal Revenue.

Approved August 20, 1962

STANLEY S. SURREY,
Assistant Secretary of the Treasury.

(Filed by the Division of the Federal Register on August 24, 1962, 8:45 a.m., and published in the issue of the Federal Register for August 25, 1962, 27 F.R. 8526)

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26 CFR 285.29: Employer identification number.

Use of identifying numbers on returns, statements or other documents filed with respect to the commodity tax on cigarette papers and tubes. See T.D. 6608, page 337.

CHAPTER 63.—ASSESSMENT

SUBCHAPTER A.—IN GENERAL

SECTION 6201.—ASSESSMENT AUTHORITY

26 CFR 151.451: Assessment of taxes.

Amended regulations authorizing directors of regional service centers to make assessments with respect to taxes on narcotic drugs. See T.D. 6609, page 334.

CHAPTER 65.—ABATEMENTS, CREDITS, AND RETURNS

SUBCHAPTER A.—PROCEDURE IN GENERAL

SECTION 6402.—AUTHORITY TO MAKE CREDITS OR REFUNDS

26 CFR 301.6402-1: Authority to make credits or refunds.

Interest on refunds of overpayments of the special tax paid by manufacturers of nonbeverage products. See Rev. Rul. 62-143, page 370.

SUBCHAPTER B.—RULES OF SPECIAL APPLICATIONS

SECTION 6412.—FLOOR STOCKS REFUNDS

26 CFR 46.6412(d): Statutory provisions; floor stocks refunds.

Extension to September 30, 1967, of the time for filing claims for refund of tax paid on floor stocks of imported sugar. See T.D. 6611, page 284.

SECTION 6420.—GASOLINE USED ON FARMS

26 CFR 48.6420(b)–1: Claims. Rev. Rul. 62–174

An owner, tenant, or operator of a farm, who has filed a timely Form 2240, Claim for Refund of Federal Tax on Gasoline Used on a Farm, may file a valid *amended* claim without regard to the September 30 date prescribed by section 6420(b) of the Internal Revenue Code of 1954, provided the original claim is still pending. However, once the original claim has been extinguished by payment, a subsequent claim is a new claim, the filing of which is prohibited by section 6420(b) of the Code.

Advice has been requested whether an owner, tenant, or operator of a farm, who files a timely Form 2240, Claim for Refund of Federal Tax on Gasoline Used on a Farm, may file an amended claim subsequent to the expiration of the statutory period prescribed by section 6420(b) of the Internal Revenue Code of 1954.

Under the provisions of section 6420(a) of the Code, if gasoline is used on a farm for farming purposes, the ultimate purchaser is entitled to a payment (without interest) determined by multiplying the number of gallons so used by the rate of tax on gasoline under section 4081 of the Code which applied on the date he purchased such gasoline.

Section 6420(b) of the Code provides that not more than one claim may be filed under section 6420 by any person with respect to gasoline used during the 1-year period ending on June 30 of any year and that no claim shall be allowed under that section with respect to any 1-year period unless filed on or before September 30 of the year in which such 1-year period ends.

Section 48.6420(a)–1(b) of the Manufacturers and Retailers Excise Tax Regulations provides that, for purposes of section 6420, the term "ultimate purchaser" includes only an owner, tenant, or operator of a farm.

For purposes of determining the allowable payment under the provisions of section 6420 of the Code, the prohibition against filing more than one claim does not preclude the filing of an *amended* claim with respect to an original claim which was timely filed. Because an amended claim merely perfects the original claim, it is permissible for an owner, tenant, or operator of a farm to file a valid amended claim within any period *during which the original claim is pending.*

Accordingly, it is held that an owner, tenant, or operator of a farm, who has filed a timely claim for payment with respect to the tax on gasoline used on a farm for farming purposes, may file a valid amended claim subsequent to the expiration of the statutory period

prescribed by section 6420(b) of the Code, provided the original claim is still pending.

However, once the original claim has been extinguished by payment, a subsequent claim is in fact a new claim even though purported to be an amendment of the original claim. Therefore, such a subsequent claim cannot be allowed, even if submitted within the period of limitations, since section 6420(b) of the Code provides that not more than one claim may be filed by any person with respect to gasoline used during the same one-year period.

SECTION 6421.—GASOLINE USED FOR CERTAIN NONHIGHWAY PURPOSES OR BY LOCAL TRANSIT SYSTEMS

26 CFR 48.6421(b): Statutory provisions; gasoline used for certain nonhighway purposes or by local transit systems; local transit systems.

Refund of a portion of the tax applicable to gasoline used by local transit systems. See T.D. 6618, page 258.

CHAPTER 66.—LIMITATIONS

SUBCHAPTER A.—LIMITATIONS ON ASSESSMENT AND COLLECTION

SECTION 6501.—LIMITATIONS ON ASSESSMENT AND COLLECTION

26 CFR 301.6501(a)-1: Period of limitations upon assessment and collection. Rev. Rul. 62-130

(Also Sections 4301, 4311, 4321, 4331, 4361, 4371; 47.4301-1, 47.4311-1, 47.4321-1, 47.4331-1, 47.4361-1, 47.4371-1.)

For purposes of determining the period in which unpaid documentary stamp taxes may be assessed, the provisions of section 6501(a) of the Internal Revenue Code of 1954, as amended by the Excise Tax Technical Changes Act of 1958, apply to any documentary stamp taxes for which liabilities existed on January 1, 1959, as well as those arising on or after that date.

Advice has been requested whether, under the provisions of section 6501(a) of the Internal Revenue Code of 1954, documentary stamp taxes incurred as a result of transactions which took place before January 1, 1959, may be assessed more than three years after the taxes became due.

Prior to its amendment by the Excise Tax Technical Changes Act of 1958, section 6501(a) of the Code provided (subject to certain exceptions not applicable here) that the amount of any tax imposed by the Code should be assessed within three years after the return was filed (whether or not such return was filed on or after the date prescribed) or, *if the tax was payable by stamp*, within three years after *such tax became due*, and no proceeding in court without assess-

ment for the collection of such tax should be begun after the expiration of such period.

As amended by the Excise Tax Technical Changes Act of 1958, section 6501(a) of the Code provides that the amount of any tax imposed by the Code shall be assessed within three years after the return was filed (whether or not such return was filed on or after the date prescribed) or, *if the tax is payable by stamp*, at any time after such tax became due and before the expiration of three years after *the date on which any part of such tax was paid*, and no proceeding in court without assessment for the collection of such tax shall be begun after the expiration of such period.

With respect to the documentary stamp taxes, the effect of this amendment is to keep the statutory period for assessment open indefinitely or until three years after the payment of some part of the tax. Thus, section 6501(a), as amended, lengthens the period in which documentary stamp taxes may be assessed.

It is well settled that, in the absence of a legislative intent to the contrary, a new statute of limitation which extends the period for assessment and collection becomes applicable to existing causes of action. The customary application of such statutes to existing causes of action is not a retroactive application, because there is no cutting down of pre-existing rights. A taxpayer does not have a legal right not to pay taxes which are justly due and unpaid on the effective date of the new statute.

The legislative background of section 6501(a), as amended, does not indicate an intent to have the amendment operate only on causes of action arising after the effective date of the amendment. Accordingly, it is held that the provisions of section 6501(a) of the Code, as amended by the Excise Tax Technical Changes Act of 1958, apply to any documentary stamp taxes for which liabilities existed on January 1, 1959, as well as those arising on or after that date.

It should be noted that, if the taxpayer had made a partial payment of the tax due, the three-year period for assessment and collection would have started to run from the date of partial payment. Furthermore, the amendment of section 6501(a) did not revive a liability for any documentary stamp tax with respect to which assessment and collection were barred prior to January 1, 1959, under the statute of limitation existing before that date.

CHAPTER 67.—INTEREST

SUBCHAPTER A.—INTEREST ON UNDERPAYMENTS

SECTION 6601.—INTEREST ON UNDERPAYMENT, NONPAYMENT, OR EXTENSIONS OF TIME FOR PAYMENT, OF TAX

26 CFR 301.6601–1: Interest on underpayments.

Computation of interest where accrued foreign taxes are abated. See Rev. Proc. 62–27, page 495.

SUBCHAPTER B.—INTEREST ON OVERPAYMENTS

SECTION 6611.—INTEREST ON OVERPAYMENTS

26 CFR 301.6611–1: Interest on overpayments.

Interest on refunds of overpayments of the special tax paid by manufacturers of nonbeverage products. See Rev. Rul. 62–143, page 370.

Computation of interest where accrued foreign taxes are abated. See Rev. Proc. 62–27, page 495.

CHAPTER 68.—ADDITIONS TO THE TAX, ADDITIONAL AMOUNTS, AND ASSESSABLE PENALTIES

SUBCHAPTER A.—ADDITIONS TO THE TAX AND ADDITIONAL AMOUNTS

SECTION 6654.—FAILURE BY INDIVIDUAL TO PAY ESTIMATED INCOME TAX

26 CFR 1.6654–1: Addition to the tax in the case of an individual. Rev. Rul. 62–202

An individual is a stockholder in a small business corporation which elected not to be taxed as a corporation. He could not include dividends and his pro rata share of undistributed taxable income of such corporation in computing his estimated income tax for the current taxable year because information regarding the amount thereof was not then available. His estimated tax and payments thereof did not meet the conditions of any of the four exceptions provided in section 6654(d) of the Internal Revenue Code of 1954. *Held*, the individual will be subject to the addition to the tax imposed by section 6654(a) of the Code for any underpayment of estimated tax.

Advice has been requested whether taxpayer will be subject to the addition to the tax imposed by section 6654(a) of the Internal Revenue Code of 1954 if, in estimating his income tax for the current taxable year, he did not include dividends and his pro rata share of undistributed taxable income of a small business corporation because information regarding the amount thereof was not available.

For the current taxable year, the taxpayer is a 20-percent stockholder in a small business corporation which elected, under the provisions of section 1372 of the Code, not to be taxed as a corporation. The taxpayer has never been an officer or employee of this corporation. The corporation had commenced business in the previous calendar year and had a fiscal taxable year ending during the current taxable year of the individual taxpayer.

The taxpayer was required to and did file a declaration of estimated tax for the current taxable year in which he estimated his income from sources other than this corporation. He requested officers of the cor-

poration to inform him of the amount of the corporation's expected income or loss so that he could include his share of the income, if any, in the computation of his estimated tax in preparing his declaration. Although the taxpayer was advised that the corporation's income figures for the first year of operation would probably be completed by the end of the third quarter of the taxpayer's taxable year, those figures were still unavailable in the last month of such year.

Subsection (a) of section 6654 of the Code provides that in the case of any underpayment of estimated tax by an individual, except as provided in subsection (d), there shall be added to the income tax for the taxable year an amount determined at the rate of six percent per annum upon the amount of the underpayment for the period of the underpayment.

The provisions of section 6654(d) set forth exceptions under which the addition to the tax with respect to any underpayment of any installment shall not be imposed. The exceptions provide that the addition shall not be imposed if the total amount of all payments of estimated tax made, on or before the last date prescribed for the payment of such installment, equals or exceeds whichever of the following is the lesser:

(A) The amount which would have been required to be paid on or before the date prescribed for payment if the estimated tax were the tax shown on the return for the preceding taxable year, providing such year was a year of 12 months and a return showing a liability for tax was filed for such year;

(B) The amount which would have been required to be paid on or before the date prescribed for payment if the estimated tax were an amount equal to a tax determined on the basis of the facts shown on the return for the preceding taxable year but based on the tax rates and the taxpayer's status with respect to personal exemptions for the current taxable year;

(C) The amount which would have been required to be paid if the estimated tax were an amount equal to 70 percent (66⅔ percent in the case of a farmer) of the tax computed by placing on an annual basis the taxable income for the calendar months in the taxable year preceding such date; or,

(D) An amount equal to 90 percent of a tax computed, at the current year rates, on the basis of the actual taxable income for the calendar months in the taxable year preceding the date prescribed for payment.

For purposes of determining estimated tax and any addition to the tax for underpayment of estimated tax, the taxpayer's pro rata share of "undistributed taxable income" of the instant corporation is includable in his gross income, under section 1373 of the Code, as a dividend distributed on the last day of the taxable year of the corporation. Since the amount thereof accordingly becomes taxable income to him on that day, and exceptions (C) and (D) to imposition of addition to tax under section 6654(a) of the Code relate to payment of installments of estimated tax based on taxable income for months in the taxable year ending before the last date prescribed for payment thereof, either of those exceptions may be applicable to

avoid imposition of such addition with respect to installments required to be paid before such last day of the corporation's taxable year.

The instant taxpayer's estimated tax and payments thereof did not meet the conditions of any of the four exceptions provided in section 6654(d) of the Code. He avers that, because of large capital gains realized by him in his prior taxable year, computation and payment of estimated tax for his current taxable year in conformance with exception (A) or (B) would have resulted in an estimated tax greatly in excess of any reasonably conceivable eventual tax liability for that year and that he would not have been financially able to pay it. However, the addition to the tax under section 6654(a) "is imposed whether or not there was reasonable cause for the underpayment." Section 1.6654–1(a)(1) of the Income Tax Regulations. As stated in *Estate of Barney Ruben* v. *Commissioner*, 33 T.C. 1071 (1960), the addition to tax imposed by subsection (a) of section 6654, is mandatory unless one of the exceptions provided in subsection (d) thereof applies, and extenuating circumstances are irrelevant.

In view of the foregoing, it is held that, even though the taxpayer could not include, in computing his estimated tax for the current taxable year, the amount of dividends and his pro rata share of undistributed taxable income of the instant corporation, because information regarding such amount was not available to him in time, and an underpayment of estimated tax, as defined in section 6654(b) of the Code, occurred, he is subject to the addition to the tax imposed by section 6654(a) of the Code, since none of the exceptions provided in section 6654(d) applies.

SUBCHAPTER B.—ASSESSABLE PENALTIES

SECTION 6676.—FAILURE TO SUPPLY IDENTIFYING NUMBERS

26 CFR 301.6676: Statutory provisions: failure to supply identifying numbers.

Penalty for failure to supply identifying numbers on returns, statements, or other documents, or to furnish an identifying number to another person. See T.D. 6606, page 311.

SECTION 6679.—FAILURE TO FILE RETURNS AS TO ORGANIZATION OR REORGANIZATION OF FOREIGN CORPORATIONS AND AS TO ACQUISITIONS OF THEIR STOCK

26 CFR 301.6679: Statutory provisions; failure to file returns as to organization or reorganization of foreign corporations and as to acquisitions of their stock.

Penalty for failure to file returns and furnish information required under section 6046. See T.D. 6623, page 299.

CHAPTER 70.—JEOPARDY, BANKRUPTCY AND RECEIVERSHIP

SUBCHAPTER A.—JEOPARDY

PART I.—TERMINATION OF TAXABLE YEAR

SECTION 6851.—TERMINATION OF TAXABLE YEAR

26 CFR 1.6851–2: Certificates of compliance with income tax laws by departing aliens.

T. D. 6620 [1]

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

Amendment of Income Tax Regulations under section 6851 of the Internal Revenue Code of 1954, relating to departing aliens.

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 exceptions in the case of certain employees of foreign governments and of international organizations from the income tax clearance requirements imposed on departing aliens in the regulations under section 6851 of the Internal Revenue Code of 1954, paragraph (a) of § 1.6851–2 of the Income Tax Regulations (26 CFR Part 1), as amended by Treasury Decision 6537, approved January 16, 1961 [C.B. 1961–1, 728], is further amended by revising subparagraphs (1) and (2) (i). The amended provisions read as follows:

§ 1.6851–2 CERTIFICATES OF COMPLIANCE WITH INCOME TAX LAWS BY DEPARTING ALIENS.—(a) *In general.*—(1) *Requirement.*—The rules of this section are applicable, except as otherwise expressly provided, to any alien who departs from the United States or any of its possessions after January 20, 1961. Except as provided in subparagraph (2) of this paragraph, no such alien, whether resident or nonresident, may depart from the United States unless he first procures a certificate that he has complied with all of the obligations imposed upon him by the income tax laws. In order to procure such a certificate, an alien who intends to depart from the United States (i) must file with the district director for the internal revenue district in which he is located the statements or returns required by paragraph (b) of this section to be filed before obtaining such certificate, (ii) must appear before such district director if the district director deems it necessary, and (iii) must pay any taxes required under paragraph (b) of this section to be paid before obtaining the certificate. Either such certificate of compliance, properly executed, or evidence that the alien is excepted under subparagraph (2) of this paragraph from obtaining the certificate must be presented at the point of departure. An alien who presents himself at the point of departure without a certificate of compliance, or evidence establishing that such a certificate is not required, will be subject at such departure point to examination by an internal revenue officer or employee and to the completion of returns and statements and payment of taxes as required by paragraph (b) of this section.

[1] 27 F.R. 11803.

(2) *Exceptions.*—(i) *Employees of foreign governments or international organizations.*—(*a*) *Diplomatic representatives, their families and servants.*—(*1*) Representatives of foreign governments bearing diplomatic passports, whether accredited to the United States or other countries, and members of their households shall not, upon departure from the United States or any of its possessions, be examined as to their liability for United States income tax or be required to obtain a certificate of compliance. If a foreign government does not issue diplomatic passports but merely indicates on passports issued to members of its diplomatic service the status of the bearer as a member of such service, such passports are considered as diplomatic passports for income tax purposes.

(*2*) Likewise, the servant of a diplomatic representative who accompanies any individual bearing a diplomatic passport upon departure from the United States or any of its possession shall not be required, upon such departure, to obtain a certificate of compliance or to submit to examination as to his liability for United States income tax. If the departure of such a servant from the United States or any of its possessions is not made in the company of an individual bearing a diplomatic passport, the servant is required to obtain a certificate of compliance. However, such certificate will be issued to him on Form 2063 without examination as to his income tax liability upon presentation to the district director for the internal revenue district in which the servant is located of a letter from the chief of the diplomatic mission to which the servant is attached certifying (*i*) that the name of the servant appears on the "White List", a list of employees of diplomatic missions, and (*ii*) that the servant is not obligated to the United States for any income tax, and will not be so obligated up to and including the intended date of departure.

(*b*) *Other employees.*—Any employee of an international organization or of a foreign government (other than a diplomatic representative to whom (*a*) of this subdivision applies) whose compensation for official services rendered to such organization or government is excluded from gross income under section 893 and who has received no gross income from sources within the United States, and any member of his household who has received no gross income from sources within the United States, shall not, upon departure from the United States or any of its possessions after November 30, 1962, be examined as to his liability for United States income tax or be required to obtain a certificate of compliance.

(*c*) *Effect of waiver.*—An alien who has filed with the Attorney General the waiver provided for under section 247(b) of the Immigration and Nationality Act (8 U.S.C. 1257(b)) is not entitled to the exception provided by this subdivision.

Because the rules prescribed in this Treasury Decision are of a liberalizing character, 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 26, 1962.

STANLEY S. SURREY,
Assistant Secretary of the Treasury.

(Filed by the Division of the Federal Register on November 29, 1962, 8:46 a.m., and published in the issue of the Federal Register for November 30, 1962, 27 F.R. 11803)

CHAPTER 74.—CLOSING AGREEMENTS AND COMPROMISES

SECTION 7122.—COMPROMISES

26 CFR 301.7122–1: Compromises.

Jurisdiction of District Directors of Internal Revenue and Regional Counsel with respect to the processing and disposition of certain offers to compromise tax liabilities under $50,000 and certain specific penalties. See Rev. Proc. 62–19, page 416.

CHAPTER 76.—JUDICIAL PROCEEDINGS

SUBCHAPTER B.—PROCEEDINGS BY TAXPAYERS

SECTION 7421.—PROHIBITION OF SUITS TO RESTRAIN ASSESSMENT OR COLLECTION

Ct. D. 1874

FEDERAL SOCIAL SECURITY AND UNEMPLOYMENT TAXES—INTERNAL REVENUE CODE OF 1954—DECISION OF COURT

1. SUITS TO ENJOIN COLLECTION OF TAXES—SCOPE OF SECTION 7421(a) OF THE INTERNAL REVENUE CODE OF 1954.

The claim of the Government that a corporation was an employer of fishing crews, with a resulting liability for social security and unemployment taxes, was not without foundation where, among other things, the corporation furnished its boats to captains of its own selection who then hired their own crews; the catch was generally sold to the corporation; credit was extended to the captains; and the loss of an unsuccessful trip was absorbed by the corporation.

The purpose of section 7421(a) of the Internal Revenue Code of 1954 is to permit the United States to assess and collect taxes alleged to be due without judicial intervention and to require that the legal right to disputed sums be determined in a suit for refund. Section 7421(a) prohibits suits for injunctions to bar the collection of federal taxes where collecting officers have made the assessment and claim that such assessment is valid.

A suit for injunctive relief may not be entertained merely because collection would cause an irreparable injury, nor because of the inadequacy of the legal remedy. It is only when, at the time of suit, on the basis of information then available, the Government has no chance of ultimately prevailing and establishing its claim on the most liberal view of the law and the facts, and equity jurisdiction otherwise exists, that the suit for injunction may be maintained.

2. JUDGMENT REVERSED.

Judgment of United States Court of Appeals for the Fifth Circuit, 291 Fed.(2d) 402 (1961), reversed.

SUPREME COURT OF THE UNITED STATES

No. 493.—October Term, 1961

J. L. Enochs, District Director of Internal Revenue, Petitioner, v. *Williams Packing & Navigation Co., Inc.*

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

[May 28, 1962]

MR. CHIEF JUSTICE WARREN delivered the opinion of the Court.

Fearing that the District Director of Internal Revenue for Mississippi would attempt to collect allegedly past due social security and unemployment taxes for the years 1953, 1954 and 1955, respondent, in late 1957, brought suit in the District Court, maintaining that it was not liable for the exactions and seeking an injunction prohibiting their collection. The District Director, petitioner herein, made no objection to the issuance of a preliminary restraining order but resisted a permanent injunction, asserting that the provisions of section 7421(a) of the Internal Revenue Code of 1954 barred any such injunctive proceeding. That section provides:

> "Except as provided in sections 6212 (a) and (c), and 6213(a), no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court."

The exception for Tax Court proceedings created by sections 6212 (a) and (c) and 6213(a) was not applicable because that body is without jurisdiction over taxes of the sort here in issue. Nevertheless, on July 14, 1959, the court, relying upon *Miller* v. *Standard Nut Margarine Co.*, 284 U.S. 498 [Ct. D. 457, C.B. XI–1, 370 (1932)], permanently enjoined collection of the taxes on the ground that they were not, in fact, payable and because collection would destroy respondent's business. 176 F. Supp 168. One June 14, 1961, the Court of Appeals for the Fifth Circuit affirmed, one judge dissenting. 291 F. 2d 402. We granted certiorari to determine whether the case came within the scope of this Court's holding in *Nut Margarine* which indicated that section 7421(a) was not, in the "special and extraordinary facts and circumstances" of that case,[1] intended to apply.[2] 368 U.S. 937.

Respondent corporation (hereinafter referred to as Williams) is engaged in the business of providing trawlers to fishermen who take shrimp, oysters and fish off the Louisiana and Mississippi coasts. It is the Government's position that these fishermen are the corporation's employees within the meaning of sections 1426(d)(2) and 1607(i) of the Internal Revenue Code of 1939, 26 U.S.C. (1952 ed.), and sections 3121(d)(2) and 3306(i) of the Internal Revenue Code of 1954. These sections specifically adopt the common-law test for ascertaining the existence of the employer-employee relationship. As stated in *United States* v. *Silk*, 331 U.S. 704, 716, "degrees of control, opportunities for profit or loss, investment in facilities, permanency of relation and skill required * * * are important for decision [under these statutes]." If, under the involved circumstances of this case, the fishermen were employees, respondent Williams is admittedly liable for social security and unemployment taxes for the years in question.[3]

The following facts, material to the question of the existence of the employment relationship, were established. Williams provided its boats to captains which it selected; they employed their own crews and could fire them at will, but the relationship between respondent corporation and the fishermen was not ordinarily of short duration. The catch was generally sold to Williams which in turn resold it to the DeJean Packing Co., a partnership closely allied to Williams both by reason of integrated operation and substantially identical ownership. The proceeds, after the deduction of expenses, were divided among the captain, the crew and the boat. Williams received an additional share if it sup-

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[1] 284 U.S., at 511.

[2] See also *Hill* v. *Wallace*, 259 U.S. 44, 62; *Allen* v. *Regents*, 304 U.S. 439, 449 [Ct. D. 1344, C.B. 1938–1, 530].

[3] See sec. 1410, 1939 Code and sec. 3111, 1954 Code (social security taxes); sec. 1600, 1939 Code and sec. 3301, 1954 Code (unemployment taxes).

Presumably the exceptions for fishing operations created by secs. 1426(b)(15) and 1607(c)(17) of the 1939 Code and by sec. 3306(c)(17) of the 1954 Code do not apply because the vessels here involved were of more than 10 net tons.

plied the nets and rigging. It extended credit to the captains and made it possible for them to obtain credit elsewhere, and if a trip was unsuccessful and if the captain or crew members no longer continued to operate a boat, Williams absorbed the loss.

With respect to the existence of a recognized right of control by the employer, as might be expected, the testimony was in conflict. Petitioner introduced evidence to show that Williams could effectively refuse ice to boats and thus determine whether they would go out, that the boats' times of return were sometimes directed by the respondent corporation, that it could dictate the nature of the catch, and that permission was needed to sell the catch to someone other than respondent. And petitioner pointed out that both respondent and its fishermen had for other purposes represented that an employer-employee relationship existed.[4] On the other hand, the District Court here found, and the respondent now asserts, that the corporation was wholly without any right of control.

Attempting to establish a basis for equitable jurisdiction, the corporation maintains that it will be thrown into bankruptcy if required to pay the entire assessment of $41,568.57. It is undisputed that Williams itself is without available funds in this amount, but the Government suggests that respondent has denuded itself of assets in anticipation of its tax liability, that DeJean's assets should be considered as belonging to respondent, and that, in any event, the respondent corporation may pay the assessment for a single quarter and then sue for a refund.

The object of section 7421(a) is to withdraw jurisdiction from the state and federal courts to entertain suits seeking injunctions prohibiting the collection of federal taxes. In *Miller* v. *Standard Nut Margarine Co., supra,* this Court was confronted with the question whether a manufacturer of "Southern Nut Product" could enjoin the collection of federal oleomargarine taxes on its goods. Prior to the assessment in issue three lower federal court cases had held that similar products were nontaxable and, by letter, the collector had informed the manufacturer that "Southern Nut Product was not subject to the tax. This Court found that "a valid oleomargarine tax could by no legal possibility have been assessed against * * * [the manufacturer], and therefore the reasons underlying * * * [sec. 7421(a)] apply, if at all, with little force."[5] Noting that collection of the tax "would destroy its business, ruin it financially and inflict serious loss for which it would have no remedy at law," the Court held that an injunction could properly issue. *Id.,* at 510–511. The courts below seem to have found that *Nut Margarine* decides that section 7421(a) does not bar suit for an injunction against the collection of taxes not due if the legal remedy is inadequate. We cannot agree.

The enactment of the comparable Tax Injunction Act of 1937, 50 Stat. 738, now, as amended, 28 U.S.C. section 1341, forbidding the federal courts to entertain suits to enjoin collection of state taxes "where a plain, speedy, and efficient remedy may be had in law or in equity in the courts of such State," throws light on the proper construction to be given section 7421(a). It indicates that if Congress had desired to make the availability of the injunctive remedy against the collection of federal taxes not lawfully due depend upon the adequacy of the legal remedy, it would have said so explicitly. Its failure to do so shows that such a suit may not be entertained merely because collection would cause an irreparable injury, such as the ruination of the taxpayer's enterprise. This is not to say, of course, that inadequacy of the legal remedy need not be established if

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[4] For instance, during World War II, respondent represented that the fishermen were employees for the purpose of securing occupational deferments for them. And in the course of a prior antitrust litigation, instituted against a union to which respondent's fishermen belonged, the union defended against the charge of price fixing on the ground that its members were employees. The Government, curiously, successfully maintained that an employment relationship did not exist. See *Gulf Coast Shrimpers & Oystermans Assn.* v. *United States,* 236 F. 2d 658 (C.A. 5th Cir. 1956).

[5] *Id.,* at 510.

The product in issue was made only with vegetable oils. The pertinent taxing statute defined "oleomargarine" as "all substances heretofore known as oleomargarine, oleo, oleomargarine-oil, butterine, lardine, suine, and neutral; all mixtures and compounds of oleomargarine, oleo, oleomargarine-oil, butterine, lardine, suine, and neutral; all lard extracts and tallow extracts; and all mixtures and compounds of tallow, beef-fat, suet, lard, lard-oil, vegetable-oil annotto [a coloring material], and other coloring matter, intestinal fat, and offal fat made in imitation or semblance of butter, or when so made, calculated or intended to be sold as butter or for butter." 24 Stat. 209. The assessment was based on the argument that the statutory reference to "vegetable-oil annotto" was meant to bring products made with vegetable oil within the definition. The Court held that the Act was obviously designed to include only vegetable-oil coloring used in conjunction with animal-fat products; in fact, after the tax year involved, the statute had been amended to bring vegetable-oil products within the definition. See 46 Stat. 1022.

section 7421(a) is inapplicable; indeed, the contrary rule is well established. See, *e.g.*, *Matthews* v. *Rogers*, 284 U.S. 521; *Miller* v. *Standard Nut Margarine Co.*, *supra*; *Dows* v. *Chicago*, 11 Wall. 108. However, since we conclude that section 7421(a) bars any suit for an injunction in this case, we need not determine whether the taxpayer would suffer irreparable injury if collection were effected.

The manifest purpose of section 7421(a) is to permit the United States to assess and collect taxes alleged to be due without judicial intervention, and to require that the legal right to the disputed sums be determined in a suit for refund. In this manner the United States is assured of prompt collection of its lawful revenue.[6] Nevertheless, if it is clear that under no circumstances could the Government ultimately prevail, the central purpose of the Act is inapplicable and, under the *Nut Margarine* case, the attempted collection may be enjoined if equity jurisdiction otherwise exists. In such a situation the exaction is merely in "the guise of a tax." *Id.*, at 509.

We believe that the question of whether the Government has a chance of ultimately prevailing is to be determined on the basis of the information available to it at the time of suit. Only if it is then apparent that, under the most liberal view of the law and the facts, the United States cannot establish its claim, may the suit for an injunction be maintained. Otherwise, the District Court is without jurisdiction, and the complaint must be dismissed. To require more than good faith on the part of the Government would unduly interfere with a collateral objective of the Act—protection of the collector from litigation pending a suit for refund. And to permit even the maintenance of a suit in which an injunction could issue only after the taxpayer's nonliability had been conclusively established might "in every practical sense operate to suspend collection of the * * * taxes until the litigation is ended." *Great Lakes Dredge & Dock Co.* v. *Huffman*, 319 U.S. 293, 299. Thus, in general, the Act prohibits suits for injunctions barring the collection of federal taxes "when [the collecting] officers * * * have made the ass[ess]ment, and claim that it is valid." *Snyder* v. *Marks*, 109 U.S. 189, 194.

The record before us clearly reveals that the Government's claim of liability was not without foundation. Therefore, we reverse the judgment of the Court of Appeals and remand the case to the District Court with directions to dismiss the complaint.

Reversed.

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

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. 62-172

List of 57 obsolete Revenue Rulings and Revenue Procedures concerning tobacco products and cigarette papers and tubes, published in C.B. 1953-1 through C.B. 1960-1.

Because of numerous changes in the law and regulations relating to products subject to tax under Chapter 52 of the Internal Revenue Code of 1954, a review has been made of the Revenue Rulings and

[6] Compare S. Rep. No. 1035, 75th Cong., 1st Sess. 2, concerning 28 U.S.C. § 1341:
"The existing practice of the Federal courts in entertaining tax-injunction suits against State officers makes it possible for foreign corporations doing business in such States to withhold from them and their governmental subdivisions, taxes in such vast amounts and for such long periods of time as to seriously disrupt State and county finances. The pressing needs of these States for this tax money is so great that in many instances they have been compelled to compromise these suits, as a result of which substantial portions of the tax have been lost to the States without a judicial examination into the real merits of the controversy."

Revenue Procedures issued with respect to such products from 1953 to date.

Particular consideration has been given to the effect of the Excise Tax Technical Changes Act of 1958, 26 U.S.C. 5701, C.B. 1958–3, 92, at 231, which substantially revised the provisions of Chapter 52 of the Code, and to the regulations issued, reissued, or amended as a result of the enactment of this law.

On the basis of the review which has been made, it has been determined that the following Revenue Rulings and Procedures have no application to the law and regulations now in effect, or they are unnecessary since the subject matter of the ruling or procedure is now specifically covered by regulations. These Revenue Rulings and Revenue Procedures are therefore found to be no longer in effect and are hereby declared to be obsolete, as follows:

Revenue Ruling number	*Cumulative Bulletin citation*
53–11	C.B. 1953–1, 532
53–153	C.B. 1953–2, 448
54–275	C.B. 1954–2, 391
54–276	C.B. 1954–2, 393
54–317	C.B. 1954–2, 392
54–348	C.B. 1954–2, 404
55–530	C.B. 1955–2, 478
55–589	C.B. 1955–2, 479
55–698	C.B. 1955–2, 474
55–708	C.B. 1955–2, 478
55–722	C.B. 1955–2, 476
56–17	C.B. 1956–1, 542
56–73	C.B. 1956–1, 539
56–74	C.B. 1956–1, 541
56–76	C.B. 1956–1, 548
56–113	C.B. 1956–1, 546
56–114	C.B. 1956–1, 548
56–140	C.B. 1956–1, 536
56–141	C.B. 1956–1, 543
56–142	C.B. 1956–1, 547
56–150	C.B. 1956–1, 538
56–193	C.B. 1956–1, 535
56–295	C.B. 1956–1, 550
56–310	C.B. 1956–2, 928
56–426	C.B. 1956–2, 925
56–469	C.B. 1956–2, 926
56–643	C.B. 1956–2, 924
57–16	C.B. 1957–1, 428
57–35	C.B. 1957–1, 495
57–97	C.B. 1957–1, 431
59–54	C.B. 1959–1, 537
59–342	C.B. 1959–2, 367
59–364	C.B. 1959–2, 368
60–157	C.B. 1960–1, 591

Revenue Procedure number	*Cumulative Bulletin citation*
55–11	C.B. 1955–2, 912
55–12	C.B. 1955–2, 914
56–1	C.B. 1956–1, 1016
56–3	C.B. 1956–1, 1018
56–4	C.B. 1956–1, 1019
56–16	C.B. 1956–1, 1041
56–20	C.B. 1956–1, 1045
56–21	C.B. 1956–2, 1379
56–30	C.B. 1956–2, 1389
56–31	C.B. 1956–2, 1392
57–7	C.B. 1957–1, 730
57–8	C.B. 1957–1, 732
57–9	C.B. 1957–1, 734
57–11	C.B. 1957–1, 739
57–20	C.B. 1957–1, 750
58–1	C.B. 1958–1, 683
58–7	C.B. 1958–1, 689
58–9	C.B. 1958–1, 692
58–12	C.B. 1958–2, 1123
59–6	C.B. 1959–1, 815
59–7	C.B. 1959–1, 817
59–28	C.B. 1959–2, 941
59–35	C.B. 1959–2, 958

Revision of Revenue Rulings and Revenue Procedures issued under Chapter 15 of the Internal Revenue Code of 1939 and Chapter 52 of the 1954 Code. See Rev. Proc. 62–24, page 489.

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 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 income tax returns of tax-exempt organizations for the years 1950 to 1962, inclusive, by the House Select Committee on Small Business. See E.O. 11055, page 309.

Inspection of certain returns by the Senate Committee on Foreign Relations. See E.O. 11065, page 310.

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SUBCHAPTER C.—SUPPLEMENTAL PROVISIONS

SUPPLEMENT B.—COMPUTATION OF NET INCOME

SECTION 115(a).—DISTRIBUTIONS BY CORPORATIONS: DEFINITION OF DIVIDEND

REGULATIONS 118, SECTION 39.115(a)-1: Dividends.

The effective date of a distribution made by a corporation to a shareholder. See Rev. Rul. 62-131, page 94.

SECTION 115(b).—DISTRIBUTIONS BY CORPORATIONS: SOURCE OF DISTRIBUTIONS

REGULATIONS 118, SECTION 39.115(b)-1: Sources of distribution in general.

The effective date of a dividend distribution as determined by reference to source. See Rev. Rul. 62-131, page 94.

SUPPLEMENT M.—INTEREST AND ADDITIONS TO THE TAX

SECTION 292.—INTEREST ON DEFICIENCIES

Computation of interest where accrued foreign taxes are abated. See Rev. Proc. 62-27, page 495.

SECTION 294.—ADDITIONS TO THE TAX IN CASE OF NONPAYMENT

REGULATIONS 118, SECTION 39.294-1: Additions to the tax.

Computation of interest where accrued foreign taxes are abated. See Rev. Proc. 62-27, page 495.

CHAPTER 10.—ADMISSIONS AND DUES

SUBCHAPTER A.—ADMISSIONS

SECTION 1700.—TAX

REGULATIONS 43, SECTION 101.14: Scope of tax. (Also Part I, Section 4231.) Ct. D. 1872

EXCISE TAXES—INTERNAL REVENUE CODE OF 1939—DECISION OF COURT

1. ADMISSIONS—CABARETS—PRIVATE CLUB V. PUBLIC PLACE.

A so-called "dinner club," operated for profit, furnished food and entertainment to its patrons. The club was organized as a private club to comply with state liquor laws. Membership cards were used

but there was no formal application for membership or a system of approval, no initiation fees or dues, no board of directors or meeting of the members.

The court held that in view of all the circumstances the club was so clearly a public place, within the meaning of section 1700(e) of the 1939 Code, that it was subject to the cabaret tax and a directed verdict for the United States should have been granted in the District Court.

2. JUDGMENT REVERSED.

Judgment of the United States District Court for the Southern District of West Virginia, No. 629, February 8, 1961, reversed.

3. CERTIORARI DENIED.

Petition for certiorari denied March 19, 1962, 369 U.S. 818.

IN THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

No. 8412

Club Ramon, Inc., Appellee v. *United States of America, Appellant*

Appeal from the United States District Court for the Southern District of West Virginia, at Bluefield, John A. Field, Jr., District Judge

[November 15, 1961]

SOPER, Circuit Judge:

The United States appeals from a judgment of the District Court, based on the verdict of a jury, that the Club Ramon, Inc. is entitled to a refund in the amount of $386.65 for taxes paid by it under Section 1700(e) of the Internal Revenue Code of 1939, as amended by Section 622 of the Revenue Act of 1942 Chapter 619, 56 Stat. 798, and by Section 3 of the Public Debt Act of 1944, 58 Stat. 272 [C.B. 1944, 815].*

The statute imposes a tax of 20% on amounts paid for admission or refreshment at "any roof garden, cabaret or other similar place furnishing a public performance for profit". The quoted phrase is defined to include "any room in any hotel, restaurant, hall or other public place where music and dancing privileges * * * are afforded the patrons in connection with the serving or selling of food [or] refreshment." The issue submitted to the jury was whether the business of the Club was conducted in a public place as defined in the statute and the jury found for the plaintiff and against the United States. This appeal is based upon the rejection of a motion of the United States offered at the conclusion of the evidence for a directed verdict on the ground that there is no showing in the evidence that the Club Ramon was a bona fide club operated in a private place but on the contrary was an enterprise conducted for profit in a public place where its patrons were afforded entertainment for which they paid. In our judgment, based on the evidence outlined below, the motion for directed verdict should have been granted.

Club Ramon, Inc. is a corporation established under the laws of West Virginia on October 13, 1951. It is, in effect, a one-man enterprise owned by Raymond O. Mattee and carried on by him for profit in Bluefield, W. Va. At its inception 20 shares of stock of the par value of $100 per share were issued of which 18 shares were issued to Mattee, 1 share to his wife, and 1 share to Dudley E. Cruise who works regularly as a clerk with the Bluefield Supply Company during the day but also acts as assistant to Mattee in the evening in the operation of the Club Ramon. These three persons constituted the Board of Directors of the corporation. Mattee became the President and Treasurer, his wife, Secretary, and Cruise, Vice President. The wife died in 1956 and the position of Secretary has not been since filled.

The certificate of incorporation states that the purpose of the corporation is to operate "a private dinner and supper club for the service of food and beverages." The by-laws of the corporation provide that the club shall be operated as a private club for the use of its members and their guests and that the Board of Directors

* The amount sued for represents the payment of excise taxes for the month of October 1951 which was made in order to test the application of the tax to the taxpaying corporation. The total liability assessed against the taxpayer for the period from October 1, 1951 to December 31, 1957 was $24,729.91, consisting of $17,254.98 in taxes, $4,233.98 in penalties and interest of $3,240.95.

shall prescribe the requirements for membership and issue appropriate identification to the members. No such regulations, however, have been passed and no attempt has been made to organize a private club in the ordinary meaning of that term. The selection of members has been entirely in the hands of Mattee and the evidence of membership is a membership card issued by Mattee bearing the member's name. The privileges of members consist in the right to have access to the Club and to partake of its entertainment for a price but no meetings of the members are held and the members have no voice in the selection of members, no control of the operation of the Club, and no share in the profits. In short, as witnesses for the taxpayer testified, the Club is Mattee and the profits are his.

The place of business is open after 5:30 P.M. in the evening. The name Club Ramon appears on the canopy over the sidewalk which shelters the entrance. The rooms include a lounge, reading and television room and a dining room containing a small area for dancing. Music is provided by a tape machine, a juke box and an electric organ. Members are permitted to consume alcoholic drinks on the premises which they may provide themselves and keep in a locker if they desire, or may purchase by the drink from the Club. In these respects the enterprise is similar to the business organization commonly known as a night club which is defined in Webster's New Collegiate Dictionary as "a commercial establishment operating at night to supply food and entertainment to its customers." In fact, the telephone company in Bluefield lists the taxpayer as a night club in its classified directory. Mattee and Cruise testified that they had no knowledge of this listing and that the business was not advertised in any other way.

The contention of Mattee that he does not furnish a public performance and does not operate a public place for entertainment is based almost entirely on restrictions imposed by him upon entrance to his establishment. The outside door of the restaurant is locked and opened only in response to a buzzer and usually but not always admission is restricted to persons bearing a membership card inscribed with their names and to their guests. Approximately 400 membership cards have been issued to residents of the city who are primarily but not exclusively local business or professional persons who desire the kind of facilities for food, drink and entertainment which the Club furnishes. The cards entitle the holders and the members of their families to admission to the Club. No formal application for membership is required. It is granted upon the recommendation of a member or upon the request of an applicant or upon the acceptance of an invitation to became a member issued by the management. In case of doubt as to the suitability of an applicant other members of the Club may be consulted before the membership card is issued but usually no such investigation is needed. Admission of non-members is granted at the request of other members who may or may not accompany the non-member. This practice is followed in extending the privileges of the Club to the patrons of a motel in the city upon the request of the operator of the motel who is a card-carrying member of the Club.

Reason for restricting admission to the Club is found in the fact that the operations of the business involve violations of the liquor laws of West Virginia. The sale of alcoholic liquors at wholesale and retail in the state is a state monopoly. They may be sold at retail only through state stores and agencies of the West Virginia Liquor Control Commission. West Virginia Code of 1955, Section 5907(29). A person may not drink alcoholic liquor in a public place or tender a drink of alcoholic liquor to another person in a public place. Section 5907(90). If the business of Club Ramon as above described be regarded as conducted in a public place within the meaning of the West Virginia statutes the use of alcoholic liquor by the patrons on the premises is a violation of the law. That the sale of alcoholic liquors regularly takes place is evidenced by the fact that the Club has acquired a stamp denoting the payment of a special tax to the United States which is required of retail dealers in liquor under 26 U.S.C. Section 5121 and 5122.

In view of all these circumstances we conclude that the Club Ramon is so clearly a public place within the meaning of the Federal Statute that a verdict for the United States should have been directed. The pretense set up in the charter and in the by-laws of the corporation that the organization is a private club has no foundation in fact and is not now urged in support of the judgment of the District Court. Hence, the question is whether a restaurant which is operated by its owner for profit and for this purpose is open to such members of

the general public and their families, without specific qualification, as the proprietor may deem it safe and prudent to admit to a place where violations of the state law are carried on, must properly be described as a public place within the meaning of the statute. We think that the answer must be in the affirmative when, as in this case, the sale of the privileges of the place was the lifeblood of the business and a large section of the general public was served. Actually the restrictions involved in the card-carrying practice were no more severe than those imposed by other public places of entertainment from which, for one purpose or another, certain classes of the general public are customarily excluded.

A contrary conclusion was reached by the court in *United States* v. *Lambeth* (9 Cir. 1949), 176 F. 2d 810, upon which the District Judge in the pending case relied.* Therein it was held that a restaurant operating nominally as a club but maintained by an individual for his own profit and engaged in violation of the state liquor laws was not a public place although it was accessible to almost anyone who desired to join. We are not in accord with this holding for it seems to us to ignore realities which are apparent to the ordinary mind. It is, of course, the duty of the trial judge to leave issues of fact to the determination of the jury but he is not obliged to submit issues as to whose outcome no reasonable doubt can be entertained. "And where the evidence is 'so overwhelmingly on one side as to leave no room to doubt what the fact is, the court should give a peremptory instruction to the jury.' * * * The rule is settled for the federal courts, and for many of the state courts, that whenever in the trial of a civil case the evidence is clearly such that if a verdict were rendered for one of the parties the other would be entitled to a new trial, it is the duty of the judge to direct the jury to find according to the views of the court. Such a practice, this court has said, not only saves time and expense, but 'gives scientific certainty to the law in its application to the facts and promotes the ends of justice.' * * * The scintilla rule has been definitely and repeatedly rejected so far as the federal courts are concerned. * * *" *Penna. R. Co.* v. *Chamberlain*, 288 U.S. 333, 343. And see *Wachovia Bank and Trust Co.* v. *United States* (4 Cir. 1961), 288 F. 2d 750, 757; *Wright* v. *Grain Dealers Nat. Mut. Fire Ins. Co.* (4 Cir. 1950), 186 F. 2d 956, 958.

Cases similar to the instant one may well arise in which the evidence presents the factual question, appropriate for jury resolution, as to whether the activities sought to be taxed are public or private. The determination in each case must depend on the force and character of the evidence there presented. What we hold here is that the facts in this case establish beyond reasonable dispute that the Club Ramon, Inc., in its organization and operation, is no more private than the ordinary discriminating restaurant, and that it is, therefore, liable for the taxes imposed.

The judgment of the District Court is reversed with direction to dismiss the complaint.

Reversed.

CHAPTER 37.—ABATEMENTS, CREDITS, AND REFUNDS

SECTION 3771.—INTEREST ON OVERPAYMENTS

Computation of interest where accrued foreign taxes are abated. See Rev. Proc. 62-27, page 495.

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*Refunds of excise taxes paid under Section 1700(e) have been granted by District Courts in the following cases in which the facts are more or less similar to those in the case at bar: *Naylor* v. *United States* (D.C.S.D. Cal. 1952) 102 F. Supp. 309; *Shrader* v. *O'Malley* (D.C. Nebr. 1954) 119 F. Supp. 627; *Bomber Club, Inc.* v. *Brodrick*, 54-2 U.S.T.C. Par. 49.054; *Southland Club, Inc.* v. *Brodrick*, 56-2 U.S.T.C. Par. 9931; *Uptown Club, Inc.* v. *United States*, 58-1 U.S.T.C. Par. 15.154; *Wynn's Trio Club, Inc.* v *Kochler*, 58-2 U.S.T.C. Par. 15.159.

SUBPART B.—RULINGS AND DECISIONS UNDER THE FEDERAL FIREARMS ACT

Rulings and decisions published in Part II, Subpart B, of the Internal Revenue Bulletin are based on the application of provisions of the Federal Firearms Act.

SECTION I.—DEFINITIONS

26 CFR 177.10: Meaning of terms. T. D. 6613 [1]

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER E, PART 177.—INTERSTATE TRAFFIC IN FIREARMS AND AMMUNITION

Miscellaneous amendments

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

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

On July 24, 1962, a notice of proposed rulemaking with respect to the amendment of 26 CFR Part 177, Interstate Traffic in Firearms and Ammunition, was published in the Federal Register (27 F.R. 6981). No objections to the rules proposed having been received within the 30-day period prescribed in the notice, the regulations as so published are hereby adopted.

In order to conform to the provisions of the Federal Firearms Act (52 Stat. 1250; 15 U.S.C. 901–909), as amended by Public Law 87–342 (75 Stat. 757) and to make certain other editorial and clarifying changes, the regulations in 26 CFR Part 177, "Interstate Traffic in Firearms and Ammunition", are amended as follows:

§ 177.10 [Amendment]

1. Section 177.10 is amended by deleting the term "crime of violence." and the definition of the term and by striking the definition of "fugitive from justice" and inserting in lieu of the latter definition the following: "Means any person who has fled from any State, Territory, the District of Columbia, or possession of the United States to avoid prosecution for a crime punishable by imprisonment for a term exceeding one year or to avoid giving testimony in any criminal proceeding.", and by striking the last sentence in the definition of "United States."

§ 177.20 [Amendment]

2. Section 177.20 is amended by inserting the following sentence at the end thereof: "In any case where a person who possesses a license issued under the act becomes a fugitive from justice or is indicted for, or convicted of, a crime punishable by imprisonment for a term exceeding one year by or in any court, such person is prohibited from transporting, shipping or receiving firearms or ammunition in

[1] 27 F.R. 10041.

interstate or foreign commerce or causing firearms or ammunition to be transported or shipped in interstate or foreign commerce."

3. Section 177.25 is amended to read as follows:

§ 177.25 STATUTORY RESTRICTIONS.—A license shall not be issued to any person who is a fugitive from justice or is under indictment for, or has been convicted of, a crime punishable by imprisonment for a term exceeding one year by or in any court.

4. Section 177.31 is amended to read as follows:

§ 177.31 GENERAL.—A proper license shall entitle the person to whom issued to transport, ship and receive firearms or ammunition in interstate or foreign commerce, within the limitations of the Act, for a period of one year from the date of issuance. A license issued under the Act shall be subject to revocation at any time the licensee is convicted of a violation of any of the provisions of the Act (see 177.43), and to administrative cancellation (see 177.30). It shall be unlawful for any manufacturer or dealer holding a license issued under the Act who becomes a fugitive from justice or is indicted for, or convicted of, a crime punishable by imprisonment for a term exceeding one year by or in any court, to transport, ship, or receive firearms or ammunition in interstate or foreign commerce or to cause firearms or ammunition to be transported or shipped in interstate or foreign commerce. A license shall not be issued in any case for a period of less than one year.

§ 177.38 through 177.42 [Deletions]

5. Sections 177.38, 177.39, 177.40, 177.41, and 177.42 are deleted in their entirety, and the undesignated centerhead preceding § 177.38 is amended to read "Revocation of License".

6. Section 177.43 is amended to read as follows:

§ 177.43 REVOCATION OF LICENSE.—Section 3(c) of the Act (15 U.S.C. 903(c)) provides that whenever any licensee is convicted of a violation of any of the provisions of the Act it shall be the duty of the clerk of the court to notify the Secretary of the Treasury within 48 hours after such conviction. Accordingly, the Director, pursuant to the authority delegated to him to administer and enforce the Act shall, upon receipt of the notice of a conviction of a licensee of a violation of any of the provisions of the Act, immediately notify the licensee, by registered mail addressed to his last known address, that his license is being revoked. The letter will state the basis of the revocation and give the licensee an opportunity to show cause within 20 days after such notification is mailed why his license should not be revoked. If the licensee fails to show cause, the license will be revoked by the Director in accordance wtih the provisions of Section 3(c) of the Act.

§ 177.44 [Deletion]

7. Section 177.44 is deleted in its entirety.

8. Section 177.56 is amended to read as follows:

§ 177.56 VARIATIONS FROM REQUIREMENTS.—The Director may approve methods of operation other than as specified in this part, where he finds that an emergency exists and the proposed variations from the specified requirements are necessary, and the proposed variations—

(a) Will not hinder the effective administration of this part, and

(b) Will not be contrary to any provision of law.

Variations from requirements granted under this section are conditioned on compliance with the procedures, conditions, and limitations set forth in the approval of the application. Failure to comply in good faith with such procedures, conditions, and limitations shall automatically terminate the authority for such variations and the licensee thereupon shall fully comply with the prescribed requirements of regulations from which the variations were authorized. Authority for any variation may be withdrawn whenever in the judgment of the Director the effective administration of this part is hindered by the continuation of such variation. Where a licensee desires to employ such variation, he shall submit a written application to do so, in triplicate, to the Assistant Regional Commissioner for transmittal to the Director. The application

shall describe the proposed variation and set forth the reasons therefor. A variation shall not be employed until the application has been approved. The licensee shall retain, as part of his records, any authorization of the Director under this section.

§ 177.80 [Amendment]

9. Section 177.80 is amended by inserting the following sentence at the end thereof: "Further, it shall be unlawful for any licensed dealer or licensed manufacturer who is a fugitive from justice or who has been indicted for, or convicted of, a crime punishable by imprisonment for a term exceeding one year by or in any court, to transport, ship, or receive any firearm or ammunition in interstate or foreign commerce or to cause any firearm or ammunition to be transported or shipped in interstate or foreign commerce."

§ 177.83 [Amendment]

10. Section 177.83 is amended by striking all the words after the term "such person" and inserting in lieu thereof, the following: "is a fugitive from justice or is under indictment for, or has been convicted of, a crime punishable by imprisonment for a term exceeding one year by or in any court."

11. Section 177.84 is amended to read as follows:

§ 177.84 INTERSTATE TRANSPORTATION BY FELONS, ETC.—It shall be unlawful for any person who is a fugitive from justice or who is under indictment for, or has been convicted of, a crime punishable by imprisonment for a term exceeding one year by or in any court, to ship, transport, or cause to be shipped or transported in interstate or foreign commerce any firearm or ammunition. (Sec. 2, 52 Stat. 1250, as amended; 15 U.S.C. 902.)

12. Section 177.85 is amended to read as follows:

§ 177.85 RECEIPT BY FELONS, ETC.—It shall be unlawful for any person who is a fugitive from justice or who is under indictment for, or has been convicted of, a crime punishable by imprisonment for a term exceeding one year by or in any court, to receive any firearm or ammunition which has been shipped or transported in interstate or foreign commerce. (Sec. 2, 52 Stat. 1250, as amended; 15 U.S.C. 902.)

§ 177.88 [Amendment]

13. Section 177.88 is amended by placing a period after the word "altered," and by striking the words in the section that appear after the word "altered,".

This Treasury Decision shall be effective on the first day of the first month which begins not less than 30 days following the date of publication in the Federal Register.

(This Treasury Decision is issued under the authority contained in Section 7 of the Federal Firearms Act (52 Stat. 1252; 15 U.S.C. 907)).

MORTIMER M. CAPLIN,
Commissioner of Internal Revenue.

Approved October 9, 1962.

STANLEY S. SURREY,
Assistant Secretary of the Treasury.

(Filed by the Division of the Federal Register on October 11, 1962, 8:50 a.m., and published in the issue of the Federal Register for October 12, 1962, 27 F.R. 10041)

SUBPART C.—RULINGS AND DECISIONS UNDER THE OTHER PUBLIC LAWS

Rulings and decisions published in Part II, Subpart C, 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.

TAX RATE EXTENSION ACT OF 1962

26 CFR 49.9000: Statutory provisions; Tax Rate Extension Act of 1962; special credit or refund of transportation tax.

Special credit or refund where the tax on the transportation of persons was collected prior to the date of change in the applicable tax but transportation begins after such date. See T.D. 6618, page 258.

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 5001.—IMPOSITION, RATE, AND ATTACHMENT OF TAX

26 CFR 251.44: Other compounds and preparations. Rev. Rul. 62–198

(Also Section 5025; 170.613.)

In order to be classed as unfit for use for beverage purposes, imported and domestic brandied fruits must consist of *solidly packed* fruits, either whole or segmented, and shall not contain liquors (distilled spirits and/or wines) exceeding the quantity or alcohol content necessary for flavoring and preserving.

In view of the complex problems relating to classification and treatment of imported and domestic brandied fruits, it is held that if the alcohol content of the liquid portion of the solidly packed brandied fruits exceeds 12 percent of alcohol by volume, or if the solids content (essentially sugar) of the liquid portion (expressed in grams per 100 ml.) is less than five times the percentage of alcohol by volume, a description and sample of the product, together with a statement of the reasons why a higher alcohol content is necessary for flavoring and preserving the product, or why a lower ratio of solids in the liquid portion is justifiable, as the case may be, should be submitted to the Director of the Alcohol and Tobacco Tax Division, Washington, D.C., for determination whether the product qualifies under the regulations as unfit for use for beverage purposes. See Section 170.613(a)(8) of the Miscellaneous Regulations Relating to Liquors.

Imported and domestic brandied fruits not meeting the standards for products unfit for beverage use referred to above, or which are sold for beverage purposes or under circumstances from which it might reasonably appear that it is the intention of the purchaser to procure the same for sale or use for beverage purposes, will be treated and classed as distilled spirits or wines (as the case may be) and as subject to the provisions of law and regulations applicable thereto.

If fruits packed in liquor are not solidly packed, they will be treated as sirups and the liquid portion must conform to the standard for sirups, consisting of sugar solutions and liquors, as set forth in section 170.613(a)(7) of the regulations.

Revenue Ruling 61-84, C.B. 1961-1, 793, is hereby superseded.

SECTION 5006.—DETERMINATION OF TAX

26 CFR 201.62: Alternate methods or procedures; and emergency variations from requirements.

Maintenance of memorandum records for industrial spirits. See Rev. Rul. 62-222, below.

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26 CFR 201.612: Maintenance and preservation of records.

Maintenance of memorandum records for industrial spirits. See Rev. Rul. 62-222, below.

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26 CFR 201.629: Summary of deposits and withdrawals, Form 1621. (Also Sections 201.62, 201.612.) — Rev. Rul. 62-222

Certain proprietors of distilled spirits plants who are qualified primarily for the production or warehousing of industrial spirits have reported that, to promote efficient plant operation, they frequently reduce spirits below 190 degrees of proof in bonded storage, thereby rendering such spirits subject to the 20-year bonding period limitation of section 5006(a)(2) of the Internal Revenue Code of 1954. This is

done in anticipation of orders for undenatured spirits of lower proof for industrial purposes, or in preparation for subsequent denaturation of spirits at less than 190 degrees of proof. These proprietors have complained that, since spirits so reduced by them will be retained only temporarily after such reduction, it is unnecessarily burdensome for them to make the adjustments in their accounts which are required under section 201.629 of the Distilled Spirits Plants Regulations and by Revenue Procedure 61–23, C.B. 1961–2, 558.

Held, the record-keeping requirements of section 201.629 of the regulations, with respect to maintenance of seasonal accounts by state and plant numbers of producers, for spirits subject to the 20–year bonding period limitation of section 5006(a)(2) of the Code, are intended to apply primarily to non-industrial beverage spirits, and to assure that the bonding period limitation as to such spirits will not be exceeded.

Therefore, proprietors of distilled spirits plants who are qualified at specific plants for the storage of spirits for industrial use may, for each such plant, apply under section 201.62(a) of the regulations for permission to maintain memorandum records of spirits which are reduced to a proof of less than 190 degrees for temporary retention in anticipation of subsequent withdrawal for industrial use without denaturation, or in anticipation of subsequent denaturation, in lieu of making the adjustments in their accounts prescribed in Revenue Procedure 61–23.

Their applications should be accompanied by sample copies of the memorandum records they propose to keep and should contain the following:

1. A stipulation that any spirits so reduced and not denatured will be withdrawn only for industrial use or will be entered into the appropriate accounts as required by section 201.629 of the regulations and Revenue Procedure 61–23;
2. A stipulation of the maximum period of time any such spirits will continue to be held in bonded storage without denaturation after being reduced to a proof of less than 190 degrees;
3. A stipulation that spirits so reduced in proof for subequent industrial use will not be transferred in bond; and
4. A stipulation that the memorandum records will be subject to the provisions of section 201.612 of the regulations.

Subpart B.—Rectification

SECTION 5025.—EXEMPTION FROM RECTIFICATION TAX

26 CFR 170.163: Products exempt from commodity taxes.

Brandied fruits packaged with liquors for flavoring and preserving. See Rev. Rul 62–198, page 365.

SECTION 5051.—IMPOSITION AND RATE OF TAX

Tolerances in filling bottles and cans of beer. See Rev. Rul. 62–121, page 379.

SECTION 5053.—EXEMPTIONS

26 CFR 252.243: Shipment to armed services. Rev. Rul. 62–101

Section 252.243 of the Exportation of Liquors Regulations provides, in part, that on removal of beer for export to the armed services of the United States, the shipment shall be consigned to the commanding officer or supply officer at the supply base or other place of delivery. *Held*, beer withdrawn for export for shipment to an agency of the United States Government is considered analogous to a shipment of beer to the armed services of the United States. Therefore, Form 1689, Beer for Export, and export bills of lading signed by an authorized official of an agency of the United States Government may be accepted by the Assistant Regional Commissioner for the purpose of clearing the brewer's bond. In such cases, section 1, items 5A and 6B of Form 1689 should be appropriately modified and used by the brewer. The official at the port of lading, who is authorized to receive beer for exportation in behalf of the agency of the United States, should execute section V of the form, appropriately modified.

SECTION 5056.—REFUND AND CREDIT OF TAX, OR RELIEF FROM LIABILITY

26 CFR 245.161: Notice by brewer. Rev. Rul. 62–163

A claim for credit or refund of tax, under section 5056(a) of the Internal Revenue Code of 1954, for beer removed from the market by a brewer and returned to stock is allowable only where the notice required by section 245.161 of the Beer Regulations has been filed prior to the return of the beer to stock.

Advice has been requested whether a claim for refund or credit of tax on taxpaid beer removed from the market and returned to stock is allowable where the brewer did not give the written notice required by section 245.161 of the Beer Regulations prior to the return of the beer to stock.

A brewer removed certain beer from the market to his brewery and returned the beer to stock without the written notice of intention required by section 245.161 of the Beer Regulations having been given to the Assistant Regional Commissioner, Alcohol and Tobacco Tax. The same beer was again removed from the brewery upon determination of tax. Subsequent thereto, a claim for credit of tax was sub-

mitted for this beer previously removed from the market. The claim was accompanied by a notice of intention to reship beer which had been removed from the market.

Under the provisions of section 245.161 of the Beer Regulations, a brewer is required to give written notice to the Assistant Regional Commissioner, Alcohol and Tobacco Tax, of taxpaid or tax-determined beer possessed by him and removed from the market which is to be destroyed in the brewery or elsewhere or which after return to the brewery is to be reconditioned, used as material, or returned to the stock of the racking room or bottling house.

The notice required by section 245.161 of the regulations is one of intention to perform an act. This provision of the regulations requires the notice to be given before the proposed action is taken by the brewer. A notice after the fact does not meet the intent of the regulations and is ineffective. With respect to beer removed from the market which is to be returned to stock, the notice (in order to constitute a proper notice under section 245.161 of the regulations) must be given prior to, at the time of, or after removal of the beer from the market but before it is returned to the stock of the brewery racking room or bottling house.

The phrase, "beer returned to stock," relates to beer which is mingled with other bottled or keg beer in stock. Therefore, if a brewer wishes to obtain refund or credit of tax, the notice of intention to return to stock must be given before the beer is received on brewery premises unless it is to be kept segregated prior to notice and mingling with other beer in stock.

PART II.—OCCUPATIONAL TAX

Subpart D.—Wholesale Dealers

SECTION 5113.—EXEMPTIONS

26 CFR 194.188: Persons making casual sales. — Rev. Rul. 62–208 [1]

Under the provisions of section 5113(c) of the Internal Revenue Code of 1954 and section 194.188 of the Liquor Dealers Regulations, an insurance company or its salvaging agents, acting in a fiduciary capacity in making sales of salvaged distilled spirits, wines, or beer, will not be required to pay special tax or keep the records and reports required of dealers under the provisions of subpart "O" of the regulations, if such products are sold in one parcel or at public auction in parcels of not less than 20 wine gallons.

Revenue Ruling 54–189, C.B. 1954–1, 334, is hereby superseded.

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[1] Prepared pursuant to Revenue Procedure 62–17, page 407.

SECTION 5131.—ELIGIBILITY AND RATE OF TAX

26 CFR 197.55: Change to higher rate. Rev. Rul. 62-143
(Also Sections 6402, 6611; 301.6402-1, 301.6611-1.)

Interest is allowable upon refunds of overpayment of the special tax paid by a manufacturer of nonbeverage products under section 5131 of the Internal Revenue Code of 1954. Interest on the overpayment is computed from the date of payment of the special tax at a higher rate.

Advice has been requested whether interest is allowable with respect to the refund of the special tax paid by a manufacturer of nonbeverage products imposed by section 5131 of the Internal Revenue Code of 1954.

A manufacturer of nonbeverage products paid special tax in the amount of $25. By the end of the fiscal year, the manufacturer had used more than his allowed 25 gallons of distilled spirits in nonbeverage products. The manufacturer then paid special tax in the amount of $50 and filed a claim for refund for the $25 originally paid.

Section 5131 of the Code provides that any person using distilled spirits produced in a domestic registered distillery or industrial alcohol plant and withdrawn from bond, or using distilled spirits withdrawn from bond, or using distilled spirits withdrawn from the bonded premises of a distilled spirits plant, on which the tax had been determined, in the manufacture or production of medicines, medicinal preparations, food products, flavors, or flavoring extracts, which are unfit for beverage purposes, on payment of a special tax per annum, shall be eligible for drawback at the time when such distilled spirits are used in the manufacture of certain nonbeverage products. The special tax for total annual use not exceeding 25 proof gallons is $25 a year. For total annual use not exceeding 50 proof gallons, the tax is $50 a year. And for total annual use of more than 50 proof gallons, the tax is $100 a year.

The special tax is payable by return rather than by stamp. See section 194.21 of the Liquor Dealers Regulations and section 197.28 of the Drawback on Distilled Spirits Used In Manufacturing Nonbeverage Products Regulations.

Sections 197.55 through 197.59 of the Nonbeverage Drawback Regulations were amended by T.D. 6549, C.B. 1961-1, 823, to provide for an adjustment or a refund of the special tax in lieu of a redemption of stamps.

Therefore, the special tax to be refunded to nonbeverage domestic drawback claimants does not come within the stamp tax redemption category of section 6805 of the Code, but is to be considered an overpayment of tax, refundable under section 6402 of the Code, on which interest is allowable by section 6611 of the Code.

Section 301.6611-1 of the Regulations on Procedure and Administration provides in part that the dates of overpayment of any tax are the date of payment of the first amount which (when added to previous payments) is in excess of the tax liability (including any

interest, addition to the tax, or additional amount) and the dates of payment of all amounts subsequently paid with respect to such liability.

Accordingly, interest is allowable where the special tax of $25 is paid by a manufacturer of nonbeverage products who, at the end of the fiscal year, discovers that he has used more than 25 gallons of distilled spirits in nonbeverage products and applies for a refund of that amount after first paying the higher special tax of $50. The interest on the overpayment is computed from the date on which the second tax is paid. However, interest may not be assessed with respect to the payment of the $50 special tax since the manufacturer does not incur a liability for such tax until he has filed a claim for drawback for spirits used in excess of 25 gallons.

Interest is also allowable where a claim for refund is made for the amount of the difference between the special tax paid and the special tax due, as in the instance where the manufacturer of nonbeverage products pays the tax in the amount of $100 at the beginning of a fiscal year but uses only 50 gallons or less during the year. Such interest is allowed from the date of the overpayment to a date determined by the District Director, which shall be not more than 30 days prior to the date of the refund check.

SUBCHAPTER C.—OPERATION OF DISTILLED SPIRITS PLANTS

PART I.—GENERAL PROVISIONS

SECTION 5201.—REGULATION OF OPERATIONS

26 CFR 201.76: Hours of operation. Rev. Rul. 62–225 [1]

Tank cars or tank trucks of spirits or trucks containing packages of spirits which have been loaded, sealed, and documented during regular business hours for transfer in bond, may be removed from distilled spirits plant premises after the close of such regular business hours.

Revenue Ruling 54–200, C.B. 1954–1, 320, is hereby superseded.

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26 CFR 201.466: Rebottling, relabeling, and restamping of bottled spirits. Rev. Rul. 62–164 [1]
(Also Part III–C, Section 5(e); 27 CFR 5.30.)

Bottles of unsalable imported distilled spirits may be dumped, filtered, rebottled, and relabeled on bottling premises of a distilled spirits plant pursuant to the provisions of section 201.466 of the Distilled Spirits Plants Regulations. Consent to such rebottling and

[1] Prepared pursuant to Revenue Procedure 62–17, page 407.

relabeling need not be obtained from the foreign producer or exporter if the original bottles are to be refilled in the operation, and if the replacement labels are identical with the labels on the bottles. However, a certificate of label approval to cover dumping, filtering, rebottling, and relabeling of the bottled spirits must be obtained in accordance with section 5.30 of the Distilled Spirits Labeling and Advertising Regulations under the Federal Alcohol Administration Act. Further, red strip stamps overprinted with the importer's name or trade name may not be used on bottling premises.

Revenue Ruling 54–155, C.B. 1954–1, 332, is hereby superseded.

SECTION 5205.—STAMPS

26 CFR 201.541: General.

Packaging distilled spirits in tinplate containers of less than one-half pint capacity with tin-lead soldered seams. See Rev. Rul. 62–111, below.

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26 CFR 201.542: Bottled-in-bond strip stamp denominations.

Overprinting of denomination on bottled-in-bond strip stamps. See T.D. 6602, page 374.

SECTION 5206.—CONTAINERS

26 CFR 175.11: Container. Rev. Rul. 62–111
(Also 175.34.)
(Also Section 5205; 201.541.)
(Also Part III–C, Section 5(e); 27 CFR 5.74.)

> Tinplate containers of less than one-half pint capacity manufactured with tin-lead soldered seams, suitably stamped and marked, may, under certain conditions, be used for the packaging of cordials, liqueurs, cocktails, highballs, gin fizzes, bitters and specialties. Under no circumstances may the product contain acetic acid.

Advice has been requested whether proprietors of distilled spirits plants may package certain distilled spirits and citrus juices in tinplate containers of less than one-half pint capacity with tin-lead soldered seams.

The proprietor of a distilled spirits plant proposes to market a prepared cocktail in a six-ounce tin can. Affixed to each can would be a strip stamp which extends across the lid, over the lip and down both sides for a short distance. The stamp would be so applied that it could not be removed without being severely mutilated. It is proposed that the legend "Destroy Stamp Upon Opening" would be lithographed on the side of the container and the legend "Open Other End" would be permanently marked on the bottom thereof.

Containers of less than one-half pint used for the packaging of distilled spirits are not classed as "liquor bottles" under the Traffic in Containers of Distilled Spirits Regulations and, therefore, are not subject to the requirements of those regulations. Since the containers

will be used for packaging of prepared cocktails, they are not subject to the standards of fill requirements prescribed by sections 5.70 through 5.74 of the Distilled Spirits Labeling and Advertising Regulations. Such containers are, however, subject to the strip stamp requirements of section 5205 of the Internal Revenue Code of 1954, and sections 201.541 through 201.552 of the Distilled Spirits Plants Regulations, and to the labeling requirements of section 5(e) of the Federal Alcohol Administration Act and the Distilled Spirits Labeling and Advertising Regulations.

Containers of less than one-half pint capacity are also subject to all applicable state laws affecting the distribution of liquors. Such containers may be sold at wholesale or retail only by qualified liquor dealers.

Accordingly, it is held that tinplate containers of less than one-half pint capacity (having tin-lead soldered seams), suitably stamped and marked, would not occasion administrative difficulty, would not jeopardize the revenue in respect of packaging and distribution, and may be used for packaging certain liquors under the following conditions:

1. Such containers may be used only for the packaging of cordials, liqueurs, cocktails, highballs, gin fizzes, bitters, and specialties exempted from the standards of fill for bottled distilled spirits under section 5.74 of the Labeling and Advertising Regulations provided, however, that the distilled spirits, or any other ingredient, used in such products do not contain acetic acid.
2. The strip stamp shall be securely affixed across the top of the container and shall extend an equal distance down each side.
3. The legend "Destroy Stamp Upon Opening" shall be permanently marked on the side or bottom of the containers and the legend "Open Other End" shall be similarly marked on the bottom thereof.

(Also 175.17, 175.30, 175.34.) Rev. Rul. 62–112

Sections 175.11 and 175.17 of the Container Regulations provide that a container of not less than one-half pint capacity designed or intended to be used for the sale of distilled spirits for other than industrial use is a "liquor bottle" and may be made of glass, earthenware, or other suitable material approved by the Director, Alcohol and Tobacco Tax Division.

Held, tinplate has been found by the Director to be a suitable material (under prescribed conditions) for the manufacture of "liquor bottles." Accordingly, bottle manufacturers who have properly qualified under the permit provisions of the Container Regulations may manufacture "liquor bottles" of such material subject to the following requirements:

1. "Liquor bottles" made of tinplate shall be of eight-ounce capacity only; no other size is authorized by this ruling. (See Rev. Rul. 62–111, page 372, for the manufacture and use of metal containers of less than eight-ounce capacity.)
2. In the manufacture of such containers, the seams, if any, shall be soldered with all tin solder.
3. "Liquor bottles" made of tinplate shall have concave bottoms (aerosol style) which shall be not less than 107 pound tinplate.
4. The strip stamp shall be securely affixed across the top of the container and shall extend an equal distance down each side.
5. Such "liquor bottles" shall bear the indicia required by section 175.34 of the Container Regulations. In addition, the legend "Destroy Stamp Upon Open-

ing" shall appear on the side or bottom of the container and the legend "Open Other End" shall appear on the bottom of the container.

6. The required indicia and legends may be applied either by lithographing or by embossing.

7. Such containers may be used only for the packaging of cordials, liqueurs, cocktails, gin fizzes, bitters and other specialties.

Revenue Ruling 61–180, C.B. 1961–2, 273, is hereby modified to restrict the size of "liquor bottles" described therein to eight ounces only and their use to packaging cordials, liqueurs, cocktails, gin fizzes, bitters, and other specialties, only.

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26 CFR 175.17: Liquor bottle.

The use and manufacture of eight-ounce tinplate "liquor bottles." See Rev. Rul. 62–112, page 373.

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26 CFR 175.30: Permit to manufacture.

The use and manufacture of eight-ounce tinplate "liquor bottles." See Rev. Rul. 62–112, page 373.

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26 CFR 175.34: Indicia for domestic liquor bottles.

Packaging distilled spirits in tinplate containers of less than one-half pint capacity with tin-lead soldered seams. See Rev. Rul. 62–111, page 372.

The use and manufacture of eight-ounce tinplate "liquor bottles." See Rev. Rul. 62–112, page 373.

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26 CFR 201.328: Liquor bottles. T.D. 6602[1]
(Also Section 5205; 201.542.)

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER E, PART 201.—DISTILLED SPIRITS PLANTS

Amendments to provide for use of 4/5 pint containers for packaging distilled spirits.

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 implement the provisions of Treasury Decision 6601 [C.B. 1962–1, 364] published in the Federal Register for June 5, 1962 (27 F.R. 5259), authorizing the use of 4/5 pint containers for the packaging of all classes and types of distilled spirits, the regulations in 26 CFR Part 201, Distilled Spirits Plants, are amended as follows:

[1] 27 F.R. 5954.

PARAGRAPH 1. Section 201.328 is amended to read:

§ 201.328 LIQUOR BOTTLES.—The proprietor shall comply with the provisions of Part 175 of this chapter respecting the use of liquor bottles. Spirits may be bottled for domestic purposes only in the sizes provided in 27 CFR Part 5. Spirits may be bottled in bond for export in bottles of any size less than five gallons. Liquor bottles may be used, but need not be used in bottling spirits in bond for export. (72 Stat. 1360, 1366, 1374; 26 U.S.C. 5206, 5233, 5301.)

PAR. 2. Section 201.457 is amended to read:

§ 201.457 LIQUOR BOTTLES. The proprietor shall comply with the provisions of Part 175 of this chapter respecting the use of liquor bottles. Spirits may be bottled for domestic purposes only in the sizes provided in 27 CFR Part 5. Liquor bottles may not be used for wines containing 24 percent alcohol by volume or less or for products manufactured with such wines unless such products contain spirits other than wine spirits used in wine production. Liquor bottles may be used, but need not be used, in bottling spirits for export. (72 Stat. 1374; 26 U.S.C. 5301.)

§ 201.542 [Amendment]

PAR. 3. The second sentence of § 201.542 is amended to read:

When bottles containing over ½ pint of bottled-in-bond spirits are of a size for which bottled-in-bond strip stamps in the exact denomination are not provided, the proprietor shall use stamps of another denomination; he shall strike out the original denominations and shall write or print on the stamps the exact quantity of spirits contained in the bottles. (72 Stat. 1358; 26 U.S.C. 5205.)

Since the purpose of this Treasury Decision is to implement the provisions of Treasury Decision 6601, which was published pursuant to notice and public hearing thereon, and since the proposed amendments are of a liberalizing nature, 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 (60 Stat. 238; 5 U.S.C. 1003). This Treasury Decision shall be effective September 1, 1962.

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

MORTIMER M. CAPLIN,
Commissioner of Internal Revenue.

Approved June 19, 1962.

STANLEY S. SURREY,
Assistant Secretary of the Treasury.

(Filed by the Division of the Federal Register on June 22, 1962, 8:51 a.m., and published in the issue of the Federal Register for June 23, 1962, 27 F.R. 5954)

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26 CFR 201.515: Specification for marks and brands. Rev. Rul. 62–165

Section 201.515 of the Distilled Spirits Plants Regulations provides, in part, that the proprietor shall place the required marks and brands on the Government head of packages of spirits by burning, cutting, printing, or stenciling or by any equally legible and durable method approved by the Director, Alcohol and Tobacco Tax Division.

Held, subject to approval in each particular instance by the Director, Alcohol and Tobacco Tax Division, the markings required to be placed on the Government head of metal drums of alcohol, pursuant to the

provisions of subpart P of the regulations, may be placed thereon by affixing a printed paper label with a satisfactory waterproof adhesive in such a manner that the label can be removed only by scraping. All of the required information not contained on the paper label so affixed must be placed on the Government head of the metal drum by one of the methods prescribed by the regulations. In any event, the serial number of the package with the distilled spirits plant identification (and distinguishing prefix, if any) and the date of filling must be so marked on the Government head of the drum.

PART II.—OPERATIONS ON BONDED PREMISES

Subpart D.—Denaturation

SECTION 5242.—DENATURING MATERIALS

26 CFR 212.11: Formula No. 18.

Use of deodorized kerosene in completely denatured alcohol formulas. See Rev. Rul. 62–144, below.

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26 CFR 212.12; Formula No. 19.

Use of deodorized kerosene in completely denatured alcohol formulas. See Rev. Rul. 62–144, below.

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26 CFR 212.65: General. Rev. Rul. 62–144
(Also 212.11, 212.12, 212.81.)

Section 212.65 of the Formulas for Denatured Alcohol and Rum Regulations provides, in part, that in order to meet the requirements of national defense or for other valid reason, the Director, Alcohol and Tobacco Tax Division, may authorize variations from the specifications for denaturants set forth in the regulations or authorize the use of substitute denaturants where such variation or substitution will not jeopardize the revenue.

Sections 212.11 and 212.12 of the regulations prescribe the denaturants to be used in completely denatured alcohol Formulas Numbers 18 and 19. Both of these formulas specify kerosene as a denaturant. Section 212.81 of the regulations sets out the specifications for the use of kerosene as a denaturant.

Laboratory tests have shown that deodorized kerosene is suitable as an alternate denaturant for kerosene in these formulas.

Accordingly, it is held that deodorized kerosene may be used as an alternate denaturant in lieu of kerosene in completely denatured alcohol Formula No. 18 and Formula No. 19 as follows:

Formula No. 18: To every 100 gallons of ethyl alcohol of not less than 160 degrees proof add:
2.50 gallons of methyl isobutyl ketone;
0.125 gallons of pyronate or a compound similar thereto;
0.50 gallon of acetaldol (b-hydroxybutyraldehyde); and
1.00 gallon kerosene or deodorized kerosene.

Formula No. 19: To every 100 gallons of ethyl alcohol of not less than 160 degrees proof add:
4.0 gallons of methyl isobutyl ketone; and
1.0 gallon of kerosene or deodorized kerosene.

The specifications for deodorized kerosene are as follows:

Distillation Range—(Applicable A.S.T.M. Method)
No distillate should come over below 340 degrees Fahrenheit and none above 570 degrees Fahrenheit.
Flash Point—115 degrees Fahrenheit minimum.

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26 CFR 212.81: Kerosene.

Use of deodorized kerosene in completely denatured alcohol formulas. See Rev. Rul. 62–144, page 376.

SUBCHAPTER D.—INDUSTRIAL USE OF DISTILLED SPIRITS

SECTION 5275.—RECORDS AND REPORTS

26 CFR 211.271: Reports of users.

Instruction for preparation of Form 1482 in accordance with the contemplated revision of the form. See Rev. Proc. 62–20, page 417.

SUBCHAPTER F.—BONDED AND TAXPAID WINE PREMISES

PART II.—OPERATIONS

SECTION 5367.—RECORDS

26 CFR 240.908: Form 2056, record of still wine.

Procedure for reporting the quantity of water added to wine by bentonite slurry treatments. See Rev. Proc. 62–34, page 534.

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. 62–120

The use of "Yeastex-61," a yeast food, to facilitate the fermentation of wine, in amounts not to exceed two pounds per 1,000 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 "Yeastex-61" in the fermentation 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. 62–145

The use of a product known as "Veltol" in the treatment of wine as a stabilizing and smoothing agent, in amounts not exceeding 250 parts per million, 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 "Veltol" in the treatment of wine must 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. 62–166

The use of the pectolytic enzyme, "Klerzyme Liquid," derived from Aspergillus Niger, in amounts not exceeding one-half pound per 1,000 gallons of wine to clarify 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 "Klerzyme Liquid" 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.

This product should be designated as "Klerzyme 200."

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26 CFR 240.1051: Materials authorized for treatment of wine.

The use of "Yeastex-61" to facilitate fermentation of wine. See Rev. Rul. 62–120, page 377.

The use of "Veltol" as a stabilizing and smoothing agent in the treatment of wine. See Rev. Rul. 62–145, above.

The use of "Klerzyme Liquid" in the clarification of wine. See Rev. Rul. 62–166, above.

Procedure for reporting the quantity of water added to wine by bentonite slurry treatments. See Rev. Proc. 62–34, page 534.

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26 CFR 240.1052: Notice.

The use of "Yeastex-61" to facilitate fermentation of wine. See Rev. Rul. 62–120, page 377.

The use of "Veltol" as a stabilizing and smoothing agent in the treatment of wine. See Rev. Rul. 62–145, above.

The use of "Klerzyme Liquid" in the clarification of wine. See Rev. Rul. 62–166, above.

SUBCHAPTER G.—BREWERIES

PART II.—OPERATIONS

SECTION 5412.—REMOVAL OF BEER IN CONTAINERS OR BY PIPELINE

26 CFR 245.126: Bottles. Rev. Rul. 62–121
(Also Section 5051.)
(Also Part III–C, Section 5(e); 27 CFR 7.27.)

Certain tolerances will be allowed in the filling of bottles and cans of beer.

Advice has been requested whether the Internal Revenue Service will recognize any tolerance in the filling of bottles and cans of beer from that amount stated on the container label.

Section 5051(a) of the Code provides as follows:

> There is hereby imposed on all beer, brewed or produced, and removed for consumption or sale, within the United States, or imported into the United States, a tax of $9 for every barrel containing not more than 31 gallons and at a like rate for any other quantity or for fractional parts of a barrel. * * * Where the Secretary or his delegate finds that the revenue will not be endangered thereby, he may by regulations prescribe tolerances for barrels and fractional parts of barrels, and, if such tolerances are prescibed, no assessment shall be made and no tax shall be collected for any excess in any case where the contents of a barrel or a fractional part of a barrel are within the limit of the applicable tolerance prescribed.

Section 5412 of the Code provides in part that beer may be removed from the brewery for consumption or sale only in hogsheads, barrels, and similar containers, marked, branded, or labeled in such manner as the Secretary of the Treasury or his delegate may by regulation prescribe.

Section 245.126 of the Beer Regulations provides in part that the statement of net contents shall indicate exactly the volume of beer within the bottle except for such variations in measuring as may occur in filling conducted with good commercial practice.

Section 7.27 of the Malt Beverages Labeling and Advertising Regulations under the Federal Alcohol Administration Act requires that the net contents be stated on the containers of beer.

The Internal Revenue Service is concerned about insuring a proper determination and payment of the tax on canned and bottled beer and with the accuracy of the net content statement appearing on the label of the product.

Accordingly, bottles and cans of beer must be filled as nearly as possible to the quantity shown on the label as the net contents. However, the following tolerances will be permitted:

1. Variations in fill due to errors in measuring which occur in filling conducted in compliance with good commercial practice, provided that there is substantially as much underfill as overfill as to each lot.

2. Reasonable discrepancies due exclusively to differences in the capacity of containers, resulting solely from unavoidable difficulties in manufacturing such containers so as to be of uniform capacity.

SECTION 5413.—BREWERS PROCURING BEER FROM OTHER BREWERS

26 CFR 245.205: Notice to assistant regional commissioner. Rev. Rul. 62-146 [1]

Under the provisions of section 5413 of the Internal Revenue Code of 1954 and sections 245.205 through 245.208 of the Beer Regulations, a brewer may obtain beer in his own hogsheads, barrels, and kegs, marked with his name and address, from another brewer, with tax-payment thereof to be made by the producer before removal. However, there is no authority in the law or regulations under which brewers may similarly purchase taxpaid or tax-determined bottled beer from another brewer in bottles containing the purchasing brewer's markings. Accordingly, permission for such a transaction may not be granted. Also, purchased taxpaid bottled beer may not be received on brewery premises for labeling.

Revenue Ruling 54–103, C.B. 1954–1, 329, is hereby superseded.

SUBTITLE F.—PROCEDURE AND ADMINISTRATION

CHAPTER 61.—INFORMATION RETURNS

SUBCHAPTER B.—MISCELLANEOUS PROVISIONS

SECTION 6109.—IDENTIFYING NUMBERS

26 CFR 194.106a: Employer identification numbers.

Use of employer identification numbers on returns, statements or other documents filed by liquor dealers. See T.D. 6606, page 311.

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26 CFR 196.34a: Employer identification numbers.

Use of employer identification numbers on returns, statements, or other documents filed by manufacturers of stills and condensers. See T.D. 6606, page 311.

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26 CFR 197.29a: Employer identification numbers.

Use of employer identification numbers on returns, statements, or other documents filed by manufacturers of nonbeverage products. See T.D. 6606, page 311.

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26 CFR 201.32a: Employer identification numbers.

Use of employer identification numbers on returns, statements, or other documents filed by manufacturers of distilled spirits. See T.D. 6606, page 311.

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[1] Prepared pursuant to Revenue Procedure 62–17, page 407.

26 CFR 201.380a: Employer identification number
(Also 240.594a, 245.117d.)

T. D. 6607 [1]

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER E, PARTS 201, 240, AND 245

Amendments relating to the use of identifying numbers

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 April 20, 1962, a notice of proposed rulemaking with respect to the amendment of 26 CFR Part 201, Distilled Spirits Plants, 26 CFR Part 240, Wine, and 26 CFR Part 245, Beer, was published in the Federal Register (27 F.R. 3816). No objections to the rules proposed having been received within the 30-day period prescribed in the notice, the following regulations are hereby adopted.

In order to conform the regulations in 26 CFR Part 201, Distilled Spirits Plants, 26 CFR Part 240, Wine, and 26 CFR Part 245, Beer, to the amendments made to the Internal Revenue Code of 1954 by the Act of October 5, 1961 (Public Law 87–397, 75 Stat. 828 [C.B. 1961–2, 348]), authorizing the requirement of identifying numbers, the regulations are amended as set out below.

Sections 201.380a, 201.380c, 201.451a, 201.451c, 240.594a, 245.117d, and 245.117f as contained in this document make reference to sections 201.32e, 245.76d, 301.6676–1, and 301.7701–12 as contained in a notice of proposed rule making published in the Federal Register for February 24, 1962 (27 F.R. 1761).

PARAGRAPH 1. 26 CFR Part 201, Distilled Spirits Plants, is amended as follows:

(A) By inserting, immediately after § 201.380, three new sections, as follows:

§ 201.380a EMPLOYER IDENTIFICATION NUMBER.—The employer identification number (defined at 26 CFR 301.7701–12) of the taxpayer who has been assigned such a number shall be shown on each return on Form 2521 or Form 2522 filed pursuant to the provisions of this part on or after October 1, 1962. Failure of the taxpayer to include his employer identification number on Forms 2521 or 2522 may result in assertion and collection of the penalty specified in 26 CFR 301.6676–1. (75 Stat. 828; 26 U.S.C. 6109, 6676.)

§ 201.380b APPLICATION FOR EMPLOYER IDENTIFICATION NUMBER.—(a) An employer identification number will be assigned pursuant to application on Form SS–4 filed by the taxpayer. Form SS–4 may be obtained from the district director with whom the Forms 2521 and 2522 are required to be filed.

(b) An application on Form SS–4 for an employer identification number shall be made by every taxpayer who filed a return on Form 2521 or Form 2522 before October 1, 1962, and who has neither secured an employer identification number nor made application therefor prior to October 1, 1962. Such application on Form SS–4 shall be filed on or before October 8, 1962.

(c) An application on Form SS–4 for an employer identification number shall be made by every taxpayer whose first return on Form 2521 or Form 2522 is filed on or after October 1, 1962, but who prior to the filing of such return on Form 2521 or Form 2522 has neither secured an employer identification number nor made application therefor. Such application on Form SS–4 shall be filed on

[1] 27 F.R. 8525.

or before the seventh day after the date on which such first return on Form 2521 or Form 2522 is filed.

(d) Each taxpayer shall make application for and shall be assigned only one employer identification number, regardless of the number of places of business for which the taxpayer is required to file a tax return under the provisions of this part. (75 Stat. 828; 26 U.S.C. 6109.)

§ 201.380c EXECUTION OF FORM SS–4.—The application on Form SS–4 shall be prepared in accordance with the provisions of § 201.32e, and shall be filed with any district director with whom returns on Forms 2521 or 2522 will be filed by the person who is required to make the application. (75 Stat. 828; 26 U.S.C. 6109.)

(B) By inserting, immediately after § 201.451, three new sections, as follows:

§ 201.451a EMPLOYER IDENTIFICATION NUMBER.—The employer identification number (defined at 26 CFR 301.7701–12) of the taxpayer who has been assigned such a number shall be shown on each return on Form 2523 or Form 2527 filed pursuant to the provisions of this part on or after October 1, 1962. Failure of the taxpayer to inelude his employer identification number on Forms 2523 or 2527 may result in assertion and collection of the penalty specified in 26 CFR 301.6676–1. (75 Stat. 828; 26 U.S.C. 6109, 6676.)

§ 201.451b APPLICATION FOR EMPLOYER IDENTIFICATION NUMBER.—The provisions of § 201.380b, relating to application for employer identification number by taxpayers filing returns on Form 2521 or Form 2522, shall be applicable to taxpayers filing returns on Form 2523 or Form 2527. (75 Stat. 828; 26 U.S.C. 6109.)

§ 201.451c EXECUTION OF FORM SS–4.—The application on Form SS–4 shall be prepared in accordance with the provisions of § 201.32e, and shall be filed with any district director with whom returns on Forms 2523 or 2527 will be filed by the person who is required to make the application. (75 Stat. 828; 26 U.S.C. 6109.)

PAR. 2. 26 CFR Part 240, Wine, is amended by inserting, immediately after § 240.594, three new sections as follows:

§ 240.594a EMPLOYER IDENTIFICATION NUMBER.—The employer identification number (defined at 26 CFR 301.7701–12) of the taxpayer who has been assigned such a number shall be shown on each return on Form 2050 or Form 2052 filed pursuant to the provisions of this part on or after October 1, 1962. Failure of the taxpayer to include his employer identification number on Forms 2050 or 2052 may result in assertion and collection of the penalty specified in 26 CFR 301.6676–1. (75 Stat. 828; 26 U.S.C. 6109, 6676.)

§ 240.594b APPLICATION FOR EMPLOYER IDENTIFICATION NUMBER.—(a) An employer identification number will be assigned pursuant to application on Form SS–4 filed by the taxpayer. Form SS–4 may be obtained from the district director with whom the Forms 2050 and 2052 are required to be filed.

(b) An application on Form SS–4 for an employer identification number shall be made by every taxpayer who filed a return on Form 2050 or Form 2052 before October 1, 1962, and who has neither secured an employer identification number nor made application therefor prior to October 1, 1962. Such application on Form SS–4 shall be filed on or before October 8, 1962.

(c) An application on Form SS–4 for an employer identification number shall be made by every taxpayer whose first return on Form 2050 or Form 2052 is filed on or after October 1, 1962, but who prior to the filing of such return on Form 2050 or Form 2052 has neither secured an employer identification number nor made application therefor. Such application on Form SS–4 shall be filed on or before the seventh day after the date on which such first return on Form 2050 or Form 2052 is filed.

(d) Each taxpayer shall make application for and shall be assigned only one employer identification number, regardless of the number of places of business for which the taxpayer is required to file a tax return under the provisions of this part. (75 Stat. 828; 26 U.S.C. 6109.)

§ 240.594c EXECUTION OF FORM SS–4.—The application on Form SS–4, together with any supplementary statement, shall be prepared in accordance with the form, instructions, and regulations applicable thereto, and shall set forth fully and clearly the data therein called for. The application shall be filed with any district director with whom returns on Forms 2050 or 2052 will be filed by the person who is required to make the application. The application shall be signed by (a) the individual, if the person is an individual; (b) the president, vice president, or other principal officer if the person is a corporation; (c) a responsible and duly authorized member or officer having knowledge of its affairs, if the person is a partnership or other unincorporated organization; or (d) the fiduciary, if the person is a trust or estate. (75 Stat. 828; 26 U.S.C. 6109.)

PAR. 3. 26 CFR Part 245, Beer, is amended by inserting immediately after § 245.117c, three new sections as follows:

§ 245.117d EMPLOYER IDENTIFICATION NUMBER.—The employer identification number (defined at 26 CFR 301.7701–12) of the taxpayer who has been assigned such a number shall be shown on each return on Form 2034 filed pursuant to the provisions of this part on or after October 1, 1962. Failure of the taxpayer to include his employer identification number on Form 2034 may result in assertion and collection of the penalty specified in 26 CFR 301.6676–1. (75 Stat. 828; 26 U.S.C. 6109, 6676.)

§ 245.117e APPLICATION FOR EMPLOYER IDENTIFICATION NUMBER.—(a) An employer identification number will be assigned pursuant to application on Form SS–4 filed by the taxpayer. Form SS–4 may be obtained from the district director with whom the Form 2034 is required to be filed.

(b) An application on Form SS–4 for an employer identification number shall be made by every taxpayer who filed a return on Form 2034 before October 1, 1962, and who has neither secured an employer identification number nor made application therefor prior to October 1, 1962. Such application on Form SS–4 shall be filed on or before October 8, 1962.

(c) An application on Form SS–4 for an employer identification number shall be made by every taxpayer whose first return on Form 2034 is filed on or after October 1, 1962, but who prior to the filing of such return on Form 2034 has neither secured an employer identification number nor made application therefor. Such application on Form SS–4 shall be filed on or before the seventh day after the date on which such first return on Form 2034 is filed.

(d) Each taxpayer shall make application for and shall be assigned only one employer identification number, regardless of the number of places of business for which the taxpayer is required to file a tax return under the provisions of this part. (75 Stat. 828; 26 U.S.C. 6109.)

§ 245.117f EXECUTION OF FORM SS–4.—The application on Form SS–4 shall be prepared in accordance with the provisions of § 245.76d, and shall be filed with any district director with whom returns on Form 2034 will be filed by the person who is required to make the application. (75 Stat. 828; 26 U.S.C. 6109.)

This Treasury Decision shall become effective on October 1, 1962.

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

MORTIMER M. CAPLIN,
Commissioner of Internal Revenue.

Approved August 20, 1962.

STANLEY S. SURREY,
Assistant Secretary of the Treasury.

(Filed by the Division of the Federal Register on August 24, 1962, 8:45 a.m., and published in the issue of the Federal Register for August 25, 1962, 27 F.R. 8525)

26 CFR 240.594a: Employer identification number.

Use of identifying numbers on returns, statements or other documents filed with respect to the commodity tax on wine. See T.D. 6607, page 381.

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26 CFR 245.76a: Data required on Form 11.

Use of employer identification numbers on returns, statements or other documents filed by brewers. See T.D. 6606, page 311.

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26 CFR 245.117d: Employer identification number.

Use of identifying numbers on returns, statements or other documents filed with respect to the commodity tax on beer. See T.D. 6607, page 381.

CHAPTER 80.—GENERAL RULES

SUBCHAPTER A.—APPLICATION OF INTERNAL REVENUE LAWS

SECTION 7805.—RULES AND REGULATIONS

26 CFR 301.7805-1: Rules and regulations.

Revision of Revenue Rulings issued under Chapter 51 of the 1954 Code, and the Federal Alcohol Administration Act. See Rev. Proc. 62-17, page 407.

SUBPART B.—RULINGS AND DECISIONS UNDER THE FEDERAL ALCOHOL ADMINISTRATION ACT

Rulings and decisions published in Part III, Subpart B, of the Internal Revenue Bulletin are based on the application of provisions of the Federal Alcohol Administration Act.

SECTION 5(b).—UNFAIR COMPETITION AND UNLAWFUL PRACTICES: TIED HOUSE

27 CFR 5.70: Application.

The term "Texas Fifth" may be used to describe half-gallon bottles of distilled spirits provided the containers are clearly marked to show the contents. See Rev. Rul. 62–223, below.

27 CFR 6.23: Inside signs; wine and malt beverages. (Also 5.70, 6.23(a).) — Rev. Rul. 62–223 [1]

> The term "Texas Fifth" may be used to describe half-gallon bottles of distilled spirits provided the containers are clearly marked to show the actual contents.
>
> The furnishing of things of value by a wholesaler to his salesmen does not come within the provisions of section 5(b)(3) of the Federal Alcohol Administration Act and is therefore permissible.
>
> It is permissible in the case of chain-store operations to place displays in any or all of the stores included in the chain. The limitations prescribed by sections 6.23 and 6.23(a) of the Federal Inducements Furnished to Retailers Regulations are applicable to each retail establishment.
>
> Revenue Ruling 54–203, C.B. 1954–1, 339, superseded.

Advice has been requested whether the term "Texas Fifth" may be used to described half-gallon bottles of distilled spirits. Advice has also been requested whether a wholesale liquor dealer may furnish Texas hats and shirts to his salesmen for the purpose of advertising a product in connection with the use of the term "Texas Fifth" and whether Texas hats may be furnished to retailers for display purposes.

Section 5(e) of the Federal Alcohol Administration Act, among other things, makes it unlawful for any person engaged in business as a manufacturer, bottler, importer, or wholesaler of alcoholic beverages to introduce into interstate commerce any distilled spirits, wine, or malt beverages, unless such products are bottled, packaged, and labeled in conformity with regulations, in such manner as will prohibit deception of the consumer with respect to the quantity of such product.

Since the containers must, under sections 5.32 and 5.37 of the Federal Labeling and Advertising of Distilled Spirits Regulations, be clearly marked to show the actual contents, the use of the term "Texas Fifth" to describe the half-gallon bottles is not "deceptive" within

[1] Prepared pursuant to Revenue Procedure 62–17, page 407.

the intent of section 5(e) of the Federal Alcohol Administration Act and is permissible.

Section 5(b)(3) of the Federal Alcohol Administration Act, subject to the jurisdictional limitations in respect of malt beverages, prohibits a manufacturer, importer, or wholesaler of alcoholic beverages from inducing a retailer to purchase his products to the exclusion in whole or in part of similar products of other persons sold or offered for sale in interstate or foreign commerce under the conditions stated therein by furnishing, giving, renting, lending, or selling to the retailer any equipment, fixtures, signs, supplies, money, services, or other thing of value, subject to such exceptions as may by regulations be prescribed.

This subsection of the Federal Alcohol Administration Act is applicable only to the furnishing of equipment, fixtures, signs, etc., to retailers. Therefore, there would be no objection to a wholesale liquor dealer's furnishing his salesmen with Texas hats and shirts for the purpose of advertising a product distributed by the wholesaler.

Sections 6.23 and 6.23(a) of the Federal Inducements Furnished to Retailers Regulations, issued pursuant to the Federal Alcohol Administration Act, provide that signs, posters, placards, etc., bearing advertising matter and for use in the windows or elsewhere in the interior of a retail establishment may be given, rented, loaned, or sold to a retailer by an industry member if they have no value to the retailer except as advertisements and if the cost of materials and installation does not exceed the prescribed limits.

There would be no objection to the wholesaler's setting up displays in retail stores by placing merchandise of the retailer around one of the Texas hats furnished by the wholesaler, provided the pertinent limitations expressed in sections 6.23 and 6.23(a) of the regulations are observed. These limitations are applicable to each retail establishment and not to each retailer. Therefore, it would be permissible in the case of chain-store operations to place such a display in each of the stores included in the chain.

Revenue Ruling 54–203, C.B. 1954–1, 339, is hereby superseded.

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27 CFR 6.23(a): Inside signs: distilled spirits.

It is permissible for a wholesale liquor dealer to place displays in retail chain stores, within prescribed limitations, in any or all of the stores included in the chain. See Rev. Rul. 62–223, page 385.

SECTION 5(e).—UNFAIR COMPETITION AND UNLAWFUL PRACTICES: LABELING

27 CFR 4.30: General. (Also 5.30.) Rev. Rul. 62–224 [1]

Distilled spirits and wines in bottles with back labels attached may, under the following conditions, be shipped to a wholesale liquor dealer who will place brand labels of his own selection on the bottles:

[1] Prepared pursuant to Revenue Procedure 62–17, page 407.

1. The back labels affixed by the bottler must bear all of the mandatory information required by section 4.30 of the Federal Labeling and Advertising of Wine Regulations and section 5.30 of the Federal Labeling and Advertising of Distilled Spirits Regulations, including a statement of net contents unless such statement is blown in the bottles. The back labels for distilled spirits must include a "Government label" and, in the case of bottled-in-bond spirits, such labels must also include the caution notice required by section 201.329(b) of the Distilled Spirits Plants Regulations and the information required by section 201.332 of those regulations.

2. The bottler must obtain certificates of label approval covering the back labels and any associated neck, spot, or strip labels to be affixed by him to the package.

3. The brand label affixed by the wholesaler, either alone or in combination with other front labels affixed to the bottle, must bear all of the mandatory information required by the regulations to appear on the front of the container.

4. The wholesaler must obtain certificates of label approval covering the complete sets of labels, including the brand label, back label, and any other spot, neck, or strip labels which will be used on the finished package.

5. Before applying brand labels, the wholesaler must obtain permission therefor from the appropriate Assistant Regional Commissioner, Alcohol and Tobacco Tax. At the discretion of the Assistant Regional Commissioner, the authority to add brand labels may be on a continuing basis or may be required for each additional labeling operation.

Revenue Ruling 54–281, C.B. 1954–2, 588, is hereby superseded.

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27 CFR 5.30: General.

Rebottling and relabeling of unsalable imported distilled spirits. See Rev. Rul. 62–164, page 371.

Whether distilled spirits in bottles with back labels attached may be shipped to a wholesale liquor dealer who will place brand labels of his own selection on the bottles. See Rev. Rul. 62–224, page 386.

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27 CFR 5.73: Standards of fill. T. D. 6603

TITLE 27—INTOXICATING LIQUORS.—CHAPTER I. PART 5.—LABELING AND ADVERTISING OF DISTILLED SPIRITS

Amendments relating to standards of fill for distilled spirits.

674924°—63——26

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:

Treasury Decision 6601 [C.B. 1962–1, 364] amending 27 CFR Part 5 Relating to Labeling and Advertising of Distilled Spirits was published in the Federal Register on June 5, 1962 (27 F.R. 5259). That Treasury decision is hereby amended by changing the effective date thereof to September 1, 1962.

MORTIMER M. CAPLIN,
Commissioner of Internal Revenue.

Approved June 19, 1962.

STANLEY S. SURREY,
Assistant Secretary of the Treasury.

(Filed by the Division of the Federal Register on June 22, 1962, 8:51 a.m., and published in the issue of the Federal Register for June 23, 1962, 27 F.R. 5954)

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27 CFR 5.74: Vintage spirits, cordials, and liqueurs, and specialties.

Packaging distilled spirits in tinplate containers of less than one-half pint capacity with tin-lead soldered seams. See Rev. Rul. 62–111, page 372.

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27 CFR 7.27: Net contents.

Tolerances in filling bottles and cans of beer. See Rev. Rul. 62–121, page 379.

PART IV

TAX CONVENTIONS

UNITED STATES-SWISS CONFEDERATION INCOME TAX CONVENTION

T.D. 6149, Section 509.116: Students or apprentices. Rev. Rul. 62–203

The salary paid to an executive of a Swiss corporation, who is a citizen and resident of Switzerland temporarily in the United States for the purpose of study of a particular industry for his employer, is not exempt from United States income tax under Article XIII of the United States-Swiss Confederation income tax convention, T.D. 6149, C.B. 1955–2, 814, at 818.

Advice has been requested whether a nonresident alien employee's salary, while undertaking a study of a particular industry in the United States, is exempt from United States income tax under the provisions of Article XIII of the United States-Swiss Confederation income tax convention, T.D. 6149, C.B. 1955–2, 814 at 818.

The nonresident alien in question is an executive of a Swiss manufacturing corporation. He is a citizen and resident of Switzerland and is in the United States for an intensive study for his employer of the industry in which it engages, after which he will return to Switzerland to resume the duties of his office there. The corporation continues to pay the executive's salary by depositing it to his bank account in Switzerland.

Article XIII of the United States-Swiss Confederation income tax convention provides that a student or apprentice, a resident of one of the contracting States, who temporarily visits the other contracting State for the purposes of study or for acquiring business or technical experience, shall not be taxable in the latter State in respect of remittances received by him from abroad for the purposes of his maintenance or studies.

The amounts in question were received by the nonresident alien as a continuation of his salary while acquiring information of benefit to his employer, rather than for his education or to pursue studies to prepare him for a position. They therefore were not received by him for the purposes of his maintenance or study.

Accordingly, it is held that the nonresident alien is not exempt from tax on these amounts under Article XIII of the convention.

PART V

ADMINISTRATIVE AND MISCELLANEOUS MATTERS

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PART V

ADMINISTRATIVE AND MISCELLANEOUS MATTERS

DEPARTMENT OF THE TREASURY—OFFICE OF THE SECRETARY

TREASURY DEPARTMENT ORDER NO. 107 (Rev. 9)

Various officials—Authority to affix seal

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 Administration 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, Disclosure 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 July 16, 1962.

[SEAL]

DOUGLAS DILLON,
Secretary of the Treasury.

(Filed by the Division of the Federal Register on July 26, 1962, 8:48 a.m., and published in the issue of the Federal Register for July 27, 1962, 27 F.R. 7397)

TREASURY DEPARTMENT CIRCULAR NO. 230 (REVISED)[1]

Rules governing the practice of attorneys and agents before the Internal Revenue Service.

Miscellaneous amendments

On April 14, 1962, notice of proposed rule making with respect to the amendments of the regulations under Part 10 of Title 31 of the Code of Federal Regulations (comprising Treasury Department Circular No. 230 (Revised)) was published in the Federal Register (27 F.R. 3611). The notice pointed out, among other things, that the proposed amendments are not intended in any way to affect the determination of the nature of professional corporations or associations for income tax purposes and are specifically limited to the rules governing the practice of attorneys and agents before the Internal Revenue Service.

After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, Part 10 of Title 31 of the Code of Federal Regulations is hereby amended as follows:

PARAGRAPH 1. Paragraph (d) (1) and (2) of § 10.3 is amended to read as follows:

§ 10.3 ELIGIBILITY FOR ENROLLMENT.

* * * * * * *

(d) *Attorneys and certified public accountants.* * * *

(1) Any attorney at law who is a member in good standing of the bar of the highest court of a State, Territory, or possession of the United States, or of the courts of the District of Columbia;

(2) Any certified public accountant who has duly qualified to practice as a certified public accountant in a State, Territory, possession of the United States, or in the District of Columbia.

PAR. 2. Section 10.4 is amended by striking out paragraph (d).

The amended provision reads as follows:

§ 10.4 INELIGIBILITY FOR ENROLLMENT.

* * * * * * *

(d) [Deleted]

§ 10.29 [Deletion]

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[1] 27 F.R. 9918.

PAR. 3. Section 10.29 is deleted.

PAR. 4. Paragraph (b) (28) of § 10.51 is amended to read as follows:

§ 10.51 DISREPUTABLE CONDUCT.

* * * * * * *

(b) *Forms.* * * *

(28) Solicitation of practice in any unethical or unprofessional manner, including, but not limited to, employment unethically arranged directly or indirectly by or through any individual, partnership, association, corporation or employee thereof.

PAR. 5. Because the amendments made by paragraphs 1 to 4, inclusive, relieve restrictions and are of a liberalizing character, such amendments shall become effective on the date of their publication in the Federal Register. (Sec. 3, Act of July 7, 1884, 23 Stat. 258, 5 U.S.C. 261; R.S. 161, 5 U.S.C. 22; secs. 2 to 12, 60 Stat. 237 et seq. (5 U.S.C. 1001 to 1011); Reorg. Plan No. 26 of 1950, 64 Stat. 1280, 5 U.S.C. 133z.)

[SEAL]

DOUGLAS DILLON,
Secretary of the Treasury.

OCTOBER 3, 1962.

(Filed by the Division of the Federal Register on October 8, 1962, 8:49 a.m., and published in the issue of the Federal Register for October 9, 1962, 27 F.R. 9918.)

DELEGATION ORDER NO. 5 (Rev. 3)
(Effective July 17, 1962)

Emergency order of succession and delegation of authority

1. By virtue of the authority vested in me by Treasury Department Order No. 129, Revision No. 2, dated April 22, 1955, the officials in the positions listed below and on a document filed at the Internal Revenue Service emergency relocation site are hereby authorized, in the event of an enemy attack on the United States, and the disability of the Commissioner, his absence from the emergency relocation site, or if there is a vacancy in the office, to succeed to the position of Acting Commissioner in the order listed, and are authorized to perform the functions of Commissioner to insure the continuity of the functions of that office:

Deputy Commissioner
Assistant Commissioner (Compliance)
Assistant Commissioner (Technical)
Assistant Commissioner (Data Processing)
Assistant Commissioner (Inspection)
Assistant Commissioner (Planning and Research)
Assistant Commissioner (Administration)

If none of these officials are available, the first available Regional Commissioner, in the order listed in the document on file at the emergency relocation site, will become Acting Commissioner.

Immediately in the event of an attack on the United States, each Regional Commissioner shall communicate as quickly as possible with the emergency National Office at the relocation site and advise the official in charge of his availability to assume the position of Acting Commissioner. After the lapse of a reasonable time for receipt of

communications from the Regional Commissioners, the official in charge of the emergency National Office will advise the available Regional Commissioner highest in the order of succession to report to the emergency National Office at the relocation site to become Acting Commissioner.

If no Regional Commissioner is available, a District Director will become Acting Commissioner in the order indicated in the above-mentioned document on file at the emergency relocation site. District Directors need not contact the emergency National Office.

2. There is hereby delegated to Regional Commissioners and District Directors, or the officials acting in their stead, upon the event of an enemy attack on the United States, all authority vested in the Commissioner of Internal Revenue by law or transfer from the Secretary of the Treasury as is necessary to insure the continuous performance of Internal Revenue Service functions by those officials in their areas of jurisdiction. This delegation of authority will remain in effect until notice is received that it has been terminated.

3. This Order supersedes Delegation Order No. 5 (Rev. 2), issued October 24, 1960 [C.B. 1960–2, 917].

MORTIMER M. CAPLIN,
Commissioner.

(Filed by the Division of the Federal Register on July 30, 1962, 8:53 a.m., and published in the issue of the Federal Register for July 31, 1962, 27 F.R. 7504)

DELEGATION ORDER NO. 86 [1]

(Effective July 12, 1962)

Delegation of authority to District Directors and the Director of International Operations to permit inspection of certain returns by certain applicants pursuant to 26 CFR 601.702(d).

Pursuant to authority vested in me as Commissioner of Internal Revenue, authority is hereby delegated to District Directors and the Director of International Operations to permit inspection of returns in their custody, inspection of which may be authorized by me pursuant to 26 CFR 601.702(d), to the same persons and subject to the same conditions as prescribed for such persons in 26 CFR 301.6103(a)–1(c).

The authority delegated herein is limited to returns as 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.

Whenever it is determined that a return or related document as defined above is available for disclosure in a particular case, a copy or certified copy may be furnished the party requesting the same.

The authority delegated herein may not be redelegated.

MORTIMER M. CAPLIN,
Commissioner.

(Filed by the Division of the Federal Register on July 27, 1962, 8:53 a.m., and published in the issue of the Federal Register for July 28, 1962, 27 F.R. 7461)

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[1] Delegation Orders Nos. 84 and 85 were not published.

DELEGATION ORDER NO. 88 [1]

(Effective October 25, 1962)

Delegation of authority to give notice to exempt organizations of revocation of exemption.

Pursuant to the authority vested in me as Commissioner of Internal Revenue, it is directed that District Directors of Internal Revenue have the authority to prepare, sign on behalf of the Commissioner, and send to taxpayers by registered or certified mail notice of revocation of exemption as provided in section 503(a)(2) of the Internal Revenue Code of 1954.

MORTIMER M. CAPLIN,
Commissioner.

(Filed by the Division of the Federal Register on November 6, 1962, 8:54 a.m., and published in the issue of the Federal Register for November 7, 1962, 27 F.R. 10861)

(Also Part I, Sections 46, 48.) T. D. 6619 [2]

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 16.—TEMPORARY REGULATIONS UNDER THE REVENUE ACT OF 1962

Temporary regulations under certain provisions of the credit for investment allowed by section 38 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:

The following regulations, prescribed under sections 46(a)(5) and 48(d) of the Internal Revenue Code of 1954, as added by section 2 of the Revenue Act of 1962 (76 Stat. 962), relate to the computation of the limitation on the credit allowed by section 38 of the Code in the case of members of an affiliated group, and to the election of a lessor of certain property to treat the lessee of the property as having purchased such property for purposes of the credit allowed by section 38.

The regulations set forth herein are temporary and are designed to inform taxpayers of certain rules governing the performance of acts required or permitted under certain provisions relating to the credit allowed by section 38 of the Code. More comprehensive rules with respect to these and other provisions relating to such credit will be issued subsequently.

In order to prescribe temporary regulations under sections 46(a)(5) and 48(d) of the Internal Revenue Code of 1954, the following regulations are adopted:

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[1] Delegation Order No. 87 was not published.

[2] 27 F.R. 11401.

§ 16.1 STATUTORY PROVISIONS; AMOUNT OF CREDIT; AFFILIATED GROUPS.

SEC. 46. AMOUNT OF CREDIT—

(a) DETERMINATION OF AMOUNT.—* * *

(5) AFFILIATED GROUPS.—In the case of an affiliated group, the $25,000 amount specified under subparagraphs (A) and (B) of paragraph (2) shall be reduced for each member of the group by apportioning $25,000 among the members of such group in such manner as the Secretary or his delegate shall by regulations prescribe. For purposes of the preceding sentence, the term "affiliated group" has the meaning assigned to such term by section 1504(a), except that all corporations shall be treated as includible corporations (without any exclusion under section 1504(b)).

[Sec. 46(a)(5) as added by sec. 2(b), Revenue Act 1962 (76 Stat. 963)]

§ 16.1–1 COMPUTATION OF LIMITATION; APPORTIONMENT OF $25,000 AMOUNT AMONG MEMBERS OF AFFILIATED GROUP.—(a) *Limitation on amount of credit.*—(1) *In general.*—Section 46(a)(2) provides that the credit allowed by section 38 (relating to credit for investment in certain depreciable property) shall not exceed—

(i) So much of the liability for tax for the taxable year as does not exceed $25,000, plus

(ii) 25 percent of so much of the liability for tax for the taxable year as exceeds $25,000.

(2) *Apportionment of $25,000 amount among members of an affiliated group.*—Section 46(a)(5) provides that in the case of an affiliated group (as defined in paragraph (d) of this section), the $25,000 amount specified in section 46(a)(2) shall be reduced for each member of the group by apportioning $25,000 among the members of the group. Except as otherwise provided in this section, the $25,000 amount shall be apportioned among those members of the affiliated group which are members on the last day of the taxable year of the common parent. For the taxable year of each such member ending with, or within which falls, the last day of the taxable year of the common parent, the credit allowed by section 38 cannot exceed—

(i) So much of its liability for tax for such taxable year as does not exceed its share of the $25,000 amount apportioned to it under the rules prescribed in this section, plus

(ii) 25 percent of so much of its liability for tax for such taxable year as exceeds its share of the $25,000 amount so apportioned to it.

(3) *Manner of apportionment.*—(i) In the case of members of an affiliated group which are members on the last day of the taxable year of the common parent, the $25,000 amount may be apportioned among such members (for the taxable year of each such member ending with, or within which falls, the last day of the taxable year of the common parent) in any manner such members may select if all such members consent to the apportionment plan. The consent of each such member to the apportionment plan shall be in the form of a statement signed by the member consenting to the plan. The statement shall set forth the name, address, and taxpayer account number of each such member of the affiliated group and of any other corporation to which any portion of such group's $25,000 amount is apportionable under paragraph (b) of this section, the identity of the common parent, the last day of the common parent's taxable year, and the amount apportioned to each corporation. The consents may be incor-

porated in one statement. The statement (or statements) shall be attached to the timely filed income tax return of the common parent and shall be irrevocable after the due date of such return (including extensions of time). However, if the due date (including extensions of time) of the return of a common parent is before February 28, 1963, the required statement (or statements) shall be considered timely filed if filed on or before February 28, 1963, with the district director with whom the common parent files its return. Each member of the affiliated group consenting to the apportionment plan shall attach a copy of its consent (or a copy of the statement containing the consents of all the corporations) to its income tax returns or, in the case of a return due before February 28, 1963, to any amended return or claim for refund.

(ii) An apportionment plan adopted by an affiliated group with respect to a particular taxable year of the common parent shall be valid only for the taxable year of each member of the group which ends with, or within which falls, the last day of such taxable year of the common parent. Thus, an affiliated group must file a separate consent to an apportionment plan with respect to each taxable year of the common parent as to which an apportionment plan is desired.

(iii) If an apportionment plan is not timely selected, the $25,000 amount specified in section 46(a)(2) shall be reduced for each member of the affiliated group, for its taxable year ending with, or within which falls, the last day of the common parent's taxable year, to an amount equal to (*a*) $25,000, divided by (*b*) the number of corporations in such group as of the close of such last day. If the common parent's taxable year ends before January 1, 1962, no portion of the $25,000 amount shall be apportioned to it or to any other member of such group for a taxable year ending before January 1, 1962, and on or after the close of the parent's taxable year, and any such parent or member shall not be considered a member for any such taxable year in determining the number of corporations referred to in (*b*) of the preceding sentence.

(b) *Short taxable year.*—(1) If (i) the return of a corporation is for a short period ending after December 31, 1961, (ii) such corporation is a member of an affiliated group as of the last day of such period, and (iii) the last day of the common parent's taxable year does not end with or within such short period, then the $25,000 amount shall be reduced for such corporation to an amount equal to $25,000 divided by the number of corporations in such group as of the close of such corporation's short period. In such case, the total amount that may be apportioned under paragraph (a)(3) of this section (either equally or according to a plan) among the members of an affiliated group which have the same common parent as the corporation with the short period shall be $25,000 less the amount apportioned to such corporation for its short period ending in the taxable year of the common parent of the affiliated group. If the common parent of the corporation with the short period is not affiliated with any other corporation at the end of such parent's taxable year within which the short period ends, the $25,000 amount shall be reduced for the parent by the amount apportioned to such corporation for its short period.

(2) In lieu of the apportionment provided for in subparagraph (1) of this paragraph, a corporation (with a short period) may waive

its right to receive the part of the $25,000 amount apportionable to it by specifically so indicating on a statement meeting the requirements of subparagraph (3) of this paragraph. In such case, no amount shall be considered apportioned to such corporation.

(3) The corporation with the short period shall attach a statement to its timely filed income tax return (including extensions of time). However, if the due date of the return (including extensions of time) is before February 28, 1963, the statement may be attached to an amended return or claim for refund filed on or before February 28, 1963. The statement shall indicate the name, address, and taxpayer account number of each member of the affiliated group as of the close of the short period, the identity of the common parent and the last day of the common parent's taxable year, and the amount apportioned to itself or, if appropriate, a waiver of the amount apportionable to it. A copy of the statement shall be furnished to the common parent.

(c) *Two or more common parents.*—If a corporation during its taxable year is a member of two or more affiliated groups as of the last day of the taxable year of the common parent of each such group, such corporation shall be considered to be a member of only the affiliated group whose common parent's taxable year ends earliest in such corporation's taxable year.

(d) *Definition of affiliated group.*—For purposes of this section, an affiliated group means one described in section 1504(a), except that all corporations shall be treated as includible corporations, without exclusion under section 1504(b). Thus, a foreign corporation or a corporation exempt from taxation under section 501 may be a member of an affiliated group for purposes of this section even though under section 1504(b) neither corporation would be an includible corporation.

(e) *Affiliated group filing a consolidated return.*—For purposes of determining the limitation based on amount of tax for the members of an affiliated group which join in filing a consolidated return, all such members shall be treated as though they were a single taxpayer. The limitation based on amount of tax for an affiliated group all of whose members join in the filing of a consolidated return shall be so much of the consolidated liability for tax as does not exceed $25,000, plus 25 percent of the consolidated liability for tax in excess of $25,000. If however, there are other members of the affiliated group which do not join in the filing of the consolidated return (such as, for example, a corporation exempt from taxation under section 501), and a consent is not timely filed apportioning the $25,000 amount among the group filing the consolidated return and the other members of the affiliated group, each member of the group which joins in filing the consolidated return shall be treated as a separate corporation for purposes of equally apportioning the $25,000 amount. In such case, the limitation based on amount of tax for the group filing the consolidated return shall be computed by substituting for the $25,000 amount the total of the amounts apportioned to each corporation which joins in filing the consolidated return.

(f) *Nonresident foreign corporation.*—(1) No part of the $25,000 amount shall be apportioned under this section to a foreign corporation not engaged in trade or business within the United States (here-

inafter referred to in this paragraph as a "nonresident foreign corporation"), nor shall such corporation be considered as a member for purposes of determining the number of corporations which divide equally the $25,000 amount under paragraph (a)(3)(iii) of this section. Furthermore, the consent of such corporation to an apportionment plan is not required.

(2) A nonresident foreign corporation which is a common parent of an affiliated group shall be considered to have a taxable year ending December 31.

(3) If a nonresident foreign corporation is a common parent of an affiliated group, the statement required by paragraph (a)(3)(i) of this section shall be considered timely filed if filed with the Director, International Operations Division, Internal Revenue Service, Washington 25, D.C., within 75 days after the end of its taxable year (as determined under subparagraph (2) of this paragraph) or February 28, 1963, whichever is later.

(g) *Examples.* The provisions of this section may be illustrated by the following examples:

Example (1). P, a domestic corporation, files an income tax return for its taxable year ending January 31, 1962. On such date P owns all the outstanding stock of S, also a domestic corporation. S files a separate income tax return on the basis of a fiscal year ending June 30. The membership of the affiliated group is ascertained as of the close of January 31, 1962, the last day of the taxable year of the common parent, P. On that day the affiliated group consists of P and S. P and S consent to an apportionment plan in which the $25,000 amount is apportioned entirely to S for its taxable year ending June 30, 1962 (S's taxable year within which the last day of the taxable year of the common parent, January 31, 1962, falls). Such consent is timely filed. For purposes of computing the credit under section 38, S's limitation based on amount of tax for its taxable year ending June 30, 1962, is so much of S's liability for tax as does not exceed $25,000, plus 25 percent of S's liability for tax in excess of $25,000. P's limitation for its taxable year ending January 31, 1962, is equal to 25 percent of P's liability for tax. On the other hand, if an apportionment plan is not timely filed, P's limitation would be so much of P's liability for tax as does not exceed $12,500 plus 25 percent of P's liability for tax in excess of $12,500, and S's limitation would be computed similarly.

Example (2). Assume the same facts as in example (1), except that P's taxable year ends December 31, 1961, on which date it owns all the outstanding stock of S. If an apportionment plan is not timely filed, the $25,000 amount is apportioned equally among members of the group as of December 31, 1961, the last day of the taxable year of the common parent, P. No portion of the $25,000 amount is apportioned to P since its taxable year ends before January 1, 1962. Since S is the only corporation which is considered a member of the group as of December 31, 1961, it is apportioned the entire $25,000 amount.

Example (3). F, 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, files an income tax return for its taxable year ending December 31, 1963, on which date it owns all the stock of P, a domestic corporation. P files a consoli-

dated return as a common parent for its fiscal year ending June 30, 1964, with its two wholly owned domestic subsidiaries, S and A. No consent to an apportionment plan is filed. The membership of the affiliated group is ascertained as of the close of December 31, 1963, the last day of the taxable year of the common parent, F. On that day the affiliated group consists of F, P, S, and A, and each member is apportioned $6,250 of the $25,000 amount ($25,000 divided by the four members). The limitation based on amount of tax for the affiliated group filing a consolidated return (P, S, and A) for the year ending June 30, 1964 (the consolidated taxable year within which December 31, 1963, falls), is computed by using $18,750 instead of the $25,000 amount. The $18,750 is arrived at by adding together the $6,250 amounts apportioned to P, S, and A on December 31, 1963. If the consolidated liability for tax of P, S, and A is $27,750 for the taxable year ending June 30, 1964, then the credit allowed by section 38 for such group for such taxable year cannot exceed $21,000 ($18,750 plus 25 percent of $9,000).

Example (4). Assume the same facts as in example (3) except that a consent by all the members of the affiliated group is filed with the timely filed income tax return of F to apportion the entire $25,000 to the group filing a consolidated tax return (P, A, and S). The credit allowed by section 38 for such group for its taxable year ending June 30, 1964, cannot exceed $25,687.50 ($25,000 plus 25 percent of $2,750).

Example (5). P, a domestic corporation filing income tax returns on a calendar-year basis, owns all the stock of S, T, and U, all domestic corporations. S, T, and U file separate returns and also file returns on a calendar-year basis. On June 30, 1963, S is liquidated. December 31, 1963, the last day of the taxable year of P, the common parent of the affiliated group, does not fall within S's short taxable year beginning January 1, 1963, and ending June 30, 1963. S does not waive its right to its equal portion of the $25,000 amount. For such short taxable year, the $25,000 amount shall be reduced for S to $6,250 ($25,000 divided by 4, the number of corporations in the affiliated group at the close of S's short taxable year). The total amount apportionable to the members of the affiliated group of which P is the common parent for their taxable years ending with December 31, 1963, is $18,750 ($25,000 minus the $6,250 apportioned to S for its short taxable year ending June 30, 1963, which date ends in the taxable year of P, its common parent). This $18,750 may be apportioned according to an apportionment plan or, if a plan is not timely filed, will be apportioned equally among P, T, and U.

§ 16.2 STATUTORY PROVISIONS; DEFINITIONS; SPECIAL RULES.

SEC. 48. DEFINITIONS; SPECIAL RULES. * * *

(d) CERTAIN LEASED PROPERTY.—A person (other than a person referred to in section 46(d)) who is a lessor of property may (at such time, in such manner, and subject to such conditions as are provided by regulations prescribed by the Secretary or his delegate) elect with respect to any new section 38 property to treat the lessee as having acquired such property for an amount equal to—

(1) If such property was constructed by the lessor (or by a corporation which controls or is controlled by the lessor within the meaning of section 368(c)), the fair market value of such property, or

(2) If paragraph (1) does not apply, the basis of such property to the lessor.

The election provided by the preceding sentence may be made only with respect to property which would be new section 38 property if acquired by the lessee. For purposes of the preceding sentence and section 46 (c), the useful life of property in the hands of the lessee is the useful life of such property in the hands of the lessor. If a lessor makes the election provided by this subsection with respect to any property, the lessee shall be treated for all purposes of this subpart as having acquired such property. If a lessor makes the election provided by this subsection with respect to any property, then, under regulations prescribed by the Secretary or his delegate, subsection (g) shall not apply with respect to such property and the deductions otherwise allowable under section 162 to the lessee for amounts paid to the lessor under the lease shall be adjusted in a manner consistent with the provisions of subsection (g).

[Sec. 48(d) as added by sec. 2(b), Revenue Act of 1962 (76 Stat. 963)]

§ 16.2–1 Election of Lessor of New Section 38 Property To Treat Lessee as Purchaser.—(a) *In general.*—Under section 48(d), a lessor of property may elect to treat the lessee of such property as having purchased such property for purposes of the credit allowed by section 38 (relating to investment in certain depreciable property) if the following conditions are satisfied:

(1) The property must be "section 38 property" (within the meaning of section 48(a)) in the hands of the lessor; that is, it must be property with respect to which depreciation (or amortization in lieu of depreciation) is allowable to the lessor, it must have a useful life of 4 years or more in his hands, and in every other respect it must meet the requirements of section 48(a). Thus, for example, property leased by a municipality to a taxpayer for use in what is commonly known as an "industrial park" is not eligible for the election since, under section 48(a)(5), property used by a governmental unit is not treated as section 38 property. In addition, property used by the lessee predominantly outside the United States is not eligible for the election since, under section 48(a)(2), such property is not section 38 property.

(2) The property must be "new section 38 property" (within the meaning of section 48(b)) in the hands of the lessor; that is, either (i) construction, reconstruction, or erection of the property must be completed by the lessor after December 31, 1961, or (ii) the property must be acquired by the lessor after December 31, 1961, and the original use of such property must commence with the lessor and after such date.

(3) The property would constitute "new section 38 property" to the lessee if such lessee had actually purchased the property. Thus, the election is not available if the lessee is not the original user of the property. The lessee is not the original user of the property if it has been previously used by the lessor or another person, or if it is reconstructed or reconditioned property. However, for purposes of this subparagraph, the lessee will be considered the original user if he is the first person to use the property for its intended function. Thus, the fact that the lessor may have, for example, tested, stored, or attempted to lease the property to other persons will not preclude the lessee from being considered the original user.

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(4) A statement of election to treat the lessee as a purchaser has been filed in the manner and within the time prescribed in paragraph (d) of this section.

(5) The lessor is not a person referred to in section 46(d); that is, a mutual savings bank, cooperative bank, or domestic building and loan association to which section 593 applies; a regulated investment company or real estate investment trust subject to taxation under subchapter M, chapter 1 of the Code; or a cooperative organization described in section 1381(a).

(6) The lessor and lessee do not join in filing a consolidated income tax return for a period which includes the date on which possession of the property is transferred to the lessee.

The election may be made on a property-by-property basis. If the conditions of this paragraph have been met, the lessee shall be treated for purposes of the credit allowed by section 38 as though he were the actual owner of the property. Thus, the lessee shall be entitled to the credit allowed by section 38 with respect to such property for the taxable year in which he places such property in service, and the lessor shall not be entitled to a credit allowed by section 38 with respect to such property. Moreover, if the leased property is disposed of by the lessee, or if it otherwise ceases to be section 38 property in his hands, the property will be subject to the provisions of section 47 (relating to early dispositions, etc.). However, the lessee will not be considered a lessor for purposes of this section if it subleases the property to another.

(b) *Basis of leased property.*—(1) If a valid election is made under this section, the amount of qualified investment under section 46(c) with respect to the leased property shall be determined by reference to the basis of such property in the hands of the lessee. Unless subparagraph (2) of this paragraph applies, the basis of the property in the hands of the lessee shall be the basis of the property in the hands of the lessor.

(2) If the property was constructed by the lessor (or by a corporation which controls or is controlled by the lessor within the meaning of section 368(c)), the basis of the property to the lessee shall be an amount equal to the fair market value of such property on the date possession is transferred to the lessee. The term "constructed" shall be given its commonly accepted meaning; that is, to build, manufacture, or erect something which did not theretofore exist. Thus, reconstruction, repairing, or reconditioning does not constitute "construction". However, it is not necessary that the materials used in construction be new in use.

(c) *Useful life of leased property.*—The estimated useful life to the lessee of property subject to the election shall be deemed to be the estimated useful life in the hands of the lessor. The lessor shall determine the estimated useful life of each leased property on an individual basis even though multiple asset accounts are used. The lessee, however, may treat the property as having a useful life shorter than the lessor's useful life.

(d) *Manner and time for making election*—(1) *Manner of making election.*—The election of a lessor shall be made by filing a statement with the lessee, signed by the lessor and including the written consent of the lessee, containing the following information:

(i) The name, address, and taxpayer account number of the lessor and the lessee;

(ii) The district director's office at which the income tax returns of the lessor and the lessee are filed;

(iii) A description of each property with respect to which the election is being made;

(iv) The date on which possession of the property (or properties) is transferred to the lessee;

(v) The estimated useful life category of the property (or properties) in the hands of the lessor; that is, 4 years or more but less than 6 years, 6 years or more but less than 8 years, or 8 years or more;

(vi) If the lessor (or a corporation which controls or is controlled by the lessor within the meaning of section 368(c)) constructed the property, the fair market value of the property as of the date possession of the property is transferred to the lessee, and in any other case, the basis of the property to the lessor.

(2) *Time for making election*—(i) *Property leased after November 20, 1962.*—In the case of property possession of which is transferred by a lessor to a lessee after November 20, 1962, the statement referred to in subparagraph (1) of this paragraph shall be filed with the lessee on or before the 60th day after possession of the property is transferred to the lessee.

(ii) *Property leased on or before November 20, 1962.*—In the case of property possession of which is transferred by a lessor to a lessee on or before November 20, 1962, the statement referred to in subparagraph (1) of this paragraph shall be filed with the lessee on or before January 21, 1963.

(3) *Election is irrevocable.*—An election under this section shall be irrevocable as of the time the statement referred to in subparagraph (1) of this paragraph is filed with the lessee.

(e) *Record requirements.*—The lessee shall attach the statement referred to in paragraph (d) (1) of this section to his income tax return for his taxable year in which the leased property is placed in service by him. The lessor shall attach to his income tax return a summary statement of all property leased during his taxable year with respect to which an election is made. Such summary statement shall contain the following information: (1) The name, address, and taxpayer account number of the lessor; and (2) in numerical account number order, each lessee's account number, name, and address, the useful life category of the property, and the basis or fair market value of the property, whichever is applicable. In addition, the lessor shall maintain records which permit specific identification of property with respect to which an election under this section is made.

(f) *Adjustment of rental deductions.*—(1) *In general.*—If a lessor makes a valid election under this section, section 48(g) (relating to adjustments to basis of property) shall not apply to the lessor with respect to property subject to the election. Thus, the lessor is not required to reduce under section 48(g)(1) the basis of property with respect to which an election is made. However, if such an election is made the deductions otherwise allowable under section 162 to the lessee for amounts paid or accrued to the lessor under the lease shall be adjusted in the manner provided in this paragraph.

(2) *Decrease in rental deduction.*—(i) The total of all deductions otherwise allowable under section 162 to the lessee for amounts paid or accrued to the lessor under the lease with respect to the leased property shall be decreased by an amount equal to the credit earned on the leased property. The "credit earned" on the leased property is determined by multiplying the qualified investment (as defined in section 46(c)) with respect to such property by 7 percent. Thus, the credit earned (and the decrease in deductions) is determined without regard to the limitation based on tax which, under section 46(a)(2), may limit the amount of the credit the lessee may take into account in any one year. For each year during a period equal to the shortest life of the useful life category used by the lessee in computing qualified investment under section 46(c) with respect to the leased property, the lessee shall decrease his deduction otherwise allowable under section 162 for such year with respect to such property. The decrease for each such year shall be equal to the credit earned divided by such shortest life, that is, 4, 6, or 8. Such decreases shall begin with the taxable year during which the lessee places the property in service. Thus, if leased property with a basis of $30,000 to the lessee, and an estimated useful life falling within the 4 years or more but less than 6 years useful life category, is placed in service by the lessee within the lessee's taxable year ending December 31, 1963, the lessee must decrease his section 162 deduction with respect to the leased property for the taxable year 1963 and for each of the 3 succeeding taxable years by $175 ($700 credit earned divided by 4).

(ii) To the extent that a required decrease is not taken into account for any taxable year because the deduction otherwise allowable under section 162 for such year with respect to the leased property is less than the required decrease for such year, then the balance of the required decrease not taken into account for such year shall reduce the amount otherwise allowable as a deduction with respect to such property for the next succeeding year (or years) for which a deduction is allowable with respect to such property. Thus, if the required decrease with respect to leased property is $200 for 1963, but the lessee's deduction otherwise allowable for such year with respect to such property is only $50, the balance of $150 must be applied in the succeeding year (or years) to decrease any deduction otherwise allowable to the lessee with respect to the leased property for such succeeding year (or years).

(3) *Increase in rental deduction.*—If in any taxable year section 47 applies (because of an early disposition, etc., of the leased property) to property which is subject to a valid election under section 48(d), and if as a result of the application of section 47 the lessee's tax for the taxable year is increased or a credit carryback or carryover is adjusted, then an appropriate increase in the lessee's deduction otherwise allowable under section 162 for such taxable year with respect to the leased property shall be made.

(g) *Example.* The provisions of this section may be illustrated by the following example:

Example. X Corporation is engaged in the business of manufacturing and leasing new and reconstructed equipment which in its hands has an estimated useful life of 10 years. After December 31, 1961, X Corporation constructs machine No. 1 at a cost of $10,000 and

reconstructs machine No. 2 at a cost of $5,000. On June 30, 1964, Y Corporation, a calendar-year taxpayer, leases both machines from X Corporation and places them in service. The fair market value of machine No. 1 on the date on which possession is transferred to Y is $15,000. Machine No. 1 would qualify as new section 38 property in Y's hands if it had been purchased by Y. If X elects to treat Y as the purchaser of machine No. 1, such machine will have a basis of $15,000 in Y's hands and an estimated useful life falling within the 8 years or more category (assuming Y does not elect a shorter useful life) for purposes of determining Y's qualified investment. Y's credit earned with respect to the property is $1,050 (7 percent of $15,000). Y's deduction attributable to the leased property will be reduced by $131.25 (credit earned of $1,050 divided by 8) for its taxable year 1964 and for each of the 7 succeeding taxable years. The election is not available with respect to machine No. 2 since a reconstructed machine would not constitute new section 38 property if Y had purchased it. In such case, while X cannot make the election to treat Y as a purchaser, X would be entitled to a credit under section 38 based on its expenditure of $5,000 as an investment in new section 38 property, since such amount represents cost of reconstruction after December 31, 1961.

Because this Treasury Decision merely provides temporary regulations designed to inform taxpayers how to compute the limitation on the credit allowed by section 38 of the Code in case of members of an affiliated group, and how, when, and where a lessor of certain property may make an election to treat the lessee of the property as having purchased such property for purposes of the credit allowed by section 38 of the Code, 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.

(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 16, 1962.

STANLEY S. SURREY,
Assistant Secretary of the Treasury.

(Filed by the Division of the Federal Register on November 19, 1962, 8:53 A.M., and published in the issue of the Federal Register for November 20, 1962, 27 F.R. 11401)

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26 CFR 601.301: Imposition of taxes, qualification requirements, and regulations.
(Also Part III–A, Section 7805; 301.7805–1.)

Rev. Proc. 62–17

Program for review of Revenue Rulings issued under the provisions of Chapter 51 of the Internal Revenue Code of 1954 and the Federal Alcohol Administration Act to identify those needing revision to conform to current provisions of the pertinent law and regulations and prepare and publish the required revisions.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to announce a program for (1) the review of Revenue Rulings issued under the provisions of Chapter 51 of the Internal Revenue Code of 1954 and the Federal Alcohol Administration Act and (2) the issuance of revisions to reflect current provisions of those laws and related regulations.

SEC. 2. BACKGROUND.

.01 Public Law 591, 83d Cong., approved August 16, 1954, and Public Law 85–859, 85th Cong., C.B. 1958–3, 92, approved September 2, 1958, made many changes in the laws administered or enforced by the Alcohol and Tobacco Tax Division. Treasury Decision 6091, C.B. 1954–2, 47, approved August 16, 1954, and Treasury Decision 6373, C.B. 1959–1, 712, approved April 16, 1959, provided for the continuance of all instructions and rulings in effect with respect to the Code, Chapter 51 of the Code, or with respect to regulations issued pursuant thereto, to the extent that such instructions or rulings were not inconsistent with the Code as revised by Public Law 591 or amended by Public Law 85–859, respectively.

.02 All Revenue Rulings issued under the provisions of Chapter 51 of the 1954 Code, and corresponding provisions of the Internal Revenue Code of 1939, and the Federal Alcohol Administration Act have been reviewed to identify those that are considered to be obsolete either because they have no application to the laws and regulations now in effect or are unnecessary because the subject matter of the ruling is now specifically covered by regulations. Revenue Ruling 62–75, C.B. 1962–1, 359, contains a list of those Revenue Rulings which are no longer in effect and declares them to be obsolete.

SEC. 3. REVENUE RULINGS TO BE REPUBLISHED.

A current study is being made of the remaining Revenue Rulings issued under Chapter 51 of the Code and the Federal Alcohol Administration Act to identify those that require revision to reflect present law and regulations and to prepare and publish the ensuing revisions. Such revisions will be republished as Revenue Rulings.

SEC. 4. INQUIRIES.

Inquiries regarding this Revenue Procedure, as well as comments regarding any particular Revenue Ruling issued under Chapter 51 of the Code and the Federal Alcohol Administration Act, should refer to its number and be addressed to the Director, Alcohol and Tobacco Tax Division, Washington 25, D.C.

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26 CFR 601.702: Publication and public inspection. Rev. Proc. 62–18

(Also Part I, Sections 6103, 6106; 301.6103(a)–1, 301.6103(b)–1, 301.6106–1.)

Procedures concerning permissible inspection of certain Federal tax returns filed under the Internal Revenue Code of 1954 and procuring copies thereof by State governments.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to set forth the procedures relating to (1) the inspection by State governments of certain

Federal tax returns and related documents filed under the Internal Revenue Code of 1954, (2) the furnishing to State governments of copies of such returns and documents, and (3) the furnishing to State governments of abstract data from such returns and documents.

SEC. 2. AUTHORITY TO INSPECT.

.01 By virtue of sections 301.6103(a)–1(d), 301.6103(b)–1, and 301.6106–1 of the Regulations on Procedure and Administration published in Treasury Decision 6543, C.B. 1961–1, 671, and Treasury Decision 6546, C.B. 1961–1, 682, the Commissioner of Internal Revenue may, upon application by the Governor of a State, open certain Federal tax returns to certain State tax officials, bodies, or commissions for certain State and local purposes depending upon the type of Federal tax return of which inspection is requested.

.02 Returns which may be open to inspection and the respective State tax officials, bodies, or commissions by whom or which inspection may be made are set forth in this Revenue Procedure.

SEC. 3. INSPECTION OF RETURNS MADE IN RESPECT OF THE TAXES IMPOSED BY CHAPTER 5, CHAPTER 11, CHAPTER 12, CHAPTER 23, CHAPTER 32, SUBCHAPTERS B, C, AND D OF CHAPTER 33, AND SUBCHAPTER B OF CHAPTER 37 OF THE CODE.

Under authority of section 301.6103(a)–1(d) of the Regulations, the Commissioner, upon application by the Governor of the State as specified in section 3.04, may grant permission for inspection of certain returns by the respective State tax officials and for the respective purposes set forth in this section.

.01 *Estate and gift tax returns.*—Returns and notices in respect of estate tax imposed by Chapter 11 of the Code and returns in respect of gift tax imposed by Chapter 12 of the Code may, in the discretion of the Commissioner or his delegate, be made available for inspection by any properly authorized official, body, or commission, lawfully charged with the administration of any tax law of a State, for the purpose of such administration, provided like cooperation is given by the State with respect to inspection of returns of estate, inheritance, legacy, succession, gift, or other tax of the State for use of the Commissioner and his representatives in the administration of the Federal tax laws.

.02 *Unemployment tax returns.*—Returns in respect of the unemployment tax imposed by Chapter 23 of the Code may, in the discretion of the Commissioner or his delegate, be made available for inspection by any properly authorized official of a State provided (a) such State has a law certified to the Secretary of the Treasury as having been approved in accordance with section 3304 of the Code and (b) the inspection is solely for the purpose of administering such law.

.03 *Excise tax returns.*—Returns in respect of excise taxes imposed by Chapter 5 of the Code (tax on transfers to avoid income tax); Chapter 32 of the Code (manufacturers excise taxes); subchapters B, C, and D of Chapter 33 of the Code (communications tax, transportation taxes, and tax on safe deposit boxes); and subchapter B of Chapter 37 of the Code (tax on coconut and palm oil) may, in the discretion of the Commissioner or his delegate, be made available for inspection by any properly authorized official, body, or commission,

lawfully charged with the administration of any tax law of the State, for the purpose of such administration.

.04 *Applications for inspection.*

1 *In general.*—Application for the inspection provided for in sections 3.01, 3.02, and 3.03 shall be made in writing, signed by the Governor of the State, and addressed to the Commissioner of Internal Revenue, Washington 25, D.C. The applications for the respective types of returns shall state the following:

a The title of the official, body, or commission by whom or which inspection is to be made;

b A specific reference to the law of the State which such official, body, or commission is charged with administering and the law under which he or it is so charged;

c The purpose for which the inspection is to be made; and

d If the inspection of an estate or gift tax return is requested, the fact that the State gives like cooperation with respect to the inspection of returns of an estate, inheritance, legacy, succession, gift, or other tax of the State, for use of the Commissioner or his representatives in the administration of the Federal tax laws.

2 *Procedure as to returns filed in the internal revenue district within or including the State requesting inspection.*

a *General inspection.*—Upon application, permission may be granted for general inspection of the returns of the taxes specified in sections 3.01, 3.02 and 3.03 which are filed in the district within or including such State. If such general inspection is desired, the application made to the Commissioner in accordance with section 3.041 shall include a statement that general inspection is desired of a specified class or classes of returns (for example, estate tax returns, gift tax returns, etc.). Permission granted to a State for the general inspection provided for in this subdivision shall, except as hereinafter provided in the case of unemployment tax returns, continue in effect until such time as the Commissioner by written notice to the Governor of the State provides that such inspection will be permitted only on the basis of periodic application therefor. Permission for general inspection of unemployment tax returns will terminate without notice at such time as the State ceases to have a law certified to the Secretary as having been approved in accordance with section 3304 of the Code. The Governor of the State shall supply in writing to the District Director of Internal Revenue, with whom the returns to be inspected were filed, a list of the names of the individuals designated to make the inspection on behalf of the official, body, or commission named in the application to the Commissioner, and shall keep such list current by appropriate deletions or additions as may be necessary.

b Inspection of specific returns. Permission granted pursuant to section 3.042a for general inspection of returns of a particular tax includes permission to inspect specifically identified returns of such tax when desired. However, if a State is interested only in examining certain returns of particular taxpayers, the application for inspection of such

returns shall be made in writing to the Commissioner as provided in section 3.041 and in addition to the information outlined in such subparagraph shall state the name and address of each taxpayer whose return or returns it is desired to inspect, the kind of tax reported on each such return, the taxable period covered by such return, and the names of the individuals designated to make the inspection on behalf of the official, body, or commission named in the application.

3 *Returns filed in other internal revenue districts.*—In the case of returns filed in an internal revenue district other than one within or including the State requesting inspection, permission for inspection provided in sections 3.01, 3.02 and 3.03 will be granted only with respect to specifically identified returns. The application for such inspection shall be made to the Commissioner as provided in section 3.042a and, in addition to the information outlined therein and section 3.042b shall specify the internal revenue district or office in which the returns to be inspected are believed to have been filed.

.05 *Time and place of inspection.*—A convenient time and place for the inspection of returns will be arranged by the internal revenue officer (District Director or Director of International Operations) with whom the returns were filed. The inspection will be permitted only in the presence of an internal revenue officer or employee and only in an office of the Internal Revenue Service during the regular hours of business of such office.

SEC. 4. INSPECTION OF CORPORATION RETURNS OF INCOME TAX OR UNEMPLOYMENT TAX.

.01 Under the provisions of sections 301.6103(b)–1(a) and 301.6106–1 of the regulations, the proper tax officers of a State shall have access, upon application made in accordance with the provisions of this paragraph, to the returns filed by any corporation with respect to the taxes imposed by chapters 1, 3, and 6 of the Code and with respect to the unemployment tax imposed by chapter 23 of the Code, or to abstracts of such returns. Application for access to the returns of any corporation, or abstracts thereof, shall be in writing, signed by the Governor of the State and addressed to the Commissioner of Internal Revenue, Washington 25, D.C. The application shall set forth the reason why access is desired; the names and official positions of the officers designated to have such access; and, with respect to each return to which access is desired, the name and address of the corporation filing the return, the kind of tax (income tax or unemployment tax) reported on the return, and the taxable year covered by the return.

.02 *Time and place of inspection.*—The internal revenue officer, District Director, or Director of International Operations, with whom the returns were filed is authorized to make such returns available in accordance with permission granted by the Commissioner. Such officer shall set a convenient time and place for the inspection. The inspection will be permitted only in the presence of an internal revenue officer or employee and only in an office of the Internal Revenue Service during the regular hours of business of such office.

.03 In addition to the inspection provided for in this section, corporation returns of income tax or unemployment tax may be made available upon proper application, respectively, under the provisions of section 3 (with respect to unemployment tax returns) and section 5 (with respect to corporation income tax returns) of this Revenue Procedure, to properly authorized State officials, and upon the conditions and for the purposes respectively set forth in these sections.

SEC. 5. INSPECTION OF INCOME TAX RETURNS.

.01 *In general.*—Under the provisions of sections 301.6103(b)-1(b) of the regulations, income tax returns filed with respect to the taxes imposed by chapters 1, 2, 3, and 6 of the Code shall, upon application made in accordance with the provisions of this paragraph, be open to inspection by any official, body, or commission, lawfully charged with the administration of any State tax law or any properly designated representative of such official, body, or commission, if the inspection is for the purpose of such administration or for the purpose of obtaining information to be furnished to local taxing authorities as provided in section 6103(b)(2) of the Code. The application shall be made in writing and signed by the Governor of the State and shall be addressed to the Commissioner of Internal Revenue, Washington 25, D.C. The application shall state the following:

1 The title of the official, body, or commission by whom or which the inspection is to be made;

2 A specific reference to the State tax law which such official, body, or commission is charged with administering and the law under which he or it is so charged;

3 The purpose for which the inspection is to be made; and

4 If the inspection is for the purpose of obtaining information to be furnished to local taxing authorities, (1) the title of the official, body, or commission of each political subdivision of the State, lawfully charged with the administration of the tax laws of such political subdivision, to whom or to which the information secured by the inspection is to be furnished, and (2) the purpose for which the information is to be used by such official, body, or commission.

.02 *Procedure as to returns filed in the internal revenue district within or including the State requesting inspection.*

1 *General inspection.*—Permission may be granted by the Commissioner to any State for general inspection of returns of the taxes imposed by chapters 1, 2, 3, and 6 of the Code which are filed in an internal revenue district within or including such State. If such general inspection is desired, the application made to the Commissioner in accordance with section 5.01 shall include a statement that general inspection is desired of returns filed in the internal revenue district or districts within or including the State with respect to the taxes imposed by chapters 1, 2, 3, and 6 of the Code. Permission granted for the general inspection provided for in this subparagraph shall continue in effect until such time as the Commissioner by written notice to the Governor of the State provides that such inspection will be permitted only on the basis of periodic applications therefor. The Governor shall supply to the district director with whom the returns to be inspected were filed a written list of the names of the

individuals designated to make the inspection on behalf of the official, body, or commission named in the application to the Commissioner, and shall keep such list current by appropriate deletions or additions as may be necessary.

2 *Inspection of specific returns.*—Permission for the general inspection provided in section 5.021 of this section includes permission to inspect a specifically identified return when desired. However, a State interested only in examining the returns of particular taxpayers may inspect such returns on written application therefor to the Commissioner. The application in such case shall state, in addition to the information outlined in section 5.01 the name and address of each taxpayer whose return or returns it is desired to inspect, the taxable year covered by each such return, and the names of the individuals designated to make the inspection on behalf of the official, body, or commission named in the application.

.03 *Procedure as to returns filed in other internal revenue districts.*—In the case of returns filed with the Director of International Operations or in an internal revenue district other than one within or including the State requesting the inspection, permission for the inspection provided for in section 5.01 will be granted only with respect to specifically identified returns. The application for such inspection shall be made to the Commissioner as provided in section 5.01 and, in addition to the information outlined therein and in section 5.022 shall specify the internal revenue district or office in which the returns to be inspected are believed to have been filed.

.04 *Time and place of inspection.*—The internal revenue officer, District Director, or Director of International Operations, with whom the returns were filed is authorized to make such returns available in accordance with permission granted by the Commissioner. Such officer shall set a convenient time and place for the inspection. The inspection will be permitted only in the presence of an internal revenue officer or employee and only in an office of the Internal Revenue Service during the regular hours of business of such office.

SEC. 6. INSPECTION OF RETURNS STORED IN FEDERAL RECORDS CENTERS.

District Directors may not authorize inspection by State tax officers at Federal records centers of tax returns stored in such centers. However, if the State has previously been granted authorization for inspection of returns by the National Office and certain of these returns are stored in a Federal records center, the State should be permitted to inspect these returns in the district office, only on a name by name basis after the returns have been requisitioned and obtained from the Federal records center.

SEC. 7. DOCUMENTS AND INFORMATION WHICH MAY BE INSPECTED.

.01 State tax officers authorized previously to inspect returns may also inspect information returns, schedules, etc., designed to be supplemental to or to become a part of the returns as well as certain records and reports relating to returns, as follows:

1 Schedules, information returns, protests, briefs, waivers, and other statements or documents designed to be supplemental to or to become a part of the return, may be inspected.

2 Examiners' reports may be inspected to the extent that such reports have previously been furnished to the taxpayer; there-

fore, 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.

3 Conference reports may not be inspected, with the exception of the pages showing recomputation of tax liability.

4 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.

5 Inspection of claims for refund will be limited to the face of the claim only, since the back of the claim contains Service records.

6 Typed copies of office copies of certificates of overassessment may be furnished; no photostatic copies of certificates of overassessment may be made.

SEC. 8. COPIES, ABSTRACTS, OR TRANSCRIPTS OF RETURNS.

.01 Any official, body, or commission lawfully charged with the administration of any State tax law, or any properly designated representative of such official, body, or commission, by whom or which inspection of a return may be permitted under sections 301.6103(a) and 301.6103(a)-2, 301.6103(b)-1 and 301.6106-1 of the regulations, may be furnished with a copy of such return upon request.

.02 If the request for a copy of a return is made other than at the time of inspection of such return by the applicant, the request shall be in writing, shall adequately identify the return, a copy of which is desired, and shall be accompanied by satisfactory evidence that the applicant is a State tax official authorized to inspect the return.

.03 If the State tax official has been authorized by the Commissioner to inspect the return, either through permission for general inspection or permission to inspect a specific return, the application for the copy should be submitted to the District Director, or the Director of International Operations, with whom the return was filed, identifying the return or returns of which a copy is desired.

.04 In all other cases, the application shall be made in writing; signed by the Governor of the State addressed to the Commissioner of Internal Revenue; shall comply with the respective requirements set forth in this procedure governing applications for permission to inspect specific returns; and shall include a request that a copy be furnished.

.05 Request may be made for either or both inspection or a copy of a return.

SEC. 9. PROCEDURE FOR FURNISHING SERVICES.

.01 District Directors, upon authorization by the Commissioner, will provide the necessary inspection, copying, abstract, or transcript service with respect to those returns which are filed in their districts.

.02 When a State is authorized to inspect returns in a District office, the State generally will be advised that it will be necessary for the State to contact the District Director to determine when the returns and related documents will be available for inspection, copying, abstract, or transcript service. District Directors should cooperate fully with properly designated State tax officers and arrange

mutually convenient dates for the inspection of, or the obtaining of information from, returns and related documents. Care should be taken that any dates arranged will not interfere with the normal flow of returns during filing periods, or interrupt investigative or administrative processes involving active use of returns and related documents.

.03 District Directors may also receive from the National Office, from time to time, lists of names, addresses, taxable periods involved, and classes of returns, with instructions to furnish copies of the returns and related documents, or abstracts or transcripts of information therefrom, when they are available, to designated State officials.

SEC. 10. STATE ABSTRACT OR TRANSCRIPT SERVICE, CHARGES, AND STATEMENTS OF ACCOUNT.

.01 States will be required to provide forms upon which such abstracts or transcripts are to be furnished. They will be forwarded periodically to the State tax commission or similar body which requested the service.

.02 Charges for State abstract or transcript service will be at the rate of $2.50 per hour.

.03 Charges for copies of returns and certifications furnished to States will be made as follows:

1 For each copy of a return or other document, 50 cents a page.

2 For each copy of Form 1040A, or a return or other document of similar size, a charge of 50 cents each will be made, even though both sides of the document are furnished.

3 For each copy of a page which is substantially larger than the size used in the largest income tax returns, 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.

4 For each certification, 50 cents.

5 No charges will be made pursuant to this Revenue Procedure for abstracts of information which are furnished to States pursuant to special cooperative agreements between the States and the Federal Government for the mutual exchange of tax information.

SEC. 11. TERMS USED.

References to the district or office in which a return is filed shall, for the purposes of applications for inspection and the inspection, mean the district or office having official custody of the return. If it is believed that the district or office where the return was filed is different from the district or office having official custody, applications made in accordance with this procedure should include statements to that effect, specifying the several locations.

SEC. 12. CROSS REFERENCES.

For procedures relating to inspection by States of returns filed under the Internal Revenue Code of 1939, see Rev. Rul. 54–349, C.B. 1954–2, 122. See also Rev. Proc. 58–15, C.B. 1958–2, 1126, modifying Rev. Rul. 54–349, for charges for abstracts or copies of such returns and documents.

26 CFR 601.203: Offers in compromise. (Also Part I, Section 7122; 301.7122–1.) Rev. Proc. 62–19

Jurisdiction of District Directors of Internal Revenue and Regional Counsel with respect to the processing and disposition of certain offers to compromise tax liabilities under $50,000 and certain specific penalties.

Revenue Procedure 60–22, C.B. 1960–2, 992, amended.

SEC. 1. PURPOSE.

The purpose of this Revenue Procedure is to make known the extension of authority to District Directors and Regional Counsel with respect to the acceptance of certain offers to compromise tax liabilities under $50,000 and specific penalties.

SEC. 2. BACKGROUND.

Revenue Procedure 60–22, C.B. 1960–2, 992, sets forth the jurisdictional alignment pertaining to the investigation and consideration of offers in compromise and outlines procedures established to implement Delegation Order No. 11 (Revised), C.B. 1960–2, 919, authorizing District Directors to accept certain offers to compromise tax liabilities under $25,000 and specific penalties.

SEC. 3. EXTENSION OF DELEGATED AUTHORITY—SCOPE AND LIMITATIONS.

Under Delegation Order No. 11 (Rev. 2), C.B. 1962–1, 396, issued December 29, 1961, District Directors, subject to the limitations contained in applicable regulations and procedures, are delegated authority, under section 7122 of the Internal Revenue Code of 1954, to accept offers to compromise tax liabilities under $50,000 and specific penalties. By direction of the Chief Counsel, ordered December 29, 1961, the Regional Counsel is also authorized to perform his prescribed legal functions in connection with the consideration and processing of accepted offers to compromise tax liabilities under $50,000 and specific penalties. Except for the extension of authority delegated to District Directors and Regional Counsel, the procedures, jurisdictional alignment and limitations set forth in Revenue Procedure 60–22 remain unchanged.

SEC. 4. EFFECT ON OTHER DOCUMENTS.

Revenue Procedure 60–22 is amended to reflect the extension of authority delegated to District Directors and Regional Counsel with respect to the acceptance of offers to compromise liabilities from under $25,000 to under $50,000.

SEC. 5. EFFECTIVE DATE.

This Revenue Procedure is effective January 1, 1962.

26 CFR 601.301: Imposition of taxes, qualification requirements, and regulations.
(Also, Part III–A, Section 5275; 211.271.)

Rev. Proc. 62–20 [1]

Procedures to be followed by users of specially denatured spirits in preparing annual reports on Form 1482, User's Report of Denatured Alcohol or Rum (Rev. 1–62), in accordance with the contemplated revision of the form.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to furnish instructions for modifying the present Form 1482, User's Report of Denatured Alcohol or Rum (Rev. 1–62), in order to simplify the preparation of the annual report. Form 1482 is being revised but will not be available for use in preparing annual reports for the fiscal year 1962.

SEC. 2. PROCEDURE.

.01 *Preparation of annual reports by permittees who also file monthly reports.*—Cumulative totals for the fiscal year will be entered in column (g) of Part I, lines 1 through 13 of the form. The heading of the column will be appropriately modified to read "Cumulative Total." No entries need be made in columns (a) through (f), Part I, of the annual report and no entries are required in Part II. It will still be necessary to complete all columns of Parts I, II, and III of the monthly reports.

.02 *Preparation of annual and monthly reports by all permittees.*—The entry at line 19, Part III, "Total Since July 1," may be omitted. Line 19 of Part III has been eliminated on the revised Form 1482. All of the other entries required in Part III must be made. A single entry will be made for the total quantity of alcohol of one formula used under one code number.

SEC. 3. 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.

[1] Based on Industry Circular No. 62–21, dated June 11, 1962.

(Also Part 1, Section 167; 26 CFR 1.167(a)-1.) Rev. Proc. 62-21 [1]

New guidelines and rules for depreciation

SUMMARY

Part I: Guidelines for Depreciation.
Group One: Guidelines for Depreciable Assets Used by Business in General.
Group Two: Guidelines for Nonmanufacturing Activities, Excluding Transportation, Communications, and Public Utilities.
Group Three: Guidelines for Manufacturing.
Group Four: Guidelines for Transportation, Communications, and Public Utilities.
Part II: Description of Procedures To Be Followed in Examining Depreciation Deductions.
Part III: The Reserve Ratio Table and the Adjustment Table for Class Lives and Instructions for Their Use.

Table 1: Rate of Growth Conversion Table.
Table 2: Reserve Ratio Table:
Section I: Straight Line Method of Depreciation.
Section II: Double Declining Balance Method of Depreciation.
Section III: Sum of the Years-Digits Method of Depreciation.
Section IV: 150 Percent Declining Balance Method of Depreciation.
Table 3: Adjustment Table for Class Lives.
Appendixes:
I. Formulae Used in Calculating Reserve Ratios and the Reserve Ratio Range.
II. Questions and Answers.

[1] Amendment I, published in I.R.B. 1962-46, 23, making various changes in Part 1 has been incorporated herein; this amendment was released as Technical Information Release 405, dated October 19, 1962. The tables in Part III, beginning at page 444, were published as Announcement 62-82, I.R.B. 1962-38, 12. They supersede the illustrative tables published as part of Revenue Procedure 62-21, I.R.B. 1962-30, 6, at page 32.

PART I.—GUIDELINES FOR DEPRECIATION

Group One: Guidelines for Depreciable Assets Used by Business in General

1. Office Furniture, Fixtures, Machines, and Equipment — 10 years

Includes furniture and fixtures which are not a structural component of the building, and machines and equipment used in the preparation of papers or data. Includes such assets as desks; files; safes; typewriters; accounting, calculating and data processing machines; communications, duplicating and copying equipment.

2. Transportation Equipment

Includes the following types of transportation equipment:

(*a*) *Aircraft (air frames and engines, except aircraft of air transport companies)* — 6 years
(*b*) *Automobiles, including taxis* — 3 years
(*c*) *Buses* — 9 years
(*d*) *General-purpose trucks:*
Light (actual unloaded weight less than 13,000 pounds) — 4 years
Heavy (actual unloaded weight 13,000 pounds or more) — 6 years
(*e*) *Railroad cars (except cars of railroad companies)* — 15 years
(*f*) *Tractor units (over-the-road)* — 4 years
(*g*) *Trailers and trailer-mounted containers* — 6 years
(*h*) *Vessels, barges, tugs and similar water transportation equipment* — 18 years

3. Land Improvements — 20 years

Includes land improvements such as paved surfaces, sidewalks, canals, waterways, drainage facilities and sewers, wharves, bridges, all fences except farm fences, landscaping, shrubbery and similar improvements. Includes agricultural land improvements not classified as soil and water conservation expenditures under the Internal Revenue Code of 1954.

Excludes land improvements which are the major asset of a business, such as cemeteries or golf courses. The depreciable life of such land improvements shall be determined according to the particular facts and circumstances.

Excludes land improvements of electric, gas, steam, and water utilities; telephone and telegraph companies; and pipeline, water, and rail carriers. (These improvements are covered under Group Four.)

4. Buildings

Includes the structural shell of the building and all integral parts thereof. Includes equipment which services normal heating, plumbing, air conditioning, fire prevention and power requirements, and equipment such as elevators and escalators.

Excludes special-purpose structures which are an integral part of the production process and which, under normal practice, are replaced contemporaneously with the equipment which they house, support or

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serve. Nonindustrial and general-purpose industrial buildings, such as warehouses, storage facilities, general factory buildings and commercial buildings, are not special-purpose structures. Special-purpose structures shall be classified with the equipment which they house, support or serve, and their depreciable lives determined by reference to the appropriate guidelines for the particular industries.

Type of Building	
Apartments	40 years
Banks	50 years
Dwellings	45 years
Factories	45 years
Garages	45 years
Grain Elevators	60 years
Hotels	40 years
Loft Buildings	50 years
Machine Shops	45 years
Office Buildings	45 years
Stores	50 years
Theaters	40 years
Warehouses	60 years

5. Subsidiary Assets [1]

Includes equipment such as jigs, dies, molds, and patterns; returnable containers and pallets; crockery, glassware, linens, and silverware; and other subsidiary assets which are commonly and properly accounted for separately from those assets falling within the guideline classes in Group Two, Three, or Four.

Where assets in this class are accounted for under a method of depreciation using a life expressed in terms of years,[a] the life shall be determined according to the facts and circumstances.

Group Two: Guidelines for Nonmanufacturing Activities, Excluding Transportation, Communications, and Public Utilities

In general, a single guideline class is specified for each industry included in this group. This single guideline class includes all depreciable property that is not covered by another guideline class. Thus, a single industry guideline class includes production machinery and equipment; power plant machinery and equipment; special equipment; and special-purpose structures (as defined in guideline class 4 under Group One).

Where more than one guideline class is specified for a particular industry, each guideline class covers that portion of the total depreciable property appropriate to the class.

The guideline classes in this group exclude depreciable assets covered under Group One.

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[1] Amendment I, published in I.R.B. 1962–46, 23, making various changes in Part 1 has been incorporated herein; this amendment was released as Technical Information Release 405, dated October 19, 1962.

[a] These items are more usually and properly accounted for under a method of accounting other than a method of depreciation using a life expressed in terms of years. The method used by the taxpayer may be continued if it is consistently used and clearly reflects income. It should be noted that the cost (or other basis) of any asset used in a trade or business and having a useful life of one year or less may be deducted currently and is not subject to depreciation.

1. Agriculture

Includes commercial farms and ranches, agricultural and horticultural services and forestry enterprises.

Excludes logging and sawmilling.

(*a*) *Machinery and Equipment*---------- 10 years

Includes machinery and equipment used in the production of crops and livestock and in the on-farm processing of feeds. Includes fences, but excludes other land improvements.

(*b*) *Animals*

Cattle, breeding or dairy	7 years
Horses, breeding or work	10 years
Hogs, breeding	3 years
Sheep and goats, breeding	5 years

Depreciable lives of animals not included in these guideline classes, such as race horses and fur-bearing animals, shall be determined according to the particular facts and circumstances.

(*c*) *Trees and Vines*

Includes trees and vines producing nuts, fruits and citrus crops. Due consideration shall be given in each producing region to the geographic, climatic, genetic, economic and other factors which determine depreciable life.

(*d*) *Farm Buildings*---------- 25 years

2. Contract Construction

Includes general building, special trade, heavy construction and marine contractors.

(*a*) *General Contract Construction*---------- 5 years

Excludes assets used only in marine contract construction.

(*b*) *Marine Contract Construction*---------- 12 years

Includes assets used only in marine contract construction.

3. Fishing

Includes the commercial catching or taking of fish and other aquatic animals and plants.

Due consideration shall be given in each segment of the industry and in each geographical location to the relevant economic, climatic and other factors which determine depreciable life.

4. Logging and Sawmilling

Includes the cutting of timber and the sawing of dimensional stock from logs.

(*a*) *Logging*---------- 6 years

Includes logging machinery and equipment and road building equipment used by logging and sawmill operators on their own account.

(*b*) *Sawmills*---------- 10 years

(*c*) *Portable Sawmills*---------- 6 years

Includes sawmills characterized by temporary foundations, and a lack or minimum amount of lumber-handling, drying, and residue-disposal equipment and facilities.

5. Mining---------- 10 years

Includes the mining and quarrying of metallic and nonmetallic minerals and the milling, beneficiation and other primary preparation of such materials.

Excludes the extraction and refining of petroleum and natural gas and the smelting and refining of other minerals.

6. Recreation and Amusement---------- 10 years

Includes recreation, entertainment and amusement establishments, such as bowling alleys, billiard and pool establishments, theaters, concert halls, and amusement parks.

Excludes facilities which consist primarily of specialized land improvements or structures, such as golf courses, swimming pools, tennis courts, sports stadia and race tracks. The depreciable life of such facilities shall be determined according to the particular facts and circumstances.

7. Services---------- 10 years

Includes the providing of personal services such as those offered by hotels and motels, laundry and dry cleaning establishments, beauty and barber shops, photographic studios and mortuaries. Includes the providing of professional services such as those offered by doctors, dentists, lawyers, accountants, architects, engineers, and veterinarians. Includes the providing of repair and maintenance services.

8. Wholesale and Retail Trade---------- 10 years

Includes purchasing, selling and brokerage activities at both the wholesale and retail level and related assembling, sorting and grading of goods.

Group Three: Guidelines for Manufacturing

In general, a single guideline class is specified for each manufacturing industry. This single guideline class includes all depreciable property that is not covered by another guideline class. Thus, a single industry guideline class includes production machinery and equipment; power plant machinery and equipment; special equipment; and special-purpose structures (as defined in guideline class 4 under Group One).

Where more than one guideline class is specified for a particular industry, each guideline class covers that portion of the total depreciable property appropriate to the class.

The guideline classes in this group exclude depreciable assets covered under Group One.

1. Aerospace Industry---------- 8 years

Includes the manufacture of aircraft, spacecraft, rockets, missiles and component parts.

2. Apparel and Fabricated Textile Products---------- 9 years

Includes the manufacture of apparel, fur garments, and fabricated textile products except knitwear, knit products and rubber and leather apparel.

3. Cement Manufacture---------- 20 years

Includes the manufacture of cement.

Excludes the manufacture of concrete and concrete products.

4. Chemicals and Allied Products---------- 11 years

Includes the manufacture of basic chemicals such as acids, alkalis, salts, and organic and inorganic chemicals; chemical products to be

used in further manufacture, such as synthetic fibers and plastics materials; and finished chemical products such as pharmaceuticals, cosmetics, soaps, fertilizers, paints and varnishes, explosives, and compressed and liquefied gases.

Excludes the manufacture of finished rubber and plastics products.

5. Electrical Equipment

(*a*) *Electrical Equipment*---------- 12 years

Includes the manufacture of electric household applicances, electronic equipment, batteries, ignition systems, and machinery used in the generation and utilization of electrical energy.

(*b*) *Electronic Equipment*---------- 8 years

Includes the manufacture of electronic communication, detection, guidance, control, radiation, computation, test and navigation equipment and components thereof.

Excludes manufacturers engaged only in the purchase and assembly of components. These manufacturers are included under guideline class 5(a).

6. Fabricated Metal Products---------- 12 years

Includes the manufacture of fabricated metal products such as cans, tinware, hardware, metal structural products, stampings and a variety of metal and wire products.

7. Food and Kindred Products Except Grain and Grain Mill Products, Sugar and Sugar Products, and Vegetable Oil Products---------- 12 years

Includes the manufacture of foods and beverages, such as meat and dairy products; baked goods; canned, frozen and preserved products; confectionery and related products; and soft drinks and alcoholic beverages.

Excludes the manufacture of grain and grain mill products, sugar and sugar products, and vegetable oils and vegetable oil products.

8. Glass and Glass Products---------- 14 years

Includes the manufacture of flat, blown, or pressed glass products, such as plate, safety and window glass, glass containers, glassware and fiberglass.

Excludes the manufacture of lenses.

9. Grain and Grain Mill Products---------- 17 years

Includes the manufacture of blended and prepared flours, cereals, feeds and other grain and grain mill products.

10. Knitwear and Knit Products---------- 9 years

Includes the manufacture of knitwear and knit products.

11. Leather and Leather Products---------- 11 years

Includes the manufacture of finished leather products, the tanning, currying and finishing of hides and skins, and the processing of fur pelts.

12. Lumber, Wood Products, and Furniture---------- 10 years

Includes the manufacture of lumber, plywood, veneers, furniture, flooring and other wood products.

Excludes logging and sawmilling and the manufacture of pulp and paper.

13. Machinery Except Electrical Machinery, Metalworking Machinery, and Transportation Equipment ---------- 12 years

Includes the manufacture of machinery such as engines and turbines; farm machinery; construction and mining machinery; food products machinery; textile machinery; woodworking machinery; paper industries machinery; compressors; pumps; ball and roller bearings; blowers; industrial patterns; process furnaces and ovens; office machines; and service industry machines and equipment.

Excludes the manufacture of electrical machinery, metalworking machinery, and transportation equipment.

14. Metalworking Machinery ---------- 12 years

Includes the manufacture of metal cutting and forming machines and associated jigs, dies, fixtures and accessories.

15. Motor Vehicles and Parts ---------- 12 years

Includes the manufacture of automobiles, trucks and buses and their component parts.

Excludes the manufacture of glass, tires and stampings.

16. Paper and Allied Products

(*a*) *Pulp and Paper* ---------- 16 years

Includes the manufacture of pulp from wood, rags and other fibers and the manufacture of paper and paperboard from pulp.

Excludes paper finishing and conversion into cartons, bags, envelopes, and similar products.

(*b*) *Paper Finishing and Converting* ---------- 12 years

Includes paper finishing and conversion into cartons, bags, envelopes and similar products.

17. Petroleum and Natural Gas

(*a*) *Drilling, Geophysical and Field Services* ---------- 6 years

Includes the drilling of oil and gas wells on a contract, fee or other basis and the provision of geophysical and other exploration services. Includes oil and gas field services, such as chemically treating, plugging and abandoning wells and cementing or perforating well casings.

Excludes integrated petroleum and natural gas producers which perform these services for their own account.

(*b*) *Exploration, Drilling and Production* ---------- 14 years

Includes the exploration, drilling, maintenance and production activities of petroleum and natural gas producers. Includes gathering pipelines and related storage facilities of such producers.

Excludes gathering pipelines and related storage facilities of pipeline companies.

(*c*) *Petroleum Refining* ---------- 16 years

Includes the distillation, fractionation, and catalytic cracking of crude petroleum into gasoline and its other components.

(*d*) *Marketing* ---------- 16 years

Includes the marketing of petroleum and petroleum products. Includes related storage facilities and complete service stations.

Excludes petroleum and natural gas trunk pipelines and related storage facilities. Excludes natural gas distribution facilities.

18. Plastics Products ..... 11 years

Includes the manufacture of processed, fabricated and finished plastics products.

Excludes the manufacture of basic plastics materials.

19. Primary Metals

Includes the smelting, reducing, refining and alloying of ferrous and nonferrous metals from ore, pig or scrap and the manufacture of castings, forgings and other basic ferrous and nonferrous metals products.

(*a*) *Ferrous Metals* ..... 18 years
(*b*) *Nonferrous Metals* ..... 14 years

20. Printing and Publishing ..... 11 years

Includes printing, publishing, lithographing and printing services such as bookbinding, typesetting, photoengraving, and electrotyping.

21. Professional, Scientific, and Controlling Instruments; Photographic and Optical Equipment; Watches and Clocks ..... 12 years

Includes the manufacture of mechanical measuring, engineering, laboratory and scientific research instruments; optical instruments and lenses; surgical, medical and dental instruments and equipment; ophthalmic equipment; photographic equipment; and watches and clocks.

22. Railroad Transportation Equipment ..... 12 years

Includes the building and rebuilding of railroad locomotives, railroad cars, and street cars.

23. Rubber Products ..... 14 years

Includes the manufacture of finished rubber products and the recapping, retreading and rebuilding of tires.

24. Ship and Boat Building ..... 12 years

Includes the building, repairing and conversion of ships and boats.

25. Stone and Clay Products Except Cement ..... 15 years

Includes the manufacture of structural clay products such as brick, tile and pipe; pottery and related products, such as vitreous-china, plumbing fixtures, earthenware and ceramic insulating materials; concrete; asphalt building materials; concrete, gypsum and plaster products; cut and finished stone; and abrasive, asbestos and miscellaneous nonmetallic mineral products.

Includes permanent or well-established sawmills.

Excludes the manufacture of cement.

26. Sugar and Sugar Products ..... 18 years

Includes the manufacture of raw sugar, sirup or finished sugar from sugar cane or sugar beets.

27. Textile Mill Products Except Knitwear

(*a*) *Textile Mill Products, Excluding Finishing and Dyeing* ---------- 14 years

Includes the manufacture of spun, woven or processed yarns and fabrics from natural or synthetic fibers.

Excludes finishing and dyeing.

(*b*) *Finishing and Dyeing*---------- 12 years

Includes textile finishing and dyeing.

28. Tobacco and Tobacco Products---------- 15 years

Includes the manufacture of cigarettes, cigars, smoking and chewing tobacco and other tobacco products.

29. Vegetable Oil Products---------- 18 years

Includes the manufacture of vegetable oils and vegetable oil products.

30. Other Manufacturing---------- 12 years

Includes the manufacture of products not covered by other guideline classes in Group Three, such as the manufacture of fountain pens and jewelry.

Excludes property used in the manufacture of products for which this guideline is clearly inappropriate. The depreciable life of such property shall be determined according to the particular facts and circumstances.

Group Four: Guidelines for Transportation, Communications, and Public Utilities

Guideline classes specified for this Group include depreciable assets other than those for which guideline classes are provided under Group One. Special-purpose structures (as defined in guideline class 4 under Group One) are included in this group.

Where more than one guideline class is specified for a particular industry, each guideline class covers that portion of the total depreciable property appropriate to the class.

1. Air Transport---------- 6 years

Includes the commercial and contract carrying of passengers and freight by air.

2. Central Steam Production and Distribution---------- 28 years

Includes the production and distribution of steam for sale.

3. Electric Utilities

Includes the production, transmission, and distribution of electricity for sale.

(*a*) *Hydraulic production plant*---------- 50 years
(*b*) *Nuclear production plant*---------- 20 years
(*c*) *Steam production plant*---------- 28 years
(*d*) *Transmission and distribution facilities*---------- 30 years

Each guideline class includes the related land improvements.

4. Gas Utilities

Includes the production, transmission, and distribution of natural and manufactured gas for sale.

(*a*) *Distribution facilities*_____ 35 years
(*b*) *Manufactured gas production plant*_____ 30 years
(*c*) *Natural gas production plant*_____ 14 years
(*d*) *Trunk pipelines and related storage facilities*_____ 22 years

Each guideline class includes the related land improvements.

5. Motor Transport—Freight_____ 8 years

Includes the commercial and contract carrying of freight by road. (Trucks, tractors and trailers are covered under guideline class 2 of Group One.)

6. Motor Transport—Passengers_____ 8 years

Includes the urban and interurban commercial and contract carrying of passengers by road. (Automobiles, buses, and taxis are covered under guideline class 2 of Group One.)

7. Pipeline Transportation_____ 22 years

Includes the private, commercial, and contract carrying of petroleum, gas, and other products by means of pipes and conveyors. Includes trunk pipelines and related storage facilities of integrated petroleum and natural gas producers.

8. Radio and Television Broadcasting_____ 6 years

Includes commercial radio and television broadcasting.

9. Railroads

Includes the commercial and contract carrying of passengers and freight by rail.

Excludes station and office buildings, floating equipment, storage warehouses, grain elevators, and other property classified in the following Interstate Commerce Commission road accounts: (16), (56), (21), (22) (included under Group One).

Excludes property classified in Interstate Commerce Commission road accounts (8) through (12) and road account (38).

Excludes transportation equipment (guideline class 2 of Group One).

(*a*) *Machinery and Equipment*_____ 14 years

Includes property classified in the following Interstate Commerce Commission accounts:

Road accounts	Equipment accounts
(26) Communication systems	(51) Steam locomotives
(27) Signals and interlockers	(52) Other locomotives
(37) Roadway machines	(53) Freight-train cars
(44) Shop machinery	(54) Passenger-train cars
	(57) Work equipment
	(58) Miscellaneous equipment

(*b*) *Structures and similar improvements*_____ 30 years

Includes property classified in the following Interstate Commerce Commission Road accounts:

(6) Bridges, trestles, and culverts
(7) Elevated structures
(13) Fences, snowsheds, and signs
(17) Roadway buildings
(18) Water stations
(19) Fuel stations
(20) Shops and enginehouses
(31) Power transmission systems
(35) Miscellaneous structures
(39) Public improvements construction

(*c*) *Grading and other right-of-way improvements*

Includes property classified in the following Interstate Commerce Commission road accounts:

(1) Engineering
(2½) Other right-of-way expenditures
(3) Grading
(5) Tunnels and subways

To the extent that the asset is depreciable, the life shall be determined according to the particular facts and circumstances.

(*d*) *Wharves and docks*_____ 20 years

Includes Interstate Commerce Commission road accounts:

(23) Wharves and docks
(24) Coal and ore wharves

(*e*) *Power plant and equipment*

Includes Interstate Commerce Commission road accounts:

(29) Power plant
(45) Power plant machinery

Electric generating equipment
Hydraulic _____ 50 years
Nuclear _____ 20 years
Steam _____ 28 years
Steam, compressed air, and other power plant and equipment _____ 28 years

10. Telephone and Telegraph Communications

Includes the providing of commercial and contract telephonic and telegraphic communication services.

Depreciable lives or depreciation rates established by the Federal Communications Commission and other governmental regulatory agencies are to be used in the computation of depreciation for tax purposes on all assets including assets covered under Group One. Where depreciable lives or depreciation rates have not been established by any governmental regulatory agency, depreciable lives shall be determined according to the particular facts and circumstances.

11. Water Transportation_____ 20 years

Includes the commercial and contract carrying of freight and passengers by water. (Vessels, barges, tugs and similar water transportation equipment are covered under guideline class 2 of Group One.)

12. Water Utilities_____ 50 years

Includes the gathering, treatment, and commercial distribution of water.

PART II.—DESCRIPTION OF PROCEDURES TO BE FOLLOWED IN EXAMINING DEPRECIATION DEDUCTIONS

SECTION 1. IN GENERAL.

Section 167 of the Internal Revenue Code of 1954 allows as a deduction in computing taxable income a reasonable allowance for depreciation of property used in a trade or business or of property held for the production of income. The purpose of the allowance is to permit taxpayers to recover through annual deductions the cost (or other basis) of the property over its useful economic life.

The determination of the useful economic life of an asset is a matter of judgment and estimate. For this reason, it is the policy of the Internal Revenue Service generally not to disturb depreciation deductions. Therefore, adjustments in the depreciation deduction should not be proposed unless there is a clear and convincing basis for a change. The procedures set forth herein are to be followed in determining whether there is a clear and convincing basis for a change.[1] These procedures are designed to provide taxpayers with a greater degree of certainty in determining the amount of their depreciation deductions and to provide greater uniformity in the audit of these deductions by the Internal Revenue Service.

These procedures will be used in connection with examinations of income tax returns the due date for the filing of which is on or after July 12, 1962 (without regard to extensions of time).[2] These procedures apply with respect to depreciation of assets acquired before the effective date of this Revenue Procedure as well as to depreciation of assets acquired after that date. However, any taxpayer has the option of having the depreciation claimed with respect to his various item or multiple-asset accounts examined individually under presently established procedures, without regard to this Revenue Procedure.

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[1] Since the prescribed guideline lives are expressed in terms of years, the procedures set forth herein cannot be applied to assets depreciated under the unit-of-production, machine-hour, or similar methods of depreciation. If any asset in a guideline class is depreciated under one of these methods, these procedures are not applicable to that guideline class. Whether depreciation claimed by the taxpayer with respect to that guideline class is reasonable will continue to be determined under Revenue Rulings 90 and 91, C.B. 1953–1, 43, 44. However, if a taxpayer using one of these methods changes to a useful-life method (expressed in terms of years) of computing depreciation for tax purposes in filing his income tax return for the first taxable year to which this Revenue Procedure applies or for the first taxable year ending on or after July 12, 1962, he will be deemed to have filed a timely application for consent to make such a change and such consent is hereby granted.

[2] This Revenue Procedure does not apply with respect to examinations of depreciation claimed for taxable years for which returns were due to be filed before July 12, 1962. The examination of depreciation claimed for such taxable years will be made in accordance with Revenue Rulings 90 and 91, C.B. 1953–1, 43, 44. Moreover, the guideline lives set forth in Part I of this Revenue Procedure will not be regarded as evidence of the appropriate useful lives to be used where taxpayers did not follow retirement and replacement practices consistent with those lives during the years under examination. In general, any taxpayer will be permitted to use the Reserve Ratio Table set forth in Part III of this Revenue Procedure to demonstrate that his retirement and replacement practice supports the life used or a proposed change in the life used, provided that the circumstances are analogous to those set forth in section 3.02(a) or 3.03(a) of Part II of this Revenue Procedure. In this connection, however, the transition rule of section 5.03 of Part II may not be used.

Where this Revenue Procedure is not followed, the examination of depreciation will be made in accordance with the principles set forth in Revenue Rulings 90 and 91, C.B. 1953–1, 43, 44. However, Bulletin "F" is withdrawn as a guide to examining officers for the determination of depreciable lives.

Where depreciation claimed in an income tax return is examined under this Revenue Procedure, the lives used by a taxpayer for his depreciable properties are first to be compared with the prescribed guideline lives set forth in Part I of this Revenue Procedure. These guideline lives apply to broad classes of assets rather than to individual assets. Each of these broad classes is hereinafter referred to as a "guideline class."

Initially, any taxpayer will be allowed to use a class life for a guideline class which is at least as short as the guideline life for that class, even if a longer life has previously been used.

The comparison of the class lives used by the taxpayer with the guideline lives will be facilitated if the taxpayer's depreciation accounts correspond to the guideline classes. Any taxpayer who is depreciating his assets in item accounts, or in multiple-asset accounts which do not correspond to the guideline classes, may regroup his assets for tax purposes in depreciation accounts corresponding to the guideline classes, but he is not required to do so. Even if a taxpayer does not regroup his assets in accounts corresponding to the guideline classes, this Revenue Procedure may be applied by regrouping the assets annually, solely for the purpose of this Revenue Procedure.

Section 2 of this Part sets forth the applicable rules where a taxpayer uses a class life equal to or longer than the guideline life and section 3 sets forth the applicable rules where a taxpayer uses a class life shorter than the guideline life. Section 4 sets forth the rules for determining the class life used by the taxpayer.

SEC. 2. CLASS LIFE EQUAL TO OR LONGER THAN THE PRESCRIBED GUIDELINE LIFE.

Where the class life used by a taxpayer is equal to or longer than the guideline life for a guideline class, the depreciation deduction claimed by the taxpayer for the assets in that class will not be disturbed if the taxpayer's retirement and replacement practices for that class hereafter are consistent with the class life being used. This consistency may be demonstrated either by the reserve ratio test set forth in section 5 of this Part or by all the facts and circumstances.

The reserve ratio test is a technique for establishing objectively that the taxpayer's retirement and replacement practices for a guideline class are consistent with the class life he is using. If the test is met, the depreciation deduction for that class will not be disturbed.[3] In

[3] In the context of this Revenue Procedure, not disturbing the depreciation deduction means not disturbing either the lives or salvage used by the taxpayer. Of course, the correct basis of assets must be used in computing the depreciation deduction. In addition, where the useful life of an individual asset must be used to determine eligibility for a special method of computing depreciation or for any other provision where eligibility depends on the useful life of the individual asset, such life must be determined for that purpose without regard to this Revenue Procedure. Examples of instances where the useful life of an individual asset must be so determined include (1) section 167(c) where the useful life of an asset must be 3 years or more to qualify for certain accelerated methods of depreciation, and (2) section 179 where the useful life of an asset must be 6 years or more to qualify for the additional first-year depreciation allowance. Moreover, the depreciation deduction claimed for an asset in the taxable year of its disposition may be governed by Revenue Ruling 62–92, C.B. 1962–1, 29.

order to give taxpayers an opportunity where needed to conform their retirement and replacement practices with the class lives being used, the reserve ratio test will be considered to be met for the first 3 taxable years to which this Revenue Procedure applies. Any class life equal to or longer than the guideline life will not be questioned for such first 3 taxable years. Thereafter, if the test is not met, a taxpayer may by the use of presently established procedures demonstrate that his retirement and replacement practices are consistent with the class life being used.

SEC. 3. CLASS LIFE SHORTER THAN THE PRESCRIBED GUIDELINE LIFE.

.01 *In general.*—Where the class life used by a taxpayer is shorter than the prescribed guideline life for a guideline class, the depreciation deduction claimed by the taxpayer for the assets in that class will not be disturbed if the conditions of subsection .02, .03, .04, or .05 of this section are met. Subsection .02 sets forth the applicable rules where the class life used by the taxpayer for the taxable year under examination is shorter than the guideline life but equal to or longer than the class life used in the preceding taxable year. Subsection .03 sets forth the applicable rules where the class life used by the taxpayer for the taxable year under examination is shorter than the guideline life and also is shorter than the class life used in the preceding taxable year. Subsection .04 sets forth the applicable rules where the class life used by the taxpayer for the taxable year under examination is shorter than the guideline life and there were no assets in that guideline class in the preceding taxable year (as in the case of the first taxable year of a new taxpayer). Subsection .05 sets forth the applicable rules for taxable years subsequent to a year for which the class life was examined and accepted by the Internal Revenue Service.

.02 *Class life equal to or longer than life used in preceding taxable year.*—Where the class life used by a taxpayer is shorter than the guideline life for a guideline class but is equal to or longer than the class life used by the taxpayer in the immediately preceding taxable year, the depreciation deduction claimed by the taxpayer for the assets in that class will not be disturbed if either paragraph (a) or (b) of this subsection applies.

(a) *Class life justified by reference to its prior use.*—The depreciation deduction will not be disturbed if the taxpayer has used approximately the same class life for a period of years equal to at least one-half the class life used in the taxable year under examination, and the reserve ratio test set forth in section 5 of this Part is met, thus demonstrating that the taxpayer's retirement and replacement practices are consistent with the class life used.[4]

[4] Because of the structure of the Reserve Ratio Table, the fact that the reserve ratio test is met for a particular class life is not meaningful, for the purpose of justifying a class life shorter than the guideline life by reference to its prior use, unless that class life has been used for a substantial period of years.

As to meeting the reserve ratio test where a class life has been used for a substantial period of years, the reserve ratio test will, because of the operation of the transition rule, be considered to be met for the first 3 taxable years to which this Revenue Procedure applies. See section 5.03(a) of this Part.

(b) *Class life justified by other factors.*—The depreciation deduction will not be disturbed if the class life used by the taxpayer is justified for the taxable year under examination on the basis of all the facts and circumstances (see subsection .06 of this section).

.03 *Class life shorter than life used in preceding year.*—Where the class life used by a taxpayer is shorter than the guideline life for a guideline class and is also shorter than the class life used by the taxpayer in the immediately preceding taxable year, the depreciation deduction claimed by the taxpayer will not be disturbed if either paragraph (a) or (b) of this subsection applies.

(a) *Class life justified by prior retirement and replacement practices.*—The depreciation deduction will not be disturbed if the taxpayer's prior retirement and replacement practices indicate that such shorter class life is justified, as demonstrated by the following factors:

(1) the taxpayer's reserve ratio for the guideline class for the taxable year immediately preceding the taxable year under examination was below the lower limit of the appropriate reserve ratio range;[5] and

(2) the taxpayer has used approximately the same class life as the life used in such immediately preceding year for a period of years equal to at least one-half of the class life used in such preceding year;[6] and

(3) the shorter class life used in the taxable year under examination is not shorter than can be justified on the basis of the Adjustment Table for Class Lives.[7]

(b) *Class life justified by other factors.*—The depreciation deduction will not be disturbed if the class life used by the taxpayer is justified for the taxable year under examination on the basis of all the facts and circumstances (see subsection .06 of this section).

.04 *Class life shorter than guideline life in case of new taxpayer or new guideline class.*—Where the class life used by a taxpayer is shorter than the guideline life for a guideline class and there were no assets in that class in the immediately preceding taxable year (as,

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[5] In some cases, the fact that the reserve ratio is below the lower limit is not meaningful in determining whether the use of a shorter class life is justified by the taxpayer's retirement and replacement practices. Since a new taxpayer or a taxpayer with a new guideline class of assets will necessarily have low reserve ratios, such fact is not meaningful until a guideline class has a history equal in years to the guideline life for that class. Similarly, this fact is not meaningful where the retirement or acquisition of assets in a guideline class produces a sudden and unusual decrease in a taxpayer's reserve ratio when compared with the reserve ratio for the immediately preceding taxable year.

In these cases, the fact that a reserve ratio is below the lower limit cannot be used to justify a class life shorter than the guideline life. Whether the taxpayer's prior retirement and replacement practices for a guideline class justify the shorter class life used by the taxpayer must be determined on the basis of all the facts and circumstances.

[6] Because of the structure of the Reserve Ratio Table, the fact that a taxpayer's reserve ratio is below the lower limit of the appropriate reserve ratio range for a particular class life is not meaningful, for the purpose of justifying a class life shorter than the guideline life by reference to prior retirement and replacement practices, unless that class life has been used for a substantial period of years.

[7] This table and the instructions for using it are set forth in section 3 of Part III of this Revenue Procedure. If the taxpayer's reserve ratio for a guideline class is below the lower limit of the appropriate reserve ratio range, the Adjustment Table for Class Lives will indicate which shorter class life is consistent with the taxpayer's retirement and replacement practices. If the taxpayer uses an even shorter class life, it cannot be justified on the basis of the table, but must be justified on the basis of other facts and circumstances.

for example, in the case of the first taxable year of a new taxpayer), the depreciation deduction claimed by the taxpayer will not be disturbed if the class life used by the taxpayer is justified for the taxable year under examination on the basis of all the facts and circumstances (see subsection .06 of this section).

.05 *Subsequent use of class life previously justified.*—Where the class life used by a taxpayer was examined by the Internal Revenue Service and was accepted by reason of subsection .02, .03, or .04 of this section, or where such class life was accepted on audit by the Internal Revenue Service under presently established procedures for examining depreciation (whether before or after the effective date of this Revenue Procedure), the depreciation deduction claimed by the taxpayer for the assets in that class in any subsequent taxable year based on that class life will not be disturbed if the taxpayer's retirement and replacement practices for that class are consistent with the class life being used. This consistency may be demonstrated either by the reserve ratio test set forth in section 5 of this Part or by all the facts and circumstances.

The reserve ratio test is a technique for establishing objectively that the taxpayer's retirement and replacement practices for a guideline class are consistent with the class life he is using. If the test is met, the depreciation deduction for that class will not be disturbed.[8] In order to give taxpayers an opportunity where needed to conform their retirement and replacement practices with the class lives being used, the reserve ratio test will be considered to be met for the first three taxable years to which this Revenue Procedure applies. The previously justified class life will not be questioned during that period. Thereafter, if the test is not met, a taxpayer may by the use of presently established procedures demonstrate that his retirement and replacement practices are consistent with the class life being used.

.06 *Facts and circumstances.*—Where a class life used by a taxpayer is shorter than the guideline life and has not been previously justified, a significant factor (except where the taxpayer is a regulated public utility) in determining whether the class life is justified for the taxable year under examination on the basis of all the facts and circumstances is the fact that the life used by the taxpayer in computing his depreciation deduction is the same as the life used in computing the depreciation shown on the taxpayer's books of account and financial statements.[9] Substantial weight should also be given to any other objective factors which indicate that the taxpayer intends to follow a more rapid retirement and replacement practice than is reflected in the guideline life and to whether the taxpayer has previously followed retirement and replacement practices consistent with lives previously used. Other situations in which the class life used by a taxpayer may be justified by the facts include situations (1) where there is an abnormally intensive use of assets, (2) where there

[8] See footnote 3.

[9] Where this factor is relied upon as a significant factor in justifying the class life being used, the life used by the taxpayer for tax purposes in succeeding years should continue to correspond to the life used in computing the depreciation shown on the books of account and financial statements if the taxpayer wishes to retain the benefits of the reserve ratio test under subsection .05 of this section. If such lives do not correspond, the taxpayer may be required to justify the class life used in such succeeding taxable years on the basis of all the facts and circumstances pertaining to such years.

are a number of assets in a guideline class which were not new when acquired by the taxpayer, (3) where there is extraordinary obsolescence which affects the particular taxpayer, and (4) where a guideline class of a particular taxpayer contains a disproportionate amount of relatively short-lived assets.

SEC. 4. DETERMINING THE CLASS LIFE USED BY THE TAXPAYER.

.01 *In general.*—For the purpose of comparing the class life used by a taxpayer with the guideline life for any guideline class, the class life is to be determined in accordance with the following rules:

.02 *Taxpayer using guideline classes.*—If a taxpayer actually depreciates assets in a depreciation account corresponding to a guideline class, the class life is the same as the life used by the taxpayer in computing the depreciation allowance for that account. However, see subsection .04 of this section where salvage is a factor in computing depreciation for that account.

.03 *Taxpayer not using guideline classes.*—If a taxpayer depreciates assets in item accounts or in multiple-asset accounts which do not correspond to the guideline classes, the assets will be regrouped (for the purpose of comparing the class life used by the taxpayer with the guideline life) in classes corresponding to the prescribed guideline classes. The class life used by the taxpayer for each class will then be determined by computing the weighted average of the lives used for the item or multiple-asset accounts coming within that guideline class.[10]

The weighted average of the lives used by the taxpayer for the assets falling within a guideline class is to be determined as follows (regardless of the method of depreciation used by the taxpayer): Compute the straight-line depreciation, based on the life used by the taxpayer with respect to each item account or multiple-asset account coming within the guideline class. Divide the total depreciation so computed into the total basis[11] of all the assets in such item or multiple-asset accounts to obtain the class life. See subsection .04 of this section where salvage is a factor in computing depreciation with respect to any assets in the guideline class.

.04 *Salvage.*—In any case where salvage is a factor in computing the amount of depreciation claimed by a taxpayer with respect to a guideline class, the class life is determined by dividing the straight-line depreciation (computed by using the lives and salvage actually used by the taxpayer for all assets in the class) into the total basis (not reduced by salvage) of all assets in the class. For example, if the total basis of all assets in a guideline class is $1,000, and the taxpayer has used a life of 8 years for that class and has taken into account salvage of $200, he will be considered as using a class life of 10 years, since the annual straight-line depreciation based on the life and salvage used by the taxpayer for the assets in that class ($100) divided into the total basis of such assets ($1,000) is 10.

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[10] If any multiple-asset account maintained by the taxpayer overlaps two or more of the prescribed guideline classes, the taxpayer should provide sufficient information to enable the weighted average of the lives for all the assets coming within each such guideline class to be computed with reasonable accuracy, considering the circumstances of the particular case.

[11] The term "basis" as used in this Revenue Procedure means cost or other basis, adjusted only as provided in section 1016(a)(1).

SEC. 5. RESERVE RATIO TEST.

.01 *In general.*—The reserve ratio test is an objective technique for establishing that the depreciation reserve for assets in a guideline class bears a reasonable relationship to the basis of those assets. In many cases, this test can be used to demonstrate that the retirement and replacement practices being followed by a taxpaper with respect to a guideline class are consistent with the class life being used. In cases where the test is not met, whether the taxpayer's retirement and replacement practices are consistent with the class life being used must be determined on the basis of all the facts and circumstances. Section 6 sets forth the rules for lengthening a class life where it cannot be justified by either the reserve ratio test or all the facts and circumstances.

Subsection .02 of this section sets forth the general rule for applying the reserve ratio test. Subsection .03 sets forth a transition rule. Because of the operation of the transition rule, the reserve ratio test will be considered met for the first three taxable years to which this Revenue Procedure applies.

Table 2 in Part III of this Revenue Procedure sets forth the appropriate ratios of depreciation reserves to basis, taking into account the method of depreciation, the life, and the rate of growth for any particular guideline class. This table also prescribes upper and lower limits of acceptable ranges for reserve ratios. In addition, Part III contains the rules for computing the taxpayer's reserve ratio for a guideline class and for selecting the appropriate reserve ratio range for that class from the Reserve Ratio Table.

.02 *General rule.*—Where the reserve ratio test is being used to demonstrate that a taxpayer's retirement and replacement practices with respect to a guideline class are consistent with the class life being used, the test will be met if the taxpayer's reserve ratio for that class does not exceed the upper limit of the appropriate reserve ratio range. Any taxpayer who has been retiring and replacing assets in a guideline class consistent with the life previously used and who continues to do so will not exceed the appropriate upper limit. Even if the taxpayer adopts a shorter class life after the publication of this Revenue Procedure, his reserve ratio will not exceed the appropriate upper limit, so long as his retirement and replacement practices are thereafter consistent with the shorter class life. In these situations, the taxpayer will satisfy the general rule for applying the reserve ratio test and the transition rule set forth in subsection .03 of this section will not be needed.

Where the taxpayer's reserve ratio for a guideline class does exceed the upper limit (and the transition rule does not apply), the taxpayer may, by the use of presently established procedures, resort to other factors to demonstrate that his retirement and replacement practices are consistent with the class life being used.[12]

[12] In certain cases, the fact that the taxpayer's reserve ratio for a guideline class exceeds the upper limit of the appropriate reserve ratio range is not meaningful as an indication that the taxpayer's retirement and replacement practices are not consistent with the class life used. For example, the pattern of retirements and replacements of assets in a guideline class may produce wide fluctuations in a taxpayer's reserve ratio for that class whereby in some years the reserve ratio exceeds the upper limit of the appropriate reserve ratio

.03 *Transition rule.*—Where a taxpayer's retirement and replacement practices with respect to a guideline class have been inconsistent with the life previously used, the reserve ratio for that class may exceed the upper limit of the appropriate reserve ratio range and thus fail to meet the general rule for applying the reserve ratio test. If this occurs with respect to any one or more of the first 3 taxable years to which this Revenue Procedure applies, the following transition rule supersedes the general rule set forth in subsection .02 of this section:

(a) The reserve ratio test will be considered to be met for the first 3 taxable years to which this Revenue Procedure applies.

(b) The taxpayer will be given a period of years (commencing with the first year to which this Revenue Procedure applies) equal to the guideline life for that class to bring his reserve ratio within the upper limit of the appropriate reserve ratio range, provided the reserve ratio is moving toward the appropriate upper limit during this period. So long as the reserve ratio is moving toward this upper limit, the reserve ratio test will be considered to be met during this period.

(c) The reserve ratio will be considered as moving toward the appropriate upper limit so long as the amount by which the reserve ratio exceeds such upper limit for any taxable year during the period is lower than it was for any one of the 3 preceding taxable years.

If the reserve ratio for a guideline class has not come within the upper limit of the appropriate reserve ratio range by the close of the period described in paragraph (b) of this subsection, or if the reserve ratio is not moving toward such upper limit (within the meaning of paragraph (c) of this subsection) for any taxable year during this period after the first 3 taxable years, then the transition rule ceases to apply and the general rule set forth in subsection .02 of this section for the application of the reserve ratio test shall apply.

.04 *Application of reserve ratio test in the case of a new taxpayer or a new guideline class.*—The guideline classes of a new taxpayer or a new guideline class of an existing taxpayer will necessarily have low reserve ratios for a period of years. Therefore, a new taxpayer or any taxpayer with a new guideline class will ordinarily be able to use the guideline life (or a shorter class life, if justified by all the facts and circumstances) for a replacement cycle, and, of course, thereafter if his retirement and replacement practices are consistent with the class life being used. If the taxpayer's reserve ratio for such a guideline class does exceed the upper limit of the appropriate reserve ratio range during the first replacement cycle,[13] the taxpayer may, by the use of presently established procedures, resort to other factors

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range and in other years the reserve ratio falls below the lower limit of such range. Wide fluctuations of this nature in the reserve ratio may occur where a taxpayer's guideline class contains relatively few assets, most of which are retired at or about the same time. Immediately before the retirement of these assets, the reserve ratio would exceed the upper limit of the appropriate reserve ratio range; after their retirement, the reserve ratio would fall below the lower limit of such range.

[13] Since the depreciation reserve for a new guideline class of a new or existing taxpayer is initially zero, it is unlikely that the reserve ratio will exceed the appropriate upper limit during the first replacement cycle. If this does occur, it will presumably occur toward the end of the cycle. Whether the fact that the upper limit is exceeded is meaningful depends on the facts and circumstances. See footnote 12.

to demonstrate that his retirement and replacement practices are consistent with the class life being used.

SEC. 6. LENGTHENING A CLASS LIFE WHICH CANNOT BE JUSTIFIED.

.01 *In general.*—Where a class life used by a taxpayer cannot be justified under any of the rules set forth in this Part, that life shall be lengthened in accordance with subsection .02 or .03 of this section.[14] However, a class life shall not be lengthened beyond the shortest life which can be justified for the guideline class under all the facts and circumstances for the taxable year under examination.[15] See subsection .04 of this section for rules relating to the taxable year in which a class life is to be lengthened.

.02 *Lengthening a class life which is equal to or longer than the guideline life.*—Where a class life used by a taxpayer is equal to or longer than the guideline life for a guideline class, and the taxpayer's retirement and replacement practices are not consistent with the class life used, the class life shall be lengthened in accordance with the Adjustment Table for Class Lives.[16] This table and the instructions for its use are set forth in section 3 of Part III of this Revenue Procedure.

.03 *Lengthening a class life which is shorter than the guideline life.*—Where a class life used by a taxpayer is shorter than the guideline life for a guideline class and is not justified under any of the rules set forth in this Part, the class life shall be lengthened as follows:

(a) In any case where the reserve ratio test may be used as a technique for demonstrating that the taxpayer's retirement and replacement practices are consistent with the class life used, and the consistency cannot be demonstrated either by the reserve ratio test or by all the facts and circumstances, the class life shall be lengthened in accordance with the Adjustment Table for Class Lives.[17]

(b) In any other case, the class life shall be lengthened to the shortest life previously justified for that guideline class, or to the guideline life if no shorter life has been previously justified.[18]

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[14] If the assets in a guideline class are depreciated in a number of item or multiple-asset accounts, the lives used by the taxpayer for such accounts should be lengthened so that the weighted average of such lives is equal to the lengthened class life.

[15] Where the class life is lengthened to the shortest life that can be justified on the basis of all the facts and circumstances, the lengthened class life may be used by the taxpayer in subsequent taxable years if the taxpayer's retirement and replacement practices thereafter are consistent with the use of that class life.

[16] In any case where the reserve ratio test may be used as a technique for demonstrating that the taxpayer's retirement and replacement practices are consistent with the class life used, and such consistency cannot be demonstrated either by the reserve ratio test or by all the facts and circumstances, the Adjustment Table for Class Lives provides a technique for determining objectively the class life which is consistent with the taxpayer's practices. If a class life used by the taxpayer is lengthened to a life longer than the guideline life, the class life may not be shortened subsequently until such time as (1) the reserve ratio decreases to a point within the upper limit of the reserve ratio range for the lengthened class life, or (2) a shorter life is justified by reason of other facts and circumstances. Furthermore, the lengthened class life may not be lengthened subsequently unless the amount by which the reserve ratio exceeds the upper limit of the appropriate reserve ratio range continues to increase for a period of at least 3 years, after which that life may be lengthened on the basis of all the facts and circumstances.

[17] See footnote 16.

[18] Since the reserve ratio test is not available as a technique for justifying the class life used in cases to which subsection .03(b) of this section applies, the initial adjustment to the class life used must be made without regard to the Adjustment Table for Class Lives. However, where the class life used by a taxpayer is lengthened under subsection .03(b) of this section, the lengthened life shall be considered the class life used by the taxpayer for the purpose of applying the reserve ratio test. Normally, this test would be met. Thus, there would be no further adjustment to the class life, and that life may be used by

.04 *Year in which class life is to be lengthened.*—If a class life is lengthened under subsection .02 or .03(a) of this section, it shall be lengthened only for a taxable year for which (1) the reserve ratio test is not met (under the general rule or the transition rule for applying the test), and (2) the class life used cannot be justified on the basis of all the facts and circumstances. The class life shall not be lengthened for any earlier taxable year. If a class life is lengthened under subsection .03(b) of this section, it shall be lengthened only for a taxable year for which the class life used cannot be justified on the basis of all the facts and circumstances.

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the taxpayer in subsequent taxable years if his retirement and replacement practices thereafter are consistent with the use of that class life. However, if the test is not met and consistency cannot be demonstrated by all the facts and circumstances, the class life may be further lengthened under subsection .02 or .03(a) of this section for the same taxable year for which the class life was lengthened under subsection .03(b) of this section.

PART III.—THE RESERVE RATIO TABLE AND THE ADJUSTMENT TABLE FOR CLASS LIVES AND INSTRUCTIONS FOR THEIR USE

SECTION 1. IN GENERAL.

Part II of this Revenue Procedure utilizes a reserve ratio test in a number of instances. A reserve ratio is the ratio of the depreciation reserves for the assets in any guideline class to the basis [19] of those assets. The reserve ratio test is an objective technique which can be used to demonstrate that the retirement and replacement practices being followed by a taxpayer with respect to a guideline class are consistent with the class life being used. A taxpayer's reserve ratio also can be used to show that he is entitled to use a shorter class life than he has used in the past.

The reserve ratio test is made by comparing a taxpayer's reserve ratio for a guideline class with an appropriate reserve ratio range. Table 2 (Reserve Ratio Table) is used to select the appropriate reserve ratio range. Table 3 (Adjustment Table for Class Lives) is used to determine an adjustment in the class life used by a taxpayer where an adjustment based on the table is indicated under Part II of this Revenue Procedure.

SEC. 2. INSTRUCTIONS FOR APPLYING THE RESERVE RATIO TABLE.

The following rules are to be used in applying the Reserve Ratio Table:

.01 *Computation of taxpayer's reserve ratio.*—The first step in applying the Reserve Ratio Table is to compute the taxpayer's reserve ratio for a guideline class. The reserve ratio is computed by dividing the total depreciation reserves for all the assets in that class (at the close of the taxable year) by the total basis of all those assets (at the close of that year).[20] For this purpose, however, if any portion of the basis of any asset in a guideline class is subject to amortization under sections 168 or 169 of the 1954 Code (or corresponding provisions of prior law) or is recovered by means of the additional first-year depreciation allowance provided by section 179 of the 1954 Code, that portion shall be excluded from the total basis of all the assets in the class and any amortization or depreciation deducted with respect to that portion shall be excluded from the total depreciation reserves for the class.

[19] The term "basis" as used in this Revenue Procedure means cost or other basis, adjusted only as provided in section 1016(a)(1).

[20] If the basis and depreciation reserve attributable to any asset in a guideline class have been removed from the asset and reserve accounts but the asset is still being used in the taxpayer's trade or business, that basis and depreciation reserve are to be taken into account in computing the taxpayer's reserve ratio for the class.

If any multiple-asset account maintained by the taxpayer overlaps two or more guideline classes, the taxpayer should provide sufficient information to enable the portion of the depreciation reserve for that account which is attributable to assets falling within each guideline class to be determined with reasonable accuracy, considering the circumstances of the particular case.

.02 *Selecting the appropriate reserve ratio range.*—The second step in applying the Reserve Ratio Table is to select the appropriate reserve ratio range from the table. To identify the appropriate reserve ratio range for a guideline class, it is necessary to know (a) the method of depreciation being used for the assets in the guideline class, (b) the test life for the class, and (c) the rate of growth for the class.

(a) *Method of Depreciation.*—The method of depreciation used for the assets in a guideline class means the method actually used by the taxpayer in computing depreciation for tax purposes with respect to those assets, such as the straight-line method, the double-declining balance method, the 150-percent declining balance method, or the sum-of-the-years digits method. See subsection .03 of this section where a taxpayer uses more than one method of depreciation with respect to assets falling within a single guideline class.

(b) *Determining the test life.*—The test life [21] for a guideline class is to be determined under the following rules:

(1) *Class life equal to or longer than the guideline life.*—Where the class life used by a taxpayer is equal to or longer than the guideline life for a guideline class, the test life is the guideline life for that class, unless subparagraph (4) of this paragraph applies.

(2) *Class life equal to or longer than life previously justified.*—Where the class life used by a taxpayer is equal to or longer than the life justified for a guideline class in a preceding taxable year under section 3.02, 3.03, or 3.04 of Part II of this Revenue Procedure or under presently established procedures, the test life is the previously justified life, unless subparagraph (4) of this paragraph applies.

(3) *Class life not previously justified.*—Where the class life used by a taxpayer is shorter than the guideline life for a guideline class and has not previously been justified—

(A) for purposes of section 3.02(a) of Part II of this Revenue Procedure (class life justified by reference to its prior use), the test life is the class life used in the taxable year under examination;

(B) for purposes of section 3.03(a) of Part II of this Revenue Procedure (class life justified by prior retirement and replacement practices), the test life is the class life used for the taxable year immediately preceding the taxable year under examination.

(4) *Lengthened class life.*—Where the class life used by a taxpayer has been lengthened under section 6 of Part II of

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[21] The class life used by a taxpayer may vary from year to year. If there are variations, the representative class life for applying the Reserve Ratio Table would be the average class life used by the taxpayer over a period of years. To avoid any difficulties that may be encountered in computing this average, paragraph (b) of this subsection provides test lives which should be used in various situations to select the appropriate reserve ratio range. Generally, the suggested test life is slightly more favorable to the taxpayer than an average of class lives used over a period of years. However, if a taxpayer is using the sum-of-the-years digits method of depreciation, an average of class lives may in certain instances be more favorable than the suggested test life. A taxpayer therefore has the option of using an average of the class lives used for a guideline class for the three taxable years preceding the taxable year under examination in lieu of the otherwise prescribed test life.

this Revenue Procedure, the test life is the life to which the class life was lengthened.

(c) *Determining the rate of growth*[22] *for a guideline class.*—The rate of growth for a guideline class may be determined from the Rate of Growth Conversion Table (Table 1). To use that table, it is necessary to know (1) the asset ratio for the guideline class, and (2) the class life period for that class.

(1) *The asset ratio.*—The asset ratio for a guideline class is computed by dividing the total basis of all the assets in the class at the close of the taxable year for which the rate of growth is being determined (referred to hereinafter as the growth rate year) by the total basis of all the assets in the class at the close of the taxable year ending one class life period earlier (referred to hereinafter as the base year).[23]

(2) *The class life period.*—The class life period for a guideline class is a period of years equal to the class life used by the taxpayer for the class for the growth rate year.[24] Thus, if the class life used by the taxpayer for a guideline class for the growth rate year is 10 years, the class life period for that class is 10 years and the base year is the 10th taxable year preceding the growth rate year. However, see subparagraph (3) if the base year falls before the first taxable year to which this Revenue Procedure applies.

(3) *Substitute class life period.*—To compute the asset ratio for a guideline class, it is necessary to know the total basis of the assets in that class at the close of both the base year and the growth rate year. Records adequate for this purpose may not be available for some taxable years preceding the date of publication of this Revenue Procedure. Therefore, if a base year with respect to a guideline class is a taxable year for which the income tax return was due to be filed before July 12, 1962, and the taxpayer does not have sufficient information to determine the total basis of the assets in that class at the close of that taxable year, then the earliest taxable year for which sufficient information is available may be used as the base year provided that (1) such substitute base year is not later than the first taxable year to which this Revenue Procedure applies, and (2) there are at least 2 taxable years intervening between such year and the growth rate year.[25] In this case, the period of years

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[22] Technically, the rate of growth for a guideline class is the average annual compounded percentage increase in the total basis of the assets in the class measured from the close of a base year to the close of the growth rate year.

[23] If a taxpayer does not maintain sufficient records to enable the rate of growth to be computed for a guideline class, the reserve ratio test cannot be applied. Consequently, whether the taxpayer's retirement and replacement practices are consistent with the class life being used would have to be determined on the basis of all the facts and circumstances.

[24] Where a taxpayer's guideline class has a history equal in years to less than the class life period (as, for example, in the case of a new taxpayer), the class life period will be considered to be the period of years between the close of the first taxable year of the guideline class and the close of the growth rate year, provided that there are at least 2 taxable years intervening between the first year and the growth rate year. Since a rate of growth cannot be computed for the first 3 taxable years of a taxpayer's guideline class, the reserve ratio test will be considered to be met during that period.

[25] Since the reserve ratio test is considered to be met for the first 3 taxable years to which this Revenue Procedure applies, it will generally not be necessary to compute the rate of growth during this period. However, if a taxpayer's reserve ratio for a guide-

between the close of the substitute base year and the close of the growth rate year shall be considered as the class life period for the purpose of applying the Rate of Growth Conversion Table.

(d) *Selecting the appropriate reserve ratio range.*—After the test life and the rate of growth have been determined for a guideline class, the appropriate reserve ratio range for that class is to be selected from the Reserve Ratio Table, using (1) the method of depreciation used by the taxpayer for the class, (2) the test life set forth in the table which is closest to the test life determined for the class, and (3) the rate of growth for the class. The reserve ratio range so determined will consist of an appropriate reserve ratio, and upper and lower limits of a range for acceptable reserve ratios.

.03 *Special rule where different methods of depreciation are used for assets falling within a single guideline class.*—If a taxpayer uses two or more different methods of depreciation with respect to assets falling within a guideline class, the appropriate reserve ratio range for that class is the weighted average of the separate reserve ratio ranges determined for the different methods of depreciation. The separate reserve ratio range for each method of depreciation is determined in accordance with subsection .02 of this section, using the test life and rate of growth for the entire guideline class in connection with each method.

(a) *The upper limit.*—The upper limit of the weighted average of these separate ranges is computed as follows:

(1) multiply the upper limit of each separate reserve ratio range determined for a separate method of depreciation by a fraction, the numerator of which is the total basis of the assets in the guideline class as to which that method of depreciation was used and the denominator of which is the total basis of all the assets in that class; and

(2) total the resulting figures.

(b) *The lower limit.*—The lower limit of the weighted average of these separate ranges is computed in like manner.

SEC. 3. INSTRUCTIONS FOR APPLYING ADJUSTMENT TABLE FOR CLASS LIVES.

.01 *In general.*—Where the rules contained in Part II of this Revenue Procedure indicate that a shorter class life used by a taxpayer may be justified by reference to the Adjustment Table for Class Lives, or that a class life used by a taxpayer should be lengthened in accordance with that Table, the appropriate class life is to be determined from Table 3.

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line class exceeds the upper limit of the appropriate reserve ratio range in the fourth taxable year to which this Revenue Procedure applies, it will be necessary to determine the rate of growth for that class for the 3 preceding taxable years in order to apply the transition rule set forth in section 5.03 of Part II. These determinations unavoidably require information respecting base years before the effective date of this Revenue Procedure. If a taxpayer does not have sufficient information to determine rates of growth for these 3 preceding taxable years, the appropriate reserve ratio range for these taxable years will be considered to be the same as the appropriate range for the fourth taxable year to which this Revenue Procedure applies.

In one situation, it will be necessary to compute the rate of growth for one of the first 3 taxable years to which this Revenue Procedure applies. This is where a taxpayer is seeking to justify a class life shorter than the guideline life under section 3.03(a) of Part II of this Revenue Procedure for one of those taxable years.

.02 *Using Adjustment Table to justify shorter class life.*—Where a shorter class life than used in preceding taxable years is to be justified on the basis of the Adjustment Table for Class Lives (see section 3.03(a) of Part II of this Revenue Procedure), the shortest class life that can be so justified may be found in the second column in the Table, opposite the class life used by the taxpayer for the year immediately preceding the taxable year under examination.

.03 *Using Adjustment Table to lengthen a class life.*—Where a class life used by a taxpayer is to be lengthened under section 6.02 or 6.03(a) of Part II of this Revenue Procedure, the class life to which the life used by the taxpayer should be lengthened may be found in the fourth column in the Adjustment Table for Class Lives, opposite the appropriate 3-year average class life. The 3-year average class life is determined by adding the class lives used by the taxpayer for the taxable year under examination and the 2 preceding taxable years and dividing the resulting total by 3.[26]

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[26] Since the class life used by a taxpayer for a guideline class may vary from year to year, a 3-year average is used to insure that the life used in applying the Adjustment Table is representative.

TABLE 1.—*Rate of Growth Conversion Table*

In the appropriate class life period column, find the figure which most closely approximates the asset ratio.[1] The corresponding rate of growth will appear in the marginal columns.

Rates of growth (percent)	Class life period (years)																Rates of growth (percent)
	3	4	5	6	7	8	9	10	11	12	13	14	15	16	18	20	
−5	0.86	0.82	0.77	0.74	0.70	0.66	0.63	0.60									−5
−4	.88	.85	.82	.78	.75	.72	.69	.66	0.64	0.61	0.59	0.56	0.54	0.52	0.48	0.44	−4
−3	.91	.88	.86	.83	.81	.78	.76	.74	.72	.69	.67	.65	.63	.61	.58	.54	−3
−2	.94	.92	.90	.89	.87	.85	.83	.82	.80	.78	.77	.75	.74	.72	.70	.67	−2
−1	.97	.96	.95	.94	.93	.92	.91	.90	.90	.89	.88	.87	.86	.85	.84	.82	−1
0	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	0
1	1.03	1.04	1.05	1.06	1.07	1.08	1.09	1.10	1.12	1.13	1.14	1.15	1.16	1.17	1.20	1.22	1
2	1.06	1.08	1.10	1.13	1.15	1.17	1.20	1.22	1.24	1.27	1.29	1.32	1.35	1.37	1.43	1.49	2
3	1.09	1.13	1.16	1.19	1.23	1.27	1.30	1.34	1.38	1.43	1.47	1.51	1.56	1.60	1.70	1.81	3
4	1.12	1.17	1.22	1.26	1.32	1.37	1.42	1.48	1.54	1.60	1.66	1.73	1.80	1.87	2.03	2.19	4
5	1.16	1.22	1.28	1.34	1.41	1.48	1.55	1.63	1.71	1.80	1.89	1.98	2.08	2.18	2.41	2.65	5
6	1.19	1.26	1.34	1.42	1.50	1.59	1.69	1.79	1.90	2.01	2.13	2.26	2.40	2.54	2.85	3.21	6
7	1.22	1.31	1.40	1.50	1.61	1.72	1.84	1.97	2.10	2.25	2.41	2.58	2.76	2.95	3.38	3.87	7
8	1.26	1.36	1.47	1.59	1.71	1.85	2.00	2.16	2.33	2.52	2.72	2.94	3.17	3.43	4.00	4.66	8
9	1.30	1.41	1.54	1.68	1.83	1.99	2.17	2.37	2.58	2.81	3.07	3.34	3.64	3.97	4.72	5.60	9
10	1.33	1.46	1.61	1.77	1.95	2.14	2.36	2.59	2.85	3.14	3.45	3.80	4.18	4.60	5.56	6.73	10
11	1.37	1.52	1.68	1.87	2.08	2.30	2.56	2.84	3.15	3.50	3.88	4.31	4.78	5.31	6.54	8.06	11
12	1.40	1.57	1.76	1.97	2.21	2.48	2.77	3.11	3.48	3.90	4.36	4.89	5.47	6.13	7.69	9.65	12
13	1.44	1.63	1.84	2.08	2.35	2.66	3.00	3.40	3.84	4.34	4.90	5.54	6.25	7.07	9.02	11.52	13
14	1.48	1.69	1.92	2.20	2.50	2.85	3.25	3.71	4.23	4.82	5.49	6.26	7.14	8.14	10.58	13.74	14
15	1.52	1.75	2.01	2.31	2.66	3.06	3.52	4.05	4.65	5.35	6.15	7.08	8.14	9.36	12.38	16.37	15
16	1.56	1.81	2.10	2.44	2.83	3.28	3.80	4.41	5.12	5.94	6.89	7.99	9.27	10.75	14.46	19.46	16
17	1.60	1.87	2.19	2.56	3.00	3.51	4.11	4.81	5.62	6.58	7.70	9.01	10.54	12.33	16.88	23.11	17
18	1.64	1.94	2.29	2.70	3.18	3.76	4.44	5.23	6.18	7.29	8.60	10.15	11.97	14.13	19.67	27.39	18
19	1.68	2.00	2.39	2.84	3.38	4.02	4.78	5.70	6.78	8.06	9.60	11.42	13.59	16.17	22.90	32.43	19
20	1.73	2.07	2.49	2.99	3.58	4.30	5.16	6.19	7.43	8.92	10.70	12.84	15.41	18.49	26.62	38.34	20

See notes on page 445.

TABLE 1.—*Rate of Growth Conversion Table*—Continued

In the appropriate class life period column, find the figure which most closely approximates the asset ratio.[1] The corresponding rate of growth will appear in the marginal columns.

Rates of growth (percent)	Class life period (years)																Rates of growth (percent)
	22	24	25	26	28	30	32	34	36	38	40	42	44	46	48	50	
−3	0. 51	0. 48	0. 47	0. 45	0. 43	0. 40	------	------	------	------	------	------	------	------	------	------	−3
−2	. 64	. 62	. 60	. 59	. 57	. 54	0. 52	0. 50	0. 48	0. 46	0. 45	0. 43	0. 41	0. 40	0. 38	0. 36	−2
−1	. 80	. 79	. 78	. 77	. 76	. 74	. 72	. 71	. 70	. 68	. 67	. 66	. 64	. 63	. 62	. 60	−1
0	1. 00	1. 00	1. 00	1. 00	1. 00	1. 00	1. 00	1. 00	1. 00	1. 00	1. 00	1. 00	1. 00	1. 00	1. 00	1. 00	0
1	1. 24	1. 27	1. 28	1. 30	1. 32	1. 35	1. 38	1. 40	1. 43	1. 46	1. 49	1. 52	1. 55	1. 58	1. 61	1. 64	1
2	1. 55	1. 61	1. 64	1. 67	1. 74	1. 81	1. 88	1. 96	2. 04	2. 12	2. 21	2. 30	2. 39	2. 49	2. 59	2. 69	2
3	1. 92	2. 03	2. 09	2. 16	2. 29	2. 43	2. 58	2. 73	2. 90	3. 08	3. 26	3. 46	3. 67	3. 90	4. 13	4. 38	3
4	2. 37	2. 56	2. 67	2. 77	3. 00	3. 24	3. 51	3. 79	4. 10	4. 44	4. 80	5. 19	5. 62	6. 08	6. 57	7. 11	4
5	2. 92	3. 22	3. 39	3. 56	3. 92	4. 32	4. 76	5. 25	5. 79	6. 38	7. 04	7. 76	8. 56	9. 43	10. 40	11. 47	5
6	3. 60	4. 05	4. 29	4. 55	5. 11	5. 74	6. 45	7. 25	8. 15	9. 15	10. 29	11. 56	12. 98	14. 59	16. 39	18. 42	6
7	4. 43	5. 07	5. 43	5. 81	6. 65	7. 61	8. 72	9. 98	11. 42	13. 08	14. 97	17. 14	19. 63	22. 47	25. 73	29. 46	7
8	5. 44	6. 34	6. 85	7. 40	8. 63	10. 06	11. 74	13. 69	15. 97	18. 62	21. 72	25. 34	29. 56	34. 47	40. 21	46. 90	8
9	6. 66	7. 91	8. 62	9. 40	11. 17	13. 27	------	------	------	------	------	------	------	------	------	------	9
10	8. 14	9. 85	10. 84	11. 92	14. 42	17. 45	------	------	------	------	------	------	------	------	------	------	10

[1] The asset ratio for a guideline class is computed by dividing the total basis of all the assets in the class at the close of the taxable year for which the rate of growth is being determined by the total basis of all the assets in the class at the close of the taxable year ending one class life period earlier. See section 2.02(c) of this Part for more complete instructions on computing the asset ratio.

NOTE.—The rate of growth for a guideline class is the average annual compounded percentage increase in the total basis of the assets from the close of a base year to the close of the growth rate year.

TABLE 2.—*Reserve Ratio Table*

Section I: Straight Line Method of Depreciation

Test life (years)	Rate of growth (percent)													Test life (years)
	−5	−4	−3	−2	−1	0	1	2	3	4	5	6	7	
3	51 46–59	51 46–59	51 46–58	50 45–58	50 45–58	50 45–58	50 45–57	50 45–57	49 44–57	49 44–56	49 44–56	49 44–56	48 44–55	3
4	52 46–60	51 46–60	51 46–59	51 45–59	50 45–58	50 45–58	50 45–58	49 45–57	49 44–57	49 44–56	48 44–56	48 44–56	48 43–55	4
5	52 47–61	52 46–61	51 46–60	51 46–59	50 45–59	50 45–58	50 45–58	49 44–57	49 44–57	48 44–56	48 43–56	48 43–55	47 43–55	5
6	52 47–62	52 47–61	52 46–60	51 46–60	51 45–59	50 45–58	50 45–58	49 44–57	49 44–56	48 43–56	48 43–55	47 43–54	47 42–54	6
7	53 47–62	52 47–61	52 46–60	51 46–60	51 45–59	50 45–58	49 45–57	49 44–57	48 44–56	48 43–55	47 43–54	47 42–54	46 42–53	7
8	53 48–63	53 47–62	52 47–61	51 46–60	51 46–59	50 45–58	49 45–57	49 44–57	48 43–56	47 43–55	47 42–54	46 42–53	46 41–52	8
9	54 48–63	53 47–62	52 47–61	52 46–60	51 46–59	50 45–58	49 44–57	48 44–56	48 43–55	47 43–54	46 42–53	46 42–52	45 41–52	9
10	54 48–64	53 48–63	52 47–62	52 46–61	51 46–59	50 45–58	49 44–57	48 44–56	48 43–55	47 42–54	46 42–53	45 41–52	44 40–51	10
11	-------	54 48–63	53 47–62	52 46–61	51 46–60	50 45–58	49 44–57	48 44–56	47 43–55	46 42–54	46 41–52	45 41–51	44 40–50	11
12	-------	54 48–63	53 47–62	52 47–61	51 46–60	50 45–58	49 44–57	48 43–56	47 43–54	46 42–53	45 41–52	44 40–51	43 40–49	12
13	-------	54 48–64	53 48–63	52 47–61	51 46–60	50 45–58	49 44–57	48 43–55	47 42–54	46 42–53	45 41–51	44 40–50	43 39–49	13
14	-------	55 49–65	54 48–63	52 47–61	51 46–60	50 45–58	49 44–57	48 43–55	47 42–54	46 41–52	44 40–51	43 40–49	42 39–48	14
15	-------	55 49–65	54 48–63	52 47–62	51 46–60	50 45–58	49 44–57	48 43–55	46 42–53	45 41–52	44 40–50	43 39–49	42 38–47	15
16	-------	55 49–65	54 48–64	53 47–62	51 46–60	50 45–58	49 44–57	47 43–55	46 42–53	45 41–51	44 40–50	42 39–48	41 38–46	16
18	-------	56 50–66	55 49–65	53 47–63	52 46–60	50 45–58	49 44–56	47 43–54	46 41–53	44 40–51	43 39–49	41 38–47	40 37–45	18
20	-------	57 50–67	55 49–65	53 48–63	52 46–61	50 45–58	48 44–56	47 42–54	45 41–52	44 40–50	42 38–48	40 37–46	39 36–44	20

See note on page 458.

TABLE 2.—*Reserve Ratio Table*—Continued

Section I: Straight Line Method of Depreciation—Continued

Test life (years)	Rate of growth (percent)													Test life (years)
	8	9	10	11	12	13	14	15	16	17	18	19	20	
3	48 44–55	48 43–55	48 43–55	48 43–54	48 43–54	47 43–54	47 43–54	47 42–53	47 42–53	47 42–53	46 42–52	46 42–52	46 42–52	3
4	48 43–55	47 43–54	47 43–54	47 42–54	47 42–53	46 42–53	46 42–52	46 42–52	45 41–52	45 41–51	45 41–51	45 41–51	44 40–50	4
5	47 43–54	47 42–54	46 42–53	46 41–53	46 41–52	45 41–52	45 41–51	45 41–51	44 40–50	44 40–50	44 40–49	43 39–49	43 39–49	5
6	46 42–53	46 42–53	45 41–52	45 41–51	45 41–51	44 40–50	44 40–50	43 40–49	43 39–49	42 39–48	42 39–48	42 38–47	41 38–46	6
7	46 41–52	45 41–52	45 41–51	44 40–50	44 40–50	43 39–49	43 39–48	42 39–48	42 38–47	41 38–46	41 38–46	40 37–45	40 37–45	7
8	45 41–52	44 40–51	44 40–50	43 40–49	43 39–48	42 39–48	42 38–47	41 38–46	40 37–45	40 37–45	39 36–44	39 36–43	38 36–43	8
9	44 40–51	44 40–50	43 39–49	42 39–48	42 38–47	41 38–46	40 37–46	40 37–45	39 36–44	39 36–43	38 35–42	38 35–42	37 34–41	9
10	44 40–50	43 39–49	42 39–48	42 38–47	41 38–46	40 37–45	39 36–44	39 36–43	38 35–42	38 35–42	37 34–41	36 34–40	36 33–39	10
11	43 39–49	42 39–48	42 38–47	41 37–46	40 37–45	39 36–44	38 36–43	38 35–42	37 34–41	36 34–40	36 33–39	35 33–38	34 32–38	11
12	43 39–48	42 38–47	41 37–46	40 37–45	39 36–44	38 35–43	38 35–42	37 34–41	36 34–40	35 33–39	35 32–38	34 32–37	33 31–36	12
13	42 38–47	41 38–46	40 37–45	39 36–44	38 35–42	37 35–41	36 34–40	36 33–39	35 33–38	34 32–37	33 31–36	33 31–35	32 30–34	13
14	41 38–47	40 37–45	39 36–44	38 35–43	37 35–41	36 34–40	36 33–39	35 33–38	34 32–37	33 31–36	32 30–35	32 30–34	31 29–33	14
15	41 37–46	40 36–44	39 36–43	38 35–42	37 34–40	36 33–39	35 32–38	34 32–37	33 31–36	32 30–35	31 30–34	30 29–33	30 28–32	15
16	40 37–45	39 36–44	38 35–42	37 34–41	36 33–39	35 33–38	34 32–37	33 31–36	32 30–34	31 29–33	30 29–32	29 28–31	29 27–30	16
18	39 36–43	38 35–42	36 34–40	35 33–39	34 32–37	33 31–36	32 30–35	31 29–33	30 29–32	29 28–31	28 27–30	28 26–29	27 26–28	18
20	38 35–42	36 34–40	35 33–38	34 32–37	33 31–35	32 30–34	30 29–32	29 28–31	28 27–30	27 26–29	26 26–28	26 25–27	25 24–26	20

See note on page 458.

TABLE 2.—*Reserve Ratio Table*—Continued

Section I: Straight Line Method of Depreciation—Continued

Test life (years)	Rate of growth (percent)														Test life (years)
	−3	−2	−1	0	1	2	3	4	5	6	7	8	9	10	
22	56 49–66	54 48–63	52 47–61	50 45–58	48 44–56	46 42–54	45 41–51	43 39–49	41 38–47	40 37–44	38 35–42	37 34–40	35 33–39	34 32–38	22
24	56 50–66	54 48–64	52 47–61	50 45–58	48 43–56	46 42–53	44 40–50	42 39–48	40 37–46	39 36–43	37 34–41	35 33–39	34 32–37	33 31–35	24
25	56 50–67	54 48–64	52 47–61	50 45–58	48 43–56	46 42–53	44 40–50	42 38–48	40 37–45	38 35–43	37 34–40	35 33–38	33 31–36	32 30–34	25
26	56 50–67	54 48–64	52 47–61	50 45–58	48 43–55	46 42–53	44 40–50	42 38–47	40 37–44	38 35–42	36 34–40	34 32–38	33 31–35	31 30–34	26
28	57 51–67	55 49–64	52 47–61	50 45–58	48 43–55	45 41–52	43 39–49	41 38–46	39 36–44	37 34–41	35 33–38	33 31–36	32 30–34	30 28–32	28
30	57 51–68	55 49–65	53 47–62	50 45–58	48 43–55	45 41–52	43 39–49	40 37–46	38 35–43	36 34–40	34 32–37	32 30–35	31 29–33	29 28–31	30
32	-------	55 49–65	53 47–62	50 45–58	47 43–55	45 41–51	42 39–48	40 37–45	38 35–42	35 33–39	33 31–36	31 30–34	-------	-------	32
34	-------	55 50–66	53 47–62	50 45–58	47 43–54	44 40–51	42 38–47	39 36–44	37 34–41	34 32–38	32 30–35	30 29–33	-------	-------	34
36	-------	56 50–66	53 47–62	50 45–58	47 43–54	44 40–50	41 38–47	39 36–43	36 34–40	34 32–37	32 30–34	29 28–31	-------	-------	36
38	-------	56 50–67	53 48–62	50 45–58	47 42–54	44 40–50	41 38–46	38 35–42	35 33–39	33 31–36	31 29–33	28 27–30	-------	-------	38
40	-------	57 50–67	53 48–63	50 45–58	47 42–54	44 40–50	40 37–46	37 35–42	35 33–38	32 30–35	30 28–32	28 26–29	-------	-------	40
42	-------	57 51–68	54 48–63	50 45–58	46 42–54	43 39–49	40 37–45	37 34–41	34 32–37	31 30–34	29 28–31	27 26–28	-------	-------	42
44	-------	57 51–68	54 48–63	50 45–58	46 42–53	43 39–49	40 36–44	36 34–40	33 31–36	31 29–33	28 27–30	26 25–27	-------	-------	44
46	-------	58 51–68	54 48–63	50 45–58	46 42–53	42 39–48	39 36–44	36 33–39	33 31–36	30 28–32	28 26–29	25 24–26	-------	-------	46
48	-------	58 51–69	54 48–64	50 45–58	46 42–53	42 39–48	39 36–43	35 33–39	32 30–35	29 28–31	27 26–28	24 24–26	-------	-------	48
50	-------	58 52–69	54 48–64	50 45–58	46 42–53	42 38–48	38 35–42	35 32–38	31 30–34	29 27–30	26 25–27	24 23–25	-------	-------	50

See note on page 458.

TABLE 2.—*Reserve Ratio Table*—Continued

Section II: Double Declining Balance Method of Depreciation

Test life (years)	Rate of growth (percent)													Test life (years)
	−5	−4	−3	−2	−1	0	1	2	3	4	5	6	7	
3	69 **65–74**	69 **65–73**	68 **65–73**	68 **65–73**	68 **64–73**	68 **64–72**	68 **64–72**	68 **64–72**	67 **64–72**	67 **64–71**	67 **63–71**	67 **63–71**	67 **63–71**	3
4	66 **63–71**	66 **62–71**	66 **62–71**	65 **62–70**	65 **62–70**	65 **61–70**	65 **61–69**	64 **61–69**	64 **61–69**	64 **61–68**	64 **60–68**	63 **60–68**	63 **60–67**	4
5	65 **61–70**	65 **61–70**	64 **61–70**	64 **60–69**	64 **60–69**	63 **60–68**	63 **60–68**	62 **59–67**	62 **59–67**	62 **59–67**	61 **58–66**	61 **58–66**	61 **58–65**	5
6	64 **61–70**	64 **60–69**	63 **60–69**	63 **59–68**	62 **59–68**	62 **59–67**	62 **59–67**	61 **58–66**	61 **58–66**	60 **57–65**	60 **57–65**	60 **57–64**	59 **56–64**	6
7	64 **60–69**	63 **60–69**	63 **59–68**	62 **59–68**	62 **58–67**	61 **58–66**	61 **58–66**	60 **57–65**	60 **57–65**	59 **56–64**	59 **56–63**	58 **56–63**	58 **55–62**	7
8	63 **60–69**	63 **59–68**	62 **59–68**	62 **58–67**	61 **58–66**	61 **57–66**	60 **57–65**	60 **56–64**	59 **56–64**	59 **56–63**	58 **55–62**	57 **55–62**	57 **54–61**	8
9	63 **60–69**	63 **59–68**	62 **59–68**	61 **58–67**	61 **58–66**	60 **57–65**	60 **56–65**	59 **56–64**	58 **55–63**	58 **55–62**	57 **54–62**	56 **54–61**	56 **53–60**	9
10	63 **60–69**	63 **59–68**	62 **58–68**	61 **58–67**	60 **57–66**	60 **57–65**	59 **56–64**	58 **56–63**	58 **55–63**	57 **54–62**	56 **54–61**	56 **53–60**	55 **53–59**	10
11	-------	63 **59–68**	62 **58–68**	61 **58–67**	60 **57–66**	60 **56–65**	59 **56–64**	58 **55–63**	57 **54–62**	57 **54–61**	56 **53–60**	55 **52–59**	54 **52–58**	11
12	-------	63 **59–68**	62 **58–68**	61 **58–67**	60 **57–66**	59 **56–65**	59 **55–64**	58 **55–63**	57 **54–62**	56 **53–61**	55 **53–60**	55 **52–59**	54 **51–58**	12
13	-------	63 **59–69**	62 **58–68**	61 **58–67**	60 **57–65**	59 **56–64**	58 **55–63**	57 **54–62**	56 **54–61**	56 **53–60**	55 **52–59**	54 **51–58**	53 **51–57**	13
14	-------	63 **59–69**	62 **58–68**	61 **57–67**	60 **57–65**	59 **56–64**	58 **55–63**	57 **54–62**	56 **53–61**	55 **52–60**	54 **52–58**	53 **51–57**	52 **50–56**	14
15	-------	63 **59–69**	62 **58–68**	61 **57–67**	60 **56–65**	59 **56–64**	58 **55–63**	57 **54–62**	56 **53–60**	55 **52–59**	54 **51–58**	53 **50–57**	52 **49–55**	15
16	-------	63 **59–69**	62 **58–68**	61 **57–67**	60 **56–65**	59 **56–64**	58 **55–63**	57 **54–61**	55 **53–60**	54 **52–59**	53 **51–57**	52 **50–56**	51 **49–55**	16
18	-------	63 **60–70**	62 **59–68**	61 **57–67**	60 **56–65**	58 **55–64**	57 **54–62**	56 **53–61**	55 **52–59**	54 **51–58**	52 **50–56**	51 **49–55**	50 **48–53**	18
20	-------	64 **60–70**	62 **59–68**	61 **58–67**	60 **56–65**	58 **55–64**	57 **54–62**	56 **53–60**	54 **52–59**	53 **50–57**	52 **49–55**	50 **48–54**	49 **47–52**	20

See note on page 458.

TABLE 2.—*Reserve Ratio Table*—Continued

Section II: Double Declining Balance Method of Depreciation—Continued

Test life (years)	Rate of growth (percent)													Test life (years)
	8	9	10	11	12	13	14	15	16	17	18	19	20	
3	66 **63–71**	66 **63–70**	66 **63–70**	66 **62–70**	66 **62–70**	66 **62–69**	65 **62–69**	65 **62–69**	65 **62–69**	65 **62–69**	65 **61–68**	64 **61–68**	64 **61–68**	3
4	63 **60–67**	62 **59–67**	62 **59–67**	62 **59–66**	62 **59–66**	62 **58–66**	61 **58–65**	61 **58–65**	61 **58–65**	61 **58–64**	60 **57–64**	60 **57–64**	60 **57–64**	4
5	61 **58–65**	60 **57–65**	60 **57–64**	60 **57–64**	59 **56–64**	59 **56–63**	59 **56–63**	58 **56–62**	58 **55–62**	58 **55–62**	57 **55–61**	57 **54–61**	57 **54–61**	5
6	59 **56–63**	58 **56–63**	58 **55–62**	58 **55–62**	57 **55–61**	57 **54–61**	56 **54–60**	56 **54–60**	56 **53–60**	56 **53–59**	55 **53–59**	55 **52–58**	54 **52–58**	6
7	58 **55–62**	57 **54–61**	57 **54–61**	56 **54–60**	56 **53–60**	55 **53–59**	55 **52–58**	54 **52–58**	54 **52–57**	54 **51–57**	53 **51–56**	53 **50–56**	52 **50–55**	7
8	56 **54–61**	56 **53–60**	55 **53–59**	55 **52–59**	54 **52–58**	54 **52–58**	53 **51–57**	53 **51–56**	52 **50–56**	52 **50–55**	51 **49–55**	51 **49–54**	50 **49–54**	8
9	55 **53–59**	55 **52–59**	54 **52–58**	54 **51–57**	53 **51–57**	52 **50–56**	52 **50–55**	51 **49–55**	51 **49–54**	50 **48–53**	50 **48–53**	49 **48–52**	49 **47–52**	9
10	54 **52–58**	54 **51–58**	53 **51–57**	53 **50–56**	52 **50–55**	51 **49–55**	51 **49–54**	50 **48–53**	50 **48–52**	49 **47–52**	48 **47–51**	48 **46–50**	47 **46–50**	10
11	54 **51–58**	53 **50–57**	52 **50–56**	52 **49–55**	51 **49–54**	50 **48–53**	50 **48–52**	49 **47–52**	48 **46–51**	48 **46–50**	47 **45–49**	46 **45–49**	46 **44–48**	11
12	53 **50–57**	52 **50–56**	51 **49–55**	51 **49–54**	50 **48–53**	49 **47–52**	48 **47–51**	48 **46–50**	47 **45–50**	46 **45–50**	46 **44–48**	45 **44–47**	44 **43–46**	12
13	52 **50–56**	51 **49–55**	50 **48–54**	50 **48–53**	49 **47–52**	48 **46–51**	47 **46–50**	47 **45–49**	46 **44–48**	45 **44–47**	44 **43–46**	44 **42–46**	43 **42–45**	13
14	51 **49–55**	51 **48–54**	50 **48–53**	49 **47–52**	48 **46–51**	47 **45–50**	46 **45–49**	46 **44–48**	45 **43–47**	44 **42–46**	43 **42–45**	42 **41–44**	42 **41–43**	14
15	51 **49–54**	50 **48–53**	49 **47–52**	48 **46–51**	47 **45–50**	46 **44–49**	45 **44–48**	44 **43–47**	44 **42–46**	43 **42–45**	42 **41–44**	41 **40–43**	41 **40–42**	15
16	50 **48–53**	49 **47–52**	48 **46–51**	47 **45–50**	46 **45–49**	45 **44–48**	44 **43–46**	44 **42–45**	43 **41–44**	42 **41–43**	41 **40–42**	40 **39–42**	39 **38–41**	16
18	49 **47–52**	48 **46–51**	47 **45–49**	46 **44–48**	45 **43–47**	44 **42–45**	43 **41–44**	42 **40–43**	41 **40–42**	40 **39–41**	39 **38–40**	38 **37–39**	37 **36–38**	18
20	48 **46–50**	46 **45–49**	45 **44–48**	44 **43–46**	43 **42–45**	42 **41–44**	41 **40–42**	40 **39–41**	39 **38–40**	38 **37–39**	37 **36–38**	36 **35–37**	35 **35–36**	20

See note on page 458.

TABLE 2.—*Reserve Ratio Table*—Continued

Section II: Double Declining Balance Method of Depreciation—Continued

Test life (years)	Rate of growth (percent)														Test life (years)
	−3	−2	−1	0	1	2	3	4	5	6	7	8	9	10	
22	63 59–69	61 58–67	60 56–65	58 55–63	57 54–62	55 52–60	54 51–58	52 50–56	51 48–54	49 47–53	48 46–51	46 45–49	45 44–48	44 42–46	22
24	63 59–69	61 58–67	60 56–65	58 55–63	56 53–61	55 52–59	53 51–57	52 49–55	50 48–53	48 46–51	47 45–50	45 44–48	44 42–46	43 41–44	24
25	63 59–69	61 58–67	60 56–65	58 55–63	56 53–61	55 52–59	53 50–57	51 49–55	50 47–53	48 46–51	46 45–49	45 43–47	43 42–45	42 41–44	25
26	63 59–69	61 58–67	60 56–65	58 55–63	56 53–61	54 52–59	53 50–57	51 48–55	49 47–52	48 46–50	46 44–48	44 43–46	43 41–45	41 40–43	26
28	63 60–70	62 58–68	60 56–65	58 55–63	56 53–61	54 51–58	52 50–56	50 48–54	48 46–52	47 45–49	45 43–47	43 42–45	42 40–43	40 39–42	28
30	64 60–70	62 58–68	60 56–66	58 55–63	56 53–61	54 51–58	52 49–56	50 48–53	48 46–51	46 44–48	44 42–46	42 41–44	40 39–42	39 38–40	30
32	-------	62 58–68	60 56–66	58 55–63	56 53–60	53 51–58	51 49–55	49 47–52	47 45–50	45 43–47	43 42–45	41 40–43	-------	-------	32
34	-------	62 58–68	60 57–66	58 54–63	55 52–60	53 50–57	51 48–54	48 46–52	46 45–49	44 43–46	42 41–44	40 39–42	-------	-------	34
36	-------	62 59–69	60 57–66	58 54–63	55 52–60	53 50–57	50 48–54	48 46–51	46 44–48	43 42–45	41 40–43	39 38–41	-------	-------	36
38	-------	63 59–69	60 57–66	58 54–63	55 52–60	52 50–56	50 48–53	47 45–50	45 43–47	43 41–44	40 39–42	38 37–40	-------	-------	38
40	-------	63 59–69	60 57–66	58 54–63	55 52–60	52 50–56	49 47–53	47 45–50	44 43–46	42 41–44	40 39–41	38 37–39	-------	-------	40
42	-------	63 59–71	60 57–66	58 54–64	55 52–60	52 49–56	49 47–53	46 44–49	44 42–46	41 40–43	39 38–40	37 36–38	-------	-------	42
44	-------	63 59–70	60 57–66	57 54–63	54 52–59	51 49–55	48 46–52	46 44–48	43 42–45	40 39–42	38 37–39	36 35–37	-------	-------	44
46	-------	64 60–70	60 57–66	57 54–63	54 52–59	51 49–55	48 46–51	45 43–48	42 41–44	40 38–41	37 36–38	35 34–36	-------	-------	46
48	-------	64 60–70	61 57–67	57 54–63	54 51–59	51 48–54	48 46–51	44 43–47	42 40–43	39 38–40	36 36–37	34 34–35	-------	-------	48
50	-------	64 60–70	61 57–67	57 54–63	54 51–58	50 48–54	47 45–50	44 42–46	41 40–43	38 37–40	36 35–37	33 33–34	-------	-------	50

See note on page 458.

TABLE 2.—*Reserve Ratio Table*—Continued

Section III: Sum of the Years-Digits Method of Depreciation

Test life (years)	Rate of growth (percent)													Test life (years)
	−5	−4	−3	−2	−1	0	1	2	3	4	5	6	7	
3	62 57–68	62 57–68	62 57–68	62 57–68	61 57–67	61 57–67	61 56–67	61 56–66	60 56–66	60 56–66	60 56–66	60 55–65	60 55–65	3
4	64 60–70	64 59–70	63 59–70	63 59–69	63 58–69	63 58–69	62 58–68	62 58–68	62 57–67	61 57–67	61 57–67	61 57–66	60 56–66	4
5	65 61–72	65 61–71	64 60–71	64 60–70	64 60–70	63 59–69	63 59–69	63 58–69	62 58–68	62 58–68	61 58–67	61 57–67	61 57–66	5
6	66 62–73	66 62–72	65 61–72	65 61–71	64 60–70	64 60–70	63 59–69	63 59–69	62 58–68	62 58–68	62 58–67	61 57–66	61 57–66	6
7	67 63–74	67 62–73	66 62–72	65 61–72	65 61–71	64 60–70	64 60–69	63 59–69	63 59–68	62 58–67	62 58–67	61 57–66	60 57–65	7
8	68 64–74	67 63–74	67 62–73	66 62–72	65 61–71	65 61–70	64 60–70	63 60–69	63 59–68	62 58–67	61 58–67	61 57–66	60 57–65	8
9	69 64–75	68 64–74	67 63–73	66 62–72	66 62–72	65 61–71	64 60–70	63 60–69	63 59–68	62 58–67	61 58–66	60 57–65	60 56–64	9
10	69 65–76	68 64–75	68 63–74	67 63–73	66 62–72	65 61–71	64 61–70	63 60–69	62 59–68	62 58–67	61 58–66	60 57–65	59 56–64	10
11	-------	69 64–75	68 64–74	67 63–73	66 62–72	65 61–71	64 61–70	63 60–69	62 59–68	62 58–67	61 57–66	60 57–65	59 56–63	11
12	-------	69 65–76	68 64–75	67 63–73	66 62–72	65 62–71	64 61–70	63 60–69	62 59–68	61 58–66	60 57–65	59 56–64	58 56–63	12
13	-------	70 65–76	69 64–75	68 63–74	66 62–72	65 62–71	64 61–70	63 60–68	62 59–67	61 58–66	60 57–65	59 56–64	58 55–62	13
14	-------	70 66–77	69 65–78	68 64–74	67 63–73	66 62–71	64 61–70	63 60–68	62 59–67	61 58–66	60 57–64	59 56–63	58 55–62	14
15	-------	70 66–77	69 65–76	68 64–74	67 63–73	66 62–71	64 61–70	63 60–68	62 58–67	61 57–65	59 56–64	58 55–62	57 54–61	15
16	-------	71 67–77	70 65–76	68 64–74	67 63–73	66 62–71	64 61–70	63 60–68	62 58–67	60 57–65	59 56–64	58 55–62	56 54–60	16
18	-------	72 67–78	70 66–77	69 65–75	67 63–73	66 62–71	64 61–70	63 59–68	61 58–66	60 57–64	58 55–63	57 54–61	56 53–59	18
20	-------	72 68–79	71 67–77	69 65–75	68 64–74	66 62–72	64 61–70	63 59–68	61 58–66	59 56–64	58 55–62	56 53–60	54 52–58	20

See note on page 458.

TABLE 2.—*Reserve Ratio Table*—Continued

Section III: Sum of the Years-Digits Method of Depreciation—Continued

Test life (years)	Rate of growth (percent)													Test life (years)
	8	9	10	11	12	13	14	15	16	17	18	19	20	
3	59 **55–65**	59 **55–65**	59 **55–64**	59 **55–64**	59 **54–64**	58 **54–64**	58 **54–63**	58 **54–63**	58 **54–63**	58 **54–63**	57 **53–62**	57 **53–62**	57 **53–62**	3
4	60 **56–66**	60 **56–65**	60 **56–65**	59 **55–64**	59 **55–64**	59 **55–64**	58 **55–63**	58 **54–63**	58 **54–63**	58 **54–62**	57 **54–62**	57 **53–62**	57 **53–61**	4
5	60 **56–66**	60 **56–65**	60 **56–65**	59 **56–64**	59 **55–64**	58 **55–63**	58 **55–63**	58 **54–62**	57 **54–62**	57 **54–62**	57 **54–61**	56 **53–61**	56 **53–60**	5
6	60 **56–65**	60 **56–65**	59 **56–64**	58 **55–64**	58 **55–63**	58 **55–63**	58 **54–62**	57 **54–61**	57 **54–61**	56 **53–60**	56 **53–60**	55 **52–59**	55 **52–59**	6
7	60 **56–65**	59 **56–64**	59 **56–64**	58 **55–63**	58 **55–62**	57 **54–62**	57 **54–61**	56 **53–60**	56 **53–60**	55 **52–59**	55 **52–58**	54 **52–58**	54 **51–57**	7
8	60 **56–64**	59 **56–64**	58 **55–63**	58 **55–62**	57 **54–61**	57 **54–61**	56 **53–60**	55 **53–59**	55 **52–59**	54 **52–58**	54 **51–57**	53 **51–57**	53 **50–56**	8
9	59 **56–64**	58 **55–63**	58 **55–62**	57 **54–61**	56 **54–60**	56 **53–60**	55 **52–59**	54 **52–58**	54 **51–57**	53 **51–56**	52 **50–56**	52 **50–55**	51 **49–54**	9
10	59 **56–63**	58 **55–62**	57 **54–61**	56 **54–60**	56 **53–60**	55 **52–59**	54 **52–58**	53 **51–57**	53 **50–56**	52 **50–55**	51 **49–54**	51 **49–54**	50 **48–53**	10
11	58 **55–62**	57 **54–61**	56 **54–60**	56 **53–59**	55 **52–58**	54 **52–57**	53 **51–56**	52 **50–56**	52 **49–55**	51 **49–54**	50 **48–53**	49 **47–52**	49 **47–51**	11
12	58 **55–62**	57 **54–61**	56 **53–60**	55 **52–58**	54 **52–57**	53 **51–56**	52 **50–55**	51 **49–54**	51 **49–53**	50 **48–52**	49 **47–51**	48 **46–51**	47 **46–50**	12
13	57 **54–61**	56 **53–60**	55 **52–59**	54 **52–58**	53 **51–56**	52 **50–55**	51 **49–54**	50 **48–53**	50 **48–52**	49 **47–51**	48 **46–50**	47 **45–49**	46 **45–48**	13
14	56 **54–60**	55 **53–59**	54 **52–58**	53 **51–57**	52 **50–55**	51 **49–54**	50 **48–53**	49 **48–52**	48 **47–51**	48 **46–50**	47 **45–49**	46 **44–48**	45 **44–47**	14
15	56 **53–60**	55 **52–58**	54 **51–57**	52 **50–56**	51 **49–54**	50 **48–53**	49 **47–52**	48 **46–51**	47 **46–50**	46 **45–48**	45 **44–47**	44 **43–46**	44 **42–45**	15
16	55 **53–59**	54 **52–58**	53 **51–56**	52 **50–55**	51 **49–53**	49 **48–52**	48 **47–51**	47 **46–50**	46 **45–48**	45 **44–47**	44 **43–46**	43 **42–45**	42 **41–44**	16
18	54 **52–58**	53 **51–56**	51 **49–54**	50 **48–53**	49 **47–51**	48 **46–50**	46 **45–49**	45 **44–47**	44 **43–46**	43 **42–45**	42 **41–43**	41 **40–42**	40 **39–41**	18
20	53 **51–56**	51 **49–54**	50 **48–53**	49 **47–51**	47 **46–49**	46 **44–48**	45 **43–46**	43 **42–45**	42 **41–44**	41 **40–42**	40 **39–41**	39 **38–40**	38 **37–39**	20

See note on page 458.

TABLE 2.—*Reserve Ratio Table*—Continued

Section III: Sum of the Years-Digits Method of Depreciation—Continued

Test life (years)	Rate of growth (percent)														Test life (years)
	−3	−2	−1	0	1	2	3	4	5	6	7	8	9	10	
22	71 67–78	70 65–76	68 64–74	66 62–72	64 61–69	62 59–67	60 57–65	59 56–63	57 54–61	55 53–59	53 51–57	52 50–55	50 48–53	49 47–51	22
24	72 68–78	70 66–76	68 64–74	66 62–72	64 60–69	62 59–67	60 57–65	58 55–62	56 54–60	54 52–58	52 50–55	51 49–53	49 47–51	47 46–49	24
25	72 68–79	70 66–76	68 64–74	66 62–72	64 60–69	62 59–67	60 57–64	58 55–62	56 53–59	54 52–57	52 50–55	50 48–53	48 47–50	46 45–48	25
26	72 68–79	70 66–77	68 64–74	66 62–72	64 60–69	62 58–66	60 56–64	57 55–61	55 53–59	53 51–56	51 49–54	49 48–52	48 46–50	46 44–48	26
28	73 68–80	71 66–77	68 64–74	66 62–72	64 60–69	61 58–66	59 56–63	57 54–61	55 52–58	52 50–55	50 48–53	48 46–50	46 45–48	44 43–46	28
30	73 69–80	71 67–77	69 65–75	66 62–72	64 60–69	61 58–66	59 56–63	56 54–60	54 51–57	52 49–54	49 47–52	47 46–49	45 44–47	43 42–45	30
32	-------	71 67–78	69 65–75	66 62–72	64 60–69	61 58–65	58 55–62	56 53–59	53 51–56	51 49–53	48 47–51	46 45–48	-------	-------	32
34	-------	72 67–78	69 65–75	66 62–72	63 60–68	60 57–65	58 55–62	55 53–58	52 50–55	50 48–52	47 46–49	45 44–47	-------	-------	34
36	-------	72 68–78	69 65–75	66 62–72	63 60–68	60 57–65	57 54–61	54 52–58	52 49–54	49 47–51	46 45–48	44 43–45	-------	-------	36
38	-------	72 68–79	69 65–76	66 62–72	63 60–68	60 57–64	57 54–60	54 51–57	51 49–53	48 46–50	45 44–47	43 42–44	-------	-------	38
40	-------	73 68–79	70 66–76	66 63–72	63 60–68	60 57–64	56 54–60	53 51–56	50 48–52	47 46–49	44 43–46	42 41–43	-------	-------	40
42	-------	73 69–80	70 66–76	66 63–72	63 59–68	59 56–64	56 53–59	52 50–55	49 48–52	46 45–48	43 42–45	41 40–42	-------	-------	42
44	-------	73 69–80	70 66–76	66 63–72	63 59–68	59 56–63	55 53–59	52 50–55	48 47–51	45 44–47	42 41–44	40 39–41	-------	-------	44
46	-------	74 69–80	70 66–76	66 63–72	62 59–67	59 56–63	55 52–58	51 49–54	48 46–50	45 43–46	42 41–43	39 38–40	-------	-------	46
48	-------	74 70–81	70 66–76	66 63–72	62 59–67	58 55–62	54 52–58	51 49–53	47 46–49	44 43–45	41 40–42	38 37–39	-------	-------	48
50	-------	74 70–81	70 66–77	66 63–72	62 59–67	58 55–62	54 51–57	50 48–52	46 45–48	43 42–44	40 39–41	37 37–38	-------	-------	50

See note on page 458.

TABLE 2.—*Reserve Ratio Table*—Continued

Section IV: 150 Percent Declining Balance Method of Depreciation

Test life (years)	Rate of growth (percent)													Test life (years)
	−5	−4	−3	−2	−1	0	1	2	3	4	5	6	7	
3	57 **53–63**	57 **53–62**	57 **53–62**	57 **53–62**	56 **53–62**	56 **52–61**	56 **52–61**	56 **52–61**	56 52–61	56 **52–60**	55 **52–60**	55 **52–60**	55 **51–60**	3
4	55 **52–61**	55 **52–61**	55 **51–60**	55 **51–60**	54 **51–60**	54 **51–60**	54 **50–59**	54 **50–59**	53 **50–59**	53 **50–58**	53 **50–58**	53 **49–58**	52 **49–57**	4
5	54 **51–60**	54 **51–60**	54 **50–60**	54 **50–59**	53 **50–59**	53 **50–58**	52 **49–58**	52 **49–58**	52 **49–57**	52 **48–57**	51 **48–56**	51 **48–56**	51 **48–56**	5
6	54 **50–60**	54 **50–59**	53 **50–59**	53 **49–58**	52 **49–58**	52 **49–57**	52 **48–57**	51 **48–56**	51 **48–56**	50 **47–56**	50 **47–55**	50 **47–55**	49 **47–54**	6
7	54 **50–60**	53 **50–59**	53 **49–58**	52 **49–58**	52 **49–57**	52 **48–57**	51 **48–56**	51 **48–56**	50 **47–55**	50 **47–55**	49 **46–54**	49 **46–54**	48 **46–53**	7
8	54 **50–60**	53 **50–59**	53 **49–58**	52 **49–58**	52 **48–57**	51 **48–56**	50 **48–56**	50 **47–55**	50 **47–55**	49 **46–54**	49 **46–53**	48 **45–53**	48 **45–52**	8
9	54 **50–60**	53 **50–59**	52 **49–58**	52 **49–58**	51 **48–57**	51 **48–56**	50 **47–55**	50 **47–55**	49 **46–54**	48 **46–53**	48 **45–53**	47 **45–52**	47 **44–51**	9
10	54 **50–60**	53 **50–59**	52 **49–58**	52 **48–58**	51 **48–57**	50 **47–56**	50 **47–55**	49 **46–54**	49 **46–54**	48 **45–53**	47 **45–52**	47 **44–51**	46 **44–50**	10
11	-------	53 **50–59**	52 **49–58**	52 **48–57**	51 **48–56**	50 **47–56**	50 **47–55**	49 **46–54**	48 **45–53**	48 **45–52**	47 **44–51**	46 **44–50**	46 **43–50**	11
12	-------	53 **50–59**	52 **49–58**	52 **48–57**	51 **48–56**	50 **47–56**	49 **46–55**	49 **46–54**	48 **45–53**	47 **44–52**	46 **44–51**	46 **43–50**	45 **42–49**	12
13	-------	53 **50–59**	52 **49–58**	52 **48–57**	51 **48–56**	50 **47–55**	49 **46–54**	48 **45–53**	48 **45–52**	47 **44–51**	46 **43–50**	45 **43–49**	44 **42–48**	13
14	-------	53 **50–60**	52 **49–59**	52 **48–58**	51 **47–56**	50 **47–55**	49 **46–54**	48 **45–53**	47 **44–52**	46 **44–51**	45 **43–50**	45 **42–49**	44 **41–48**	14
15	-------	54 **50–60**	53 **49–59**	52 **48–58**	51 **47–56**	50 **47–55**	49 **46–54**	48 **45–53**	47 **44–52**	46 **43–50**	45 **42–49**	44 **42–48**	43 **41–47**	15
16	-------	54 **50–60**	53 **49–59**	52 **48–58**	51 **47–56**	50 **46–55**	49 **46–54**	48 **45–52**	47 **44–51**	46 **43–50**	45 **42–49**	44 **41–48**	43 **41–46**	16
18	-------	54 **50–60**	53 **49–59**	52 **48–58**	51 **47–56**	50 **46–55**	48 **45–54**	47 **44–52**	46 **43–51**	45 **42–49**	44 **41–48**	43 **41–46**	42 **40–45**	18
20	-------	54 **51–61**	53 **50–60**	52 **48–58**	51 **47–56**	49 **46–55**	48 **45–53**	47 **44–52**	46 **43–50**	44 **42–48**	43 **41–4**	42 **40–45**	41 **39–44**	20

See note on page 458.

TABLE 2.—*Reserve Ratio Table*—Continued

Section IV: 150 Percent Declining Balance Method of Depreciation—Continued

Test life (years)	Rates of growth (percent)													Test life (years)
	8	9	10	11	12	13	14	15	16	17	18	19	20	
3	55 51–60	55 51–59	54 51–59	54 51–59	54 51–59	54 51–58	54 51–58	54 50–58	54 50–58	53 50–58	53 50–57	53 50–57	53 50–57	3
4	52 49–57	52 49–57	52 49–56	51 48–56	51 48–56	51 48–55	51 48–55	50 48–55	50 47–55	50 47–54	50 47–54	50 47–54	49 47–54	4
5	50 47–55	50 47–55	50 47–54	50 47–54	49 46–54	49 46–53	49 46–53	48 46–53	48 45–52	48 45–52	48 45–52	47 45–51	47 44–51	5
6	49 46–54	49 46–53	48 46–53	48 45–52	48 45–52	47 45–51	47 44–51	47 44–51	46 44–50	46 44–50	46 43–49	45 43–49	45 43–49	6
7	48 45–52	48 45–52	47 44–51	47 44–51	46 44–50	46 44–50	46 43–49	45 43–49	45 42–48	44 42–48	44 42–47	44 42–47	43 41–46	7
8	47 44–51	47 44–51	46 44–50	46 43–50	45 43–49	45 42–48	44 42–48	44 42–47	43 41–47	43 41–46	43 41–46	42 40–45	42 40–45	8
9	46 44–50	46 43–50	45 43–49	45 42–49	44 42–48	44 41–47	43 41–46	43 41–46	42 40–45	42 40–45	41 39–44	41 39–44	40 38–43	9
10	46 43–50	45 43–49	44 42–48	44 42–47	43 41–47	43 41–46	42 40–45	42 40–45	41 39–44	40 39–43	40 38–43	40 38–42	39 37–41	10
11	45 42–49	44 42–48	44 41–47	43 41–46	42 40–46	42 40–45	41 39–44	40 39–43	40 38–43	39 38–42	39 37–41	38 37–40	38 36–40	11
12	44 42–48	44 41–47	43 41–46	42 40–45	41 39–45	41 39–44	40 38–43	40 37–42	39 37–41	38 37–41	38 36–40	37 36–39	36 35–38	12
13	44 41–47	43 41–46	42 40–45	41 39–44	41 39–44	40 38–43	39 37–42	38 37–41	38 36–40	37 36–39	37 35–38	36 35–38	35 34–37	13
14	43 41–47	42 40–45	41 39–44	40 39–44	40 38–43	39 37–42	38 37–41	38 36–40	37 35–39	36 35–38	36 34–37	35 34–37	34 33–36	14
15	42 40–46	42 40–45	41 39–44	40 38–43	39 37–42	38 37–41	37 36–40	37 35–39	36 35–38	35 34–37	34 33–36	34 33–35	33 32–35	15
16	42 40–45	41 39–44	40 38–43	39 37–42	38 37–41	37 36–40	37 35–39	36 34–38	35 34–37	34 33–36	34 32–35	33 32–34	32 31–33	16
18	41 39–44	40 38–42	39 37–41	38 36–40	37 35–39	36 35–38	35 34–37	34 33–36	33 32–35	32 32–34	32 31–33	31 30–32	30 30–31	18
20	40 38–43	38 37–41	37 36–40	36 35–38	35 34–37	34 33–36	33 32–35	32 32–34	32 31–33	31 30–32	30 29–31	29 29–30	28 28–29	20

See note on page 458.

TABLE 2.—*Reserve Ratio Table*—Continued

Section IV: 150 Percent Declining Balance Method of Depreciation—Continued

Test life (years)	Rate of growth (percent)														Test life (years)
	−3	−2	−1	0	1	2	3	4	5	6	7	8	9	10	
22	53 50–60	52 48–58	51 47–56	49 46–55	48 45–53	47 44–51	45 43–49	44 41–48	42 40–46	41 39–44	40 38–43	39 37–41	37 36–40	36 35–38	22
24	54 50–60	52 49–58	51 47–56	49 46–55	48 45–53	46 43–51	45 42–49	43 41–47	42 40–45	40 38–43	39 37–42	38 36–40	36 35–38	35 34–37	24
25	54 50–60	52 49–58	51 47–56	49 46–54	48 45–52	46 43–50	44 42–49	43 41–47	41 39–45	40 38–43	38 37–41	37 36–39	36 34–38	34 33–36	25
26	54 50–60	52 49–58	51 47–56	49 46–54	47 44–52	46 43–50	44 42–48	43 40–46	41 39–44	40 38–42	38 36–40	37 35–39	35 34–37	34 33–36	26
28	54 50–61	52 49–58	51 47–57	49 46–54	47 44–52	46 43–50	44 43–48	42 40–46	40 38–44	39 37–41	37 36–40	36 34–38	34 33–36	33 32–34	28
30	54 51–61	53 49–59	51 47–57	49 46–54	47 44–52	45 43–50	43 41–47	42 39–45	40 38–43	38 36–41	36 35–38	35 34–37	33 32–35	32 31–33	30
32	-------	53 49–59	51 48–57	49 46–54	47 44–52	45 42–49	43 41–47	41 39–44	39 37–42	37 36–40	36 34–38	34 33–36	-------	-------	32
34	-------	53 49–60	51 48–57	49 46–54	47 44–52	45 42–49	42 40–46	40 38–44	38 37–41	37 35–39	35 34–37	33 32–35	-------	-------	34
36	-------	53 50–60	51 48–57	49 46–54	47 44–51	44 42–48	42 40–46	40 38–43	38 36–40	36 34–38	34 33–36	32 31–34	-------	-------	36
38	-------	54 50–60	51 48–57	49 46–54	46 44–51	44 42–48	42 40–45	39 38–42	37 36–40	35 34–37	33 32–35	31 30–33	-------	-------	38
40	-------	54 50–60	51 48–57	49 46–54	46 44–51	44 41–48	41 39–45	39 37–42	37 35–39	34 33–36	32 32–34	31 30–32	-------	-------	40
42	-------	54 50–61	51 48–57	49 46–54	46 43–51	44 41–47	41 39–44	38 37–41	36 35–38	34 33–36	32 31–33	30 29–31	-------	-------	42
44	-------	54 50–61	52 48–58	49 46–54	46 43–51	43 41–47	40 38–44	38 36–41	36 34–38	33 32–35	31 30–32	29 28–30	-------	-------	44
46	-------	54 50–61	52 48–58	49 46–54	46 43–50	43 41–47	40 38–43	38 36–40	35 34–37	33 32–34	30 30–32	28 28–29	-------	-------	46
48	-------	54 51–61	52 48–58	49 46–54	46 43–50	43 40–46	40 38–43	37 35–39	34 33–36	32 31–33	30 29–31	28 27–28	-------	-------	48
50	-------	55 51–62	52 48–58	49 46–54	46 43–50	42 40–46	39 38–42	36 35–39	34 33–36	31 31–33	29 28–30	27 27–28	-------	-------	50

See note on page 458.

NOTE FOR TABLE 2, SECTIONS I, II, III, AND IV

NOTE.—The ratio shown in the first row for each test life is the theoretically appropriate ratio for a stabilized account growing at the indicated rate, calculated on the assumption that there is no dispersion of asset lives about the test life. The reserve ratio accepted under this procedure as theoretically appropriate is therefore higher than if it were corrected for the fact that some assets will be retired earlier and some later than the period of the test life.

The range shown below each theoretical reserve ratio indicates the lower and upper limits of acceptable reserve ratios. The upper limit of the reserve ratio range is that reserve ratio which would result if all assets were held for a period 20 percent longer than the test life. The lower limit of the reserve ratio range is the ratio which would result if all assets were held for a period 10 percent shorter than the test life. As in the case of the theoretically appropriate ratios, the ranges accepted are at a higher level than would result were dispersion of lives taken into account in the calculations. The ratios shown are rounded to the nearest percent and will depart from mathematically calculated values to that extent.

TABLE 3.—*Adjustment Table for Class Lives*

Justifying a shorter class life by low reserve ratio [1]		Lengthening the class life in cases where reserve ratio test is not met [2]	
Class life used in the preceding taxable year	Appropriate class life	3-year average class life	Appropriate class life
3	2. 5	3	4
4	3. 5	4	5
5	4	5	6. 5
6	5	6	7. 5
7	6	7	8. 5
8	7	8	10
9	7. 5	9	11
10	8. 5	10	12. 5
11	9. 5	11	14
12	10	12	15
13	11	13	16
14	12	14	17. 5
15	13	15	19
16	13. 5	16	20
18	15. 5	18	22. 5
20	17	20	25
22	18. 5	22	27. 5
24	20. 5	24	30
26	22	26	32. 5
28	24	28	35
30	25. 5	30	37. 5
32	27	32	40
34	29	34	42. 5
36	30. 5	36	45
38	32. 5	38	47. 5
40	34	40	50
42	35. 5	42	52. 5
44	37. 5	44	55
46	39	46	57. 5
48	41	48	60
50	42. 5	50	62. 5

[1] See section 3.03(a) of Part II of this Revenue Procedure.
[2] See section 6.02 and section 6.03(a) of Part II of this Revenue Procedure.

Appendix I

FORMULAE USED IN CALCULATING RESERVE RATIOS AND THE RESERVE RATIO RANGE [1]

Revenue Procedure 62–21 may be applied in connection with examinations of depreciation computed under several generally used methods, including the (1) straight line, (2) double declining balance, (3) 150 percent declining balance, and (4) sum of the years-digits methods.

The straight line method prorates the cost of the asset over its life uniformly.[2] If the asset is depreciated over N years, the depreciation taken is $\frac{1}{N}$ times the asset cost in each year.

The double declining balance method permits depreciation equal to $\frac{2}{N}$ times the undepreciated cost of the asset.[3] The 150 percent method is similar. Under it the depreciation deduction is $\frac{1.5}{N}$ times the undepreciated cost of the asset.

The sum of the years-digits method of depreciation permits depreciation in each year at a rate equal to the remaining life of the asset divided by the sum of all the years' digits corresponding to the estimated useful life of the asset.[4]

The cumulative total of all depreciation claimed on an asset will be shown in the depreciation reserve. For a single asset the relationship, R, between its depreciation reserve and the basis of the asset is given by the following formulae in which N is the useful life estimate used in

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[1] This appendix to the tables explains the formulae which were used in computing the appropriate reserve ratios and the reserve ratio ranges. The indicated formulae may be used to calculate appropriate reserve ratios and the reserve ratio ranges for test lives and rates of growth for which values are not shown.

[2] Throughout this discussion it is assumed that salvage is zero.

[3] In the first full year the depreciation allowed is $\frac{2}{N}$ times the asset cost; the second year the depreciation allowed is $\frac{2}{N}\left(1-\frac{2}{N}\right)$ times the asset cost; the third year the depreciation is $\frac{2}{N}\left(1-\frac{2}{N}-\frac{2}{N}\left(1-\frac{2}{N}\right)\right)$ times the asset cost, etc.

[4] Mathematically stated, the sum of the years-digits method permits depreciation equal to $\frac{2N}{N(N+1)}$ times the cost of the asset in the first year, $\frac{2(N-1)}{N(N+1)}$ times the cost of the asset in the second year, $\frac{2(N-2)}{N(N+1)}$ in the third year, etc.

computing depreciation and k is the number of years for which depreciation has been claimed:

Method of depreciation	*Reserve ratio for items depreciated for* k *years*	
Straight line [5]	$R_1(k,N)=\frac{2k-1}{2N}$	for $k=1, 2, 3 \ldots N$
	$=1$	for $k=N+1, N+2 \ldots$
Double declining balance	$R_2(k,N)=1-\left(1-\frac{1}{N}\right)\left(1-\frac{2}{N}\right)^{k-1}$	for $k=1, 2, 3 \ldots$
150 percent declining balance	$R_3(k,N)=1-\left(1-\frac{.75}{N}\right)\left(1-\frac{1.5}{N}\right)^{k-1}$	for $k=1, 2, 3 \ldots$
Sum of the years-digits [5]	$R_4(k,N)=\frac{(2k-1)(N+1)-k^2}{N(N+1)}$	for $k=1, 2, 3 \ldots N$
	$=1$	for $k=N+1, N+2 \ldots$

For example, if the asset is depreciated over 10 years on the sum of the years-digits method, the reserve ratio at the end of the fifth year of use will be:

$$R_4(5, 10)=\frac{((2)(5)-1)(11)-25}{(10)(11)}=\frac{74}{110}=.673$$

In developing these formulae it was assumed that the taxpayer follows the convention of taking half a year's depreciation on assets acquired during the year.

The reserve ratio for a group of assets purchased in several years is the average of the reserve ratios, R, corresponding to assets acquired in each year appropriately weighted by investment in that year. If each year's acquisitions exceed the previous year's acquisitions by a constant proportion, i, and assets from the T previous years prior to the present are included in the group, the weighted average reserve ratio, W, for the group is given by the following formula:

$$W_{i,\,T}(i,N)=\frac{\sum_{k=1}^{T} R_j(k,N)(1+i)^{N-k}}{\sum_{k=1}^{T}(1+i)^{N-k}}$$

In this formula j is an index which refers to the different depreciation methods; for $j=1$ the formula for W gives reserve ratios for the straight line method; for $j=2$ the formula for W gives reserve ratios for the double declining balance method, and so forth. As T indicates the number of years for which acquisitions are included in the group, it also represents the period over which assets are replaced.

[5] The formulation here indicates the cumulative depreciation reserve against a single item being depreciated. For the first N years the reserve increases as more depreciation is charged annually. After N years the property is fully depreciated, no further deductions are claimed, and the reserve equals 1.

The formula is based on the assumption that acquisitions increase at a rate i. This assumption implies that the asset account as a whole will grow at a rate i. Therefore either the rate of growth of assets or the rate of growth of acquisitions may be used in the formula.

The appropriate reserve ratios shown in the Reserve Ratio Table (Table 2) are computed according to the formula for W assuming that T, the replacement period, is equal to N, the period of years over which assets are depreciated. To calculate the reserve ratio range, $.9N$ and $1.2N$ were calculated to determine periods 10 percent shorter and 20 percent longer than the depreciation period. Values were obtained for the reserve ratio for the integral values of T just greater and just below $.9N$ and $1.2N$. The lower limit and the upper limit of the reserve ratio range were then obtained by interpolating between the four calculated values of the reserve ratio.

The following example of how the reserve ratio is calculated in a specific case illustrates the derivation of the formula. Assume the depreciation period is 5 years and that depreciation is taken on the double declining balance method. Assume also that the account has been growing at 5 percent and that assets are replaced after 6 full years of use. The company's property accounts would therefore contain investments made in the current year and 5 prior years. (Those investments made in the sixth prior year are all retired during the year.)

Year	*Proportion of the cost depreciated*	*Cost of acquisitions*	*Total depreciation reserve*
0	$R_2(6, 5) = .938$	.952	.893
1	$R_2(5, 5) = .896$	1.000	.896
2	$R_2(4, 5) = .827$	1.050	.868
3	$R_2(3, 5) = .712$	1.102	.785
4	$R_2(2, 5) = .520$	1.158	.602
5	$R_2(1, 5) = .200$	1.216	.243
TOTAL		6.478	4.287

The reserve ratio will then be $\frac{4.287}{6.478}$ or .662. As the replacement period of 6 years used in this example is exactly 20 percent greater than the period used in estimating depreciation, the .662 ratio is the upper limit of the reserve ratio range for a test life of 5 years and a rate of growth of 5 percent. In general, values of upper and lower limits of the reserve ratio range were calculated by similar applications of the general formula for W, using suitable values of T for each value of N as described in the preceding paragraph.

Appendix II

Questions and Answers [1]

GENERAL APPROACH

1. Question:

Do the new guideline lives represent a liberalization of the depreciable lives contained in Bulletin "F" or of the depreciable lives actually used at present?

Answer:

Both. Because the guideline lives pertain to large classes of assets rather than to individual items, it is possible in prescribing these guideline lives to take into account technological changes and other economic factors which affect the useful life of assets to a greater extent than was possible in prescribing the lives contained in Bulletin "F". Similarly, because it is difficult for any taxpayer to show the effect of technological change, etc., on the life of an individual asset, the guideline lives will permit a shortening of depreciable lives actually used at present.

Thus, the new guidelines are substantially shorter than the Bulletin "F" lives, and, for most taxpayers, are shorter than the lives presently being used.

2. Question:

Won't these new guideline lives soon become out of date as is the case with the present Bulletin "F"?

Answer:

It is expected that these new guideline lives will be reviewed periodically to insure that they keep pace with technological developments and other factors which result in property becoming obsolete at a faster rate than expected. The guidelines will be easier to keep up to date than Bulletin "F" because they deal with broad classes of assets rather than with thousands of individual items.

3. Question:

At present, depreciation is based on the useful life of property in the taxpayer's own trade or business. How does this depreciation reform affect this approach?

Answer:

The depreciation reform retains this approach. Every taxpayer should continue to base his depreciable lives on his own best estimate of the period of their use in his trade or business. The new reform provides guideline lives, based on analyses of statistical data and engineering studies and assessments of current and prospective technological advances, for each industry in the United States. The guidelines which have been developed are felt to provide reasonable standards for taxpayers in the various industries and if used will be presumed to be acceptable unless subsequent events show that they

[1] Questions and answers 1–42 were published as part of Revenue Procedure 62–21, I.R.B. 1962–30, 6; 43–59 were announced separately in Announcement 62–84, I.R.B. 1962–40, 33.

are not appropriate for a particular taxpayer's circumstances. Of course, to no extent do the new guidelines foreclose a taxpayer from using even shorter depreciable lives if his particular retirement and replacement practices are more progressive than those of the industry of which he is a part. Thus, under the depreciation reform, depreciation continues to be based on the concept of useful life of property to the taxpayer. However, wider latitude is provided for the taxpayer in making his own best estimate of useful life, and objective standards are provided wherever possible for determining when the taxpayer's estimate should not be disturbed.

4. Question:

If this depreciation reform does not alter the useful-life approach to depreciation, how does it provide for shorter lives and elimination of controversy?

Answer:

The depreciation reform provides for shorter lives first by providing new up-to-date guideline lives for classes of assets in lieu of the average lives for individual assets set forth in Bulletin "F", and second by placing greater emphasis on the economic life of property to the taxpayer rather than its physical life. The reform will eliminate controversy by giving greater leeway to taxpayers in estimating lives, by making adjustments by examiners largely dependent on objective standards rather than individual judgments, and by the use of guidelines for broad classes of assets rather than myriads of individual items.

5. Question:

Will this depreciation reform help only the taxpayer who has lagged in his replacement practices or will it also help the taxpayer who has been following progressive replacement practices?

Answer:

Unquestionably the depreciation reform will benefit all taxpayers, although in different ways. As to those taxpayers who have been following more progressive replacement practices, so as to entitle them to continue using lives shorter than the new guidelines, the principal benefit of the reform lies in the elimination of controversy over what lives are proper. In addition, the Reserve Ratio Table will provide objective guides for establishing that a taxpayer is entitled to use even shorter lives than he has used in the past. Moreover, the progressive taxpayer may use even shorter lives if they are justified by all the facts and circumstances.

6. Question:

Will this depreciation reform help the small taxpayer as well as the large corporation?

Answer:

There are a number of aspects of the depreciation reform which will benefit the small taxpayer. First, there is the level at which the new guideline lives are set. These are substantially lower than the lives prescribed as a guide in Bulletin "F". Therefore, all small taxpayers who heretofore have relied on Bulletin "F" in setting useful lives for some or all of their assets will benefit from the new lower guideline lives. Second, there is the use of the reserve ratios to show that useful lives even shorter than the guideline life are justified.

This should be especially helpful to small taxpayers since in the case of a small taxpayer such things as variations in asset mix, technological innovations, and purchases of some used assets are likely to have a greater impact on the proper life to be used in the future than in the case of a large taxpayer, yet the small taxpayer might well find it difficult to establish precisely what that impact will be. Third, the opportunity to support lives shorter than the guidelines by reference to the facts and circumstances of the particular case will be of special benefit to the small taxpayer. This will permit recognition of deviations from industry-wide norms that are likely to occur in connection with small taxpayers. Fourth, the elimination of so-called "penalty rates" should be of major importance to the small taxpayer. Fifth, the transition rule for applying the reserve ratio test should be of special significance to those smaller taxpayers whose reserves have become unreasonably high because their past retirement and replacement practices have not conformed with the lives which they used for depreciation purposes. This transition rule will enable them to obtain the funds with which to adopt more progressive replacement practices. Finally, since use of the Revenue Procedure is optional, those small taxpayers desiring to remain under established procedures may continue to do so.

7. Question:

In the case of a taxpayer who uses lives equal to the guideline lives, but fails to replace assets consistent with such lives, do the new guidelines and the reserve ratio test merely postpone for a number of years the controversy that exists today?

Answer:

Even though in some cases lives used by taxpayers may be lengthened to a point above the new guideline lives, there are several important reasons why this will not result in the controversies that are present today. First, a taxpayer using the new guidelines will not be challenged unless and until his depreciation reserves are unreasonably high as compared with his depreciable assets. This removes the question of when to challenge lives from the ambit of the individual examiner's judgment and makes it subject instead to objective arithmetic standards, thus eliminating one of today's major areas of dispute and also achieving uniformity in the treatment of taxpayers. Second, where the lives used by a taxpayer are lengthened, the new lives will generally be determined objectively by the use of an adjustment table and thus will no longer be a matter of individual judgment. The fact that some taxpayers may in the future be required to use lives longer than the guidelines should not result in any significant controversies.

8. Question:

In prescribing new guideline lives, does the depreciation reform merely shift the area of dispute from the question of useful life to the question of salvage?

Answer:

No. If the class life being used by the taxpayer for all assets in a single guideline class is equal to or longer than the guideline life, then neither the lives nor the salvage used for individual items will be disturbed under the Revenue Procedure. If the class life, which is

of course based on both the lives and any salvage used by the taxpayer, is shorter than the guideline life, it may be justified either by the objective tests provided or by all the facts and circumstances. Once justified, the class life, including the salvage, will not be disturbed in subsequent years so long as replacement practices are thereafter consistent with that life.

9. Question:

How does this guideline approach compare with the Canadian approach to depreciation?

Answer:

The guideline approach of the Revenue Procedure avoids the rigidity of the Canadian system. The guideline approach permits taxpayers to use lives shorter than the guideline lives whereas the Canadian system does not permit the use of lives shorter than the prescribed lives, regardless of a taxpayer's retirement and replacement practices. In addition, unlike the Canadian system, this reform provides a separate class for production machinery and equipment in each different industry. This permits obsolescence and other factors which affect the economic lives of assets to be taken into account in accordance with the facts relating to the particular industry.

10. Question:

Will the new Revenue Procedure result in immediate changes in the organizational structure of the Internal Revenue Service for the handling of depreciation issues or questions?

Answer:

No immediate organizational changes are contemplated. Detailed instructions will be issued and special training courses are planned for all technical personnel concerned with depreciation matters to ensure uniform application of the depreciation reform. In addition, the Internal Revenue Service will watch closely progress in operating under the new Procedure with a view to introducing organizational or procedural changes where necessary to assure effective administration.

GUIDELINE LIVES

11. Question:

If some assets are used for a period of years longer than the guideline life, will the taxpayer be required to lengthen the life used in depreciating those assets or in depreciating assets which eventually replace those assets?

Answer:

No. It is to be expected that some assets will be held longer than the guideline life. The guideline life is an overall life for a class which will include assets having a wide range of lives. The fact that a number of assets are held for periods longer than the guideline life does not in itself mean that the guideline life is inappropriate.

12. Question:

Will a taxpayer be permitted to prove a life shorter than the guideline life for those assets which have a shorter life and use the guideline life for the other assets in that class?

Answer:

No. In comparing the lives used by the taxpayer with the guideline lives, the class life being used for a guideline class must be determined with reference to the lives of all of the assets in that class. This is the only way that the new guideline lives will provide an effective test. Otherwise, the taxpayer would demonstrate shorter lives for all the shorter-lived assets falling within a class, and would use the guideline life for all his longer-lived assets. This would defeat the purpose of the broad class approach which is based on an overall guideline life for a class containing assets having a broad range of lives.

13. Question:

Will a taxpayer who uses the new guideline lives be permitted to do so indefinitely?

Answer:

A taxpayer using lives equal to or longer than the guideline lives will not be challenged at any time so long as his retirement and replacement practices are consistent with the lives being used. This consistency may be demonstrated by the reserve ratio test as well as by presently established procedures. In any event, the taxpayer will not be subject to challenge for at least the first 3 taxable years to which the new Revenue Procedure applies.

14. Question:

If a taxpayer wishes to continue using a class life longer than the guideline life for several years after the Revenue Procedure becomes effective, will he in later years be permitted to use the guideline life?

Answer:

Yes.

15. Question:

It appears from the Revenue Procedure that a taxpayer may regroup his assets in classes corresponding to the guideline classes, in order to facilitate comparing the class lives with the guideline lives and applying the reserve ratio test. Does this regrouping constitute a change in method of accounting which requires the consent of the Commissioner of Internal Revenue?

Answer:

The regrouping of assets is not considered a change in method of accounting. Therefore the consent of the Commissioner is not required.

16. Question:

Will the same method of computing depreciation (straight-line, declining balance, sum-of-the-years digits) have to be applied with respect to all assets falling within a single guideline class?

Answer:

No. The taxpayer may use different methods of computing depreciation for different assets falling within a single guideline class provided that each method of depreciation is proper for the asset being depreciated. Thus, for example, the taxpayer may use the double-declining balance method of depreciation for the assets which he acquires new, and the straight-line method for those he acquires used. However, in order to compute the class life used for the assets in a

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guideline class for the purpose of comparison with the guideline life, it may be necessary to compute depreciation for all the assets in the class on a straight-line basis. It is to be emphasized that this straight-line figure is used only to determine the weighted average of the lives being used by the taxpayer and that it has no bearing on the actual method of depreciation that may be used.

17. Question:

Where a taxpayer uses a class life equal to the guideline life, must that same life be used consistently?

Answer:

This Revenue Procedure does not change present regulations. Under section 1.167(a)–1(b) of the regulations, a taxpayer may modify depreciable lives for any taxable year in the light of conditions existing at the end of that year.

18. Question:

How do the new guideline lives apply with respect to assets acquired used?

Answer:

The guideline lives measure the expected useful economic lives of assets acquired new. It is not possible to prescribe guidelines for used assets since the useful life of any used asset depends upon its age at the time it is acquired. However, the fact that a taxpayer has a substantial amount of used assets in a guideline class would be taken into account as a factor demonstrating that a life shorter than the guideline life may be justified for that class.

RESERVE RATIO

19. Question:

Apart from establishing that a taxpayer's reserve ratio falls within the range of acceptable reserve ratios, what use can be made of the reserve ratio test set forth in section 5 of Part II of the Revenue Procedure?

Answer:

The reserve ratio test will be useful to a taxpayer as an indication of whether his retirement and replacement practices are consistent with the class life being used. A taxpayer will be able to determine from the trend of his reserve ratios for successive years whether his practices are as progressive as he may believe them to be. Thus, the reserve ratio test will provide the taxpayer with information which may be useful in the making of business decisions as well as information which will be useful for tax purposes.

20. Question:

Can a taxpayer whose reserves are high for the first taxable years to which this Revenue Procedure is applicable use a class life equal to the guideline life? Under what circumstances will he be permitted to continue using that life?

Answer:

In order to give every taxpayer the opportunity to bring his practices into line with the new guideline lives, he will be allowed to use the new guidelines regardless of his present reserve ratios. He will be given a period of years up to a full replacement cycle to bring his reserves to an acceptable level, providing that the reserves are moving toward this level during this period.

21. Question:

Isn't it normal to have fluctuations in the ratios of depreciation reserves to depreciable assets? Will these ordinary fluctuations result in a failure to meet the reserve ratio test?

Answer:

It is normal to have a certain amount of fluctuation in depreciation reserve ratios. However, the Reserve Ratio Table has been devised to take this into account. The table provides a broad range for acceptable reserve ratios. This range is designed to provide a substantial amount of leeway before the ratio of a particular taxpayer will be considered unreasonably high.

22. Question:

Suppose that the assets in a guideline class are actively used on the average for a period equal to the guideline life, but thereafter some are retained on a standby status instead of being retired. Will this result in the accumulation of unreasonable depreciation reserves so that the taxpayer eventually will fail to meet the reserve ratio test?

Answer:

The reserve ratio ranges have been designed to provide a substantial amount of leeway to the taxpayer. Thus, a taxpayer will be able to continue to meet the reserve ratio test even though he retains some equipment on a standby basis. If the reserve ratio of a taxpayer retaining standby equipment fails to meet the reserve ratio test, the taxpayer has the opportunity to demonstrate that the class life used is appropriate on the basis of all the facts and circumstances.

23. Question:

What will cause the depreciation reserves for a guideline class to become unreasonably high?

Answer:

The reserves will become unreasonably high if a taxpayer's retirement and replacement practices are not consistent with the class life being used for depreciation purposes. Underlying factors causing this inconsistency might include (1) that the taxpayer's asset composition for a guideline class is not typical of the industry as a whole but consists primarily of assets with useful lives which are longer than the class life being used by the taxpayer, (2) that the taxpayer is leasing a substantial amount of assets having useful lives shorter than the class life used by the taxpayer for the guideline class into which the leased assets would fall if they were owned by the taxpayer, and (3) that the taxpayer is retaining and continuing to depreciate (in a multiple-asset account) assets which no longer are being used in the trade or business.

In addition, high reserves may be caused by the fact that a guideline class contains relatively few assets, most of which are nearing the end of their useful lives. This could be true even where the taxpayer's retirement and replacement practices are consistent with the class life used. In such a case, the high reserves could readily be explained and the class life used by the taxpayer could still be justified on the basis of the taxpayer's retirement and replacement practices.

24. Question:

If the Reserve Ratio Table indicates that a taxpayer has unreasonably high depreciation reserves, will the lives used by the taxpayer automatically be lengthened?

Answer:

Not automatically. Unreasonably high depreciation reserves may be an indication, as under present practice, that the lives used by a taxpayer should be lengthened. However, the taxpayer will always be permitted to show, by the use of established procedures, that his retirement and replacement practices are consistent with the lives being used.

25. Question:

If the taxpayer's reserve ratio would not be considered unreasonably high for the year under examination, may the examiner take into account, in examining that year, the fact that the reserve ratio becomes unreasonably high in a year intervening between the year under examination and the time of audit?

Answer:

No. The examiner should be concerned only with the reserve ratio for the year under examination. The fact that the reserve ratio becomes unreasonably high in a subsequent year will not be considered in connection with an earlier year that may be under examination.

26. Question:

If a taxpayer uses the guideline life for a class of assets but does not retire or replace assets consistent with that life, he will accumulate a high depreciation reserve. If that taxpayer subsequently is required to use a class life longer than the guideline life, would the depreciation reserve have to return to normal before he would again be permitted to use the guideline life?

Answer:

This taxpayer could use the guideline life again as soon as he could show that his retirement and replacement practices were consistent with the guideline life. This consistency could be demonstrated in either of two ways: The first would be on the basis of all the facts and circumstances. The second would be if the taxpayer's reserve ratio declined to the point where it came within the reserve ratio range for the lengthened class life. Thus, the taxpayer would not have to "work off" the entire amount of the excessive depreciation previously deducted before again being permitted to use the guideline life.

27. Question:

What does the theoretically appropriate reserve ratio mean?

Answer:

The theoretically appropriate reserve ratio is the ratio of accumulated depreciation reserves to the total basis of the assets in a guideline class which results when the taxpayer for more than a replacement cycle has followed policy of additions to and retirements from that class consistent with the class life used.

28. Question:

What do the upper and lower limits of the reserve ratio ranges represent?

Answer:

The upper limit of the reserve ratio range is the reserve ratio for a taxpayer's guideline class which would result if the assets in that class were used for a period 20 percent longer than the class life used by the taxpayer. The lower limit of the reserve ratio range is the reserve ratio for a taxpayer's guideline class which would result if

the assets were used for a period 10 percent shorter than the class life used by the taxpayer.

29. Question:

How does the Reserve Ratio Table account for the fact that the timing of retirement of assets is dispersed about a class life, so that some assets are retired after a period of time shorter than the class life used by a taxpayer while other assets may last considerably longer than that life?

Answer:

In practice, retirements in any guideline class will be dispersed about the class life used by the taxpayer. However, the theoretically appropriate reserve ratios in the table are based on the assumption that there is no dispersion in the retirement of assets, i.e., that all assets are retired exactly when they age to the class life used. This assumption is necessary because the dispersion factor for every taxpayer is different and it is therefore not feasible to take this factor into account.

Were a dispersion factor included in the mathematical computation of each appropriate reserve ratio, the resulting ratios would be smaller than the tabulated ratios in all cases. The upper and lower limits of the reserve ratio ranges would also be lower than indicated in the table. Thus, the effect of disregarding the dispersion factor is to provide an additional margin of leeway respecting the range of acceptable reserve ratios.

30. Question:

During the past decade, the cost of depreciable equipment has risen substantially. How does the Reserve Ratio Table take into account this fact that prices have been rising?

Answer:

The structure of the Reserve Ratio Table automatically compensates for past inflation. This is true because inflation causes both the taxpayer's reserve ratio and the appropriate reserve ratio range to decline. The taxpayer's reserve ratio falls because his relatively more expensive, recently-acquired assets have had little depreciation charged against them, whereas relatively more depreciation has been charged against the older, less expensive equipment. Rising prices will also automatically push up the dollar basis of depreciable property, thus increasing the indicated rate of growth and lowering the appropriate reserve ratio range.

MISCELLANEOUS ASPECTS

31. Question:

If a taxpayer wishes to use lives longer than the guideline lives, consistent with his replacement policy, will losses incurred on retirements be disallowed on the ground that depreciation based on the shorter guideline life was "allowable" (within the meaning of section 1016(a)(2) of the 1954 Code) even though it was not claimed by the taxpayer.

Answer:

No. The new lives are only guidelines. They will not be used to determine what is the "allowable" amount of depreciation. The taxpayer should claim the amount of depreciation that is appropriate for his own trade or business. He is not required to use the guidelines

if he feels that they are too short to reflect his actual retirement and replacement practices.

However, if artificially long lives are assigned to assets for the purpose of manipulating the depreciation deduction, an adjustment to basis under section 1016(a)(2) of the Code may be made for the depreciation properly "allowable" in the past even though it was not claimed and allowed. Present law is not changed in this respect by this depreciation reform.

32. Question:

If a taxpayer's reserve ratio is below the lower limit, it is probable that the taxpayer is entitled to use shorter depreciable lives. Is this low reserve ratio an indication that the taxpayer has taken too little depreciation in the past and that the basis of the property should be reduced for depreciation which was "allowable" even though not claimed by the taxpayer?

Answer:

No. The taxpayer's reserve ratio is not an indication that depreciation not taken was "allowable" under section 1016(a)(2). The rules concerning the application of section 1016(a)(2) are not affected by the Revenue Procedure.

33. Question:

Questions often arise as to whether particular expenditures are deductible expenses or are capital expenditures which should be recovered through depreciation. How does this depreciation reform affect the resolution of these questions?

Answer:

The depreciation reform does not affect the classification of expenditures as capital or expense. Questions in this area must be resolved on the basis of presently established principles. The depreciation reform affects only those expenditures which are properly chargeable to capital and recoverable through depreciation deductions.

34. Question:

How will retirements of assets be treated under the depreciation reform?

Answer:

The depreciation reform does not change the regulations dealing with the proper treatment of retirements of assets, how to determine whether a retirement is normal or abnormal, etc. The treatment of retirements will continue to be determined under the regulations under section 167. Thus, if a taxpayer is using a method of accounting under which no gain or loss is recognized at the time of a normal retirement of an asset from a multiple-asset account, the taxpayer may continue to use this method after the publication of the depreciation reform so long as this method clearly reflects income. If a taxpayer is using a method of accounting, as to either item or multiple-asset accounts, under which gain or loss is recognized upon disposition, then gain or loss will continue to be recognized under the present regulations applicable to the item or multiple-asset accounts.

35. Question:

Section 167(d) and the regulations thereunder provide that the taxpayer and the district director may enter into an agreement as to the useful life of any property, and that the agreement shall be binding until such time as new circumstances come into existence.

After the publication of the depreciation reform, will taxpayers be permitted to modify these agreements?

Answer:

The adoption of the depreciation reform itself will be considered as a new factor which justifies a taxpayer in modifying any agreement previously made. Thus, if the taxpayer wishes to modify an agreement previously made, he should notify the district director in accordance with the regulations under section 167(d).

36. Question:

Under the Revenue Procedure, the use of the same life in computing the depreciation deduction and in computing the depreciation shown on the books of account and financial statements is considered a significant factor in justifying a class life shorter than the guideline life. Does the significance of this factor vary according to the circumstances of the case?

Answer:

Yes. This factor is significant in the case of a publicly-held corporation since the depreciation shown on the books of account and financial statements is published and has independent importance to stockholders and other persons outside the management of the corporation. In the case of a corporation which is not publicly held, the booking factor is also significant where the figures shown on the books of account and financial statements have independent importance to persons other than the owners of the corporation, such as lending institutions and fiduciaries for employee profit-sharing plans. The booking factor would be less significant in the case of a closely-held corporation where the books of account and financial statements are not relied on by persons outside the corporation. Since regulated public utilities may be required to use depreciable lives for book purposes that differ from those used in computing the depreciation deduction, their booking practice is not a significant factor.

37. Question:

If a class life used by a taxpayer is required to be lengthened because of a failure to retire and replace assets consistent with the life used, how much will the class life be lengthened?

Answer:

The life will be lengthened to the point where it reflects the taxpayer's actual retirement and replacement practices; it will not be lengthened so as to compensate for the fact that excessive depreciation may have been taken in the past. This will result in the elimination of the present so-called "penalty rates."

38. Question:

If a class life used by a taxpayer is to be lengthened in accordance with the Adjustment Table for Class Lives, but the taxpayer maintains item accounts, how will the useful lives assigned by the taxpayer to each account be lengthened?

Answer:

The taxpayer will lengthen those item lives which he chooses to lengthen so long as the overall class life is not shorter than the appropriate class life shown in the Adjustment Table.

39. Question:

Can a taxpayer who changes from the unit-of-production method of computing depreciation to a useful-life method (expressed in

terms of years) under the blanket consent contained in the Revenue Procedure justify a class life shorter than the guideline life by the fact that the reserve ratio for the guideline class is low?

Answer:

Where the reserve ratio for a guideline class is lower than the lower limit of the appropriate reserve ratio range for that class, this fact will justify the use of a class life shorter than the guideline life only where the ratio reflects the retirement and replacement practices of the taxpayer during a substantial period of years. Under section 3.02(a) and section 3.03(a) of Part II of the Revenue Procedure, the use of approximately the same class life for a substantial period of years is essential before the fact of a low reserve ratio becomes significant. Therefore, a taxpayer who changes from the unit-of-production method would not be able to justify a class life shorter than the guideline life by a low reserve ratio since he has not previously been using a class life expressed in years.

40. Question:

How does the depreciation reform apply to a taxpayer using the retirement method of accounting or some other similar method?

Answer:

The new guidelines and the procedures for using them are not applicable to a taxpayer using the retirement method of accounting. Any taxpayer who wishes to change from the retirement method to a useful-life method of depreciation must obtain consent from the Commissioner of Internal Revenue in accordance with the provisions of section 446(e) and the regulations thereunder.

41. Question:

How does the depreciation reform apply to affiliated corporations which file consolidated returns?

Answer:

The new guideline lives and the reserve ratio test are to be applied to each corporation separately, regardless of the fact that the corporations are members of an affiliated group which is filing a consolidated return.

42. Question:

How does the depreciation reform apply in the case of a partnership?

Answer:

The new guideline lives and reserve ratio test apply to the partnership as an entity.

43. Question:

Footnote 20 in Revenue Procedure 62–21 indicates that fully-depreciated assets used in a taxpayer's trade or business must be taken into account in computing the taxpayer's reserve ratio. How are fully-depreciated assets to be treated for other purposes, such as computing the amount of depreciation, the class life, and the rate of growth?

Answer:

The treatment of fully-depreciated assets for these other purposes depends on the method of grouping assets employed by the taxpayer. If the taxpayer uses accounts in which fully-depreciated assets maintain their identities, such as in item accounting or where assets are segregated by year of acquisition, then when any such asset

or group of assets becomes fully depreciated, it should no longer be taken into consideration in computing depreciation, the class life, or the rate of growth. Thus, the basis of such fully-depreciated assets must be excluded from the total basis of the assets in the guideline class which is used to compute the class life and the rate of growth.

On the other hand, if the taxpayer consolidates his assets on a permanent basis into accounts corresponding to the guideline classes, these accounts should include all depreciable assets used in the taxpayer's trade or business, whether or not previously considered fully depreciated. This is because the assets in this type of multiple-asset account lose their individual identities and no particular item still in use can be considered as being fully depreciated. In this case, the assets previously considered as fully depreciated should be taken into consideration in computing the amount of allowable depreciation, the class life, and the rate of growth.

Regardless of the taxpayer's method of grouping assets, however, all assets used in the taxpayer's trade or business which fall within a guideline class must be taken into consideration in computing the reserve ratio for that class.

44. Question:

Section 2.01 of Part III of Revenue Procedure 62–21 indicates that the portion of the basis of any asset in a guideline class which is subject to amortization under sections 168 or 169 of the 1954 Code (or corresponding provisions of prior law) or is recovered by means of the additional first-year depreciation allowance provided by section 179 shall be excluded from the total basis of the assets in the class for the purpose of computing the taxpayer's reserve ratio. How are these amounts which are subject to section 168, 169, or 179 to be treated for other purposes, such as determining the class life and the rate of growth?

Answer:

These amounts should be excluded from the total basis of the assets in a guideline class for all purposes of Revenue Procedure 62–21. However, only that portion of the basis of an asset which is subject to section 168, 169, or 179 should be excluded. The balance of the basis which is recoverable through normal depreciation allowances should be taken into account for purposes of applying Revenue Procedure 62–21.

45. Question:

In situations where Revenue Procedure 62–21 indicates that the taxpayer's depreciation deduction is not to be distributed, may his salvage estimate be adjusted?

Answer:

No. Under the rules of the Revenue Procedure, not disturbing the depreciation deduction claimed means accepting the judgment of the taxpayer as to both useful lives and salvage, as indicated in footnotes 3 and 8 of the Revenue Procedure. Thus, if the taxpayer meets the conditions of the Revenue Procedure, his salvage estimates should not be challenged, regardless of whether he is using item or multiple-asset accounts.

46. Question:

Where Revenue Procedure 62–21 is being used, may assets be depreciated below a reasonable salvage value?

Answer:

Section 1.167(c) of the Income Tax Regulations provides that ". . . in no event shall an asset (or an account) be depreciated below a reasonable salvage value." This provision is still fully effective. However, since the determination of a reasonable salvage value is a matter of judgment and estimate, Revenue Procedure 62–21 sets forth rules governing when the taxpayer's judgment as to the reasonableness of the depreciation deduction claimed, including the reasonableness of his salvage estimate, will not be challenged. Therefore, if the conditions of the Procedure are met, depreciation will not be disallowed on the ground that the taxpayer's salvage estimate is not reasonable. However, the depreciation deduction claimed for an asset in the taxable year of its disposition may be governed by Revenue Ruling 62–92, C.B. 1962–1, 29.

47. Question:

Revenue Procedure 62–21 provides that if its conditions are met, neither the lives nor the salvage assigned by the taxpayer will be disturbed. If a taxpayer in the mining industry or the oil and gas industry meets the conditions of the Revenue Procedure, may he allocate the depreciation among the various mining or oil and gas properties in any way he sees fit?

Answer:

Where a taxpayer meets the conditions of Revenue Procedure 62–21 for not having his depreciation disturbed, he has a great deal of latitude in determining the depreciation attributable to the individual assets in the guideline class. However, if a taxpayer in the mining or oil and gas industry allocates the depreciation for a guideline class in an unrealistic manner solely for the purpose of avoiding the application of the 50-percent limitation on percentage depletion provided by section 613(a) of the 1954 Code, the examining agent may challenge the depreciation allocated to the various mining or oil and gas properties, notwithstanding the fact that the taxpayer meets the conditions of the Revenue Procedure for that guideline class. In such a case, the examining agent may not challenge the overall class life used by the taxpayer, but he may question the allocation of the overall depreciation for the guideline class to the various depletable properties.

48. Question:

Revenue Procedure 62–21 encourages taxpayers using item accounts to adopt multiple-asset accounts corresponding to the guideline classes. May a taxpayer who adopts such accounts change his treatment of retirements without consent of the Commissioner to conform to the underlying principles of accounting for multiple-asset accounts, that is, may the bases of normal retirements from the multiple-asset accounts be charged to the depreciation reserve and the salvage proceeds be credited to the reserve, or should gain or loss be reported on these retirements as was required before the regrouping?

Answer:

Any taxpayer who regroups his assets into multiple-asset accounts on a permanent basis for purposes of facilitating the use of Revenue Procedure 62–21 may use the accounting practice under which the bases of normal retirements from multiple-asset accounts are charged to the depreciation reserve and the salvage proceeds are

credited to the reserve so long as that practice clearly reflects income. Alternatively, such a taxpayer may use the practice of reporting all receipts from salvage as ordinary income so long as that practice clearly reflects income. See section 1.167(a)–8(e)(2) of the Income Tax Regulations. At the time the taxpayer regroups his assets into multiple-asset accounts, he may adopt either of these practices without securing the prior consent of the Commissioner.

49. Question:

Section 3.05, Part II of Revenue Procedure 62–21 provides in part that:

* * * where such class life was accepted on audit by the Internal Revenue Service under presently established procedures for examining depreciation (whether before or after the effective date of this Revenue Procedure), the depreciation deduction claimed by the taxpayer for the assets in that class in any subsequent year based on that class life will not be disturbed if the taxpayer's retirement and replacement practices for that class are consistent with the class life being used.

What constitutes "acceptance on audit by the Internal Revenue Service under presently established procedures for examining depreciation"?

Answer:

The class life used by a taxpayer will be considered to have been accepted on audit for purposes of applying the provisions of the Revenue Procedure in all situations in which the audit report shows adjustments to depreciation or contains comments that the depreciation deduction was examined but not adjusted, or where other specific evidence indicates that the depreciation deduction was examined. If there is no specific evidence either in the audit report or elsewhere that the depreciation deduction was examined, or if there was no audit of the return, the class life used by the taxpayer will not be considered to have been accepted on audit.

GUIDELINE CLASSES

50. Question:

How are assets to be classified in the prescribed guideline classes where a taxpayer engages in more than one industrial or commercial activity?

Answer:

The assets falling within the guideline classes in Group One (guidelines for depreciable assets used by business in general) should first be classified in the appropriate guideline classes contained in Group One. If the taxpayer is engaged in only one activity described in Group Two, Three, or Four, the remaining assets should be classified in the guideline class for that activity. If, however, the taxpayer is engaged in more than one activity, the assets used in each activity should be classified in the appropriate guideline class for that activity, except for the assets used in an activity which is considered insubstantial for the purpose of applying Revenue Procedure 62–21. An activity will be considered as insubstantial where the total basis of the assets used in that activity is less than three percent of the total basis of the assets used in all activities carried on by the taxpayer (excluding assets which fall within the guideline classes contained in Group One). If an activity carried on by the taxpayer is considered insubstantial, the assets used in that activity should be classified in

the guideline class for the activity which the insubstantial activity primarily serves or with which it is most closely associated.

These principles may be illustrated by the following examples:

(1) Corporation M mines coal and iron ore and makes steel and steel products. Corporation M has the following assets, excluding assets which fall in the guideline classses contained in Group One:

Assets used in mining	$500,000
Assets used in steel making	1,500,000
Total	2,000,000

The assets used in mining should be classified in guideline class 5 of Group Two (mining—10 years). The assets used in making steel and steel products should be classified in guideline class 19(a) of Group Three (ferrous metals—18 years).

(2) Assume that Corporation M also provides bowling alleys for its employees, and that the equipment used in connection with the bowling alleys has a basis of $50,000. Since the total basis of the assets used in the bowling alleys is less than three percent of the total basis of the assets used in mining, steel making, and recreational facilities, the recreation and amusement activity carried on by M Corporation will be considered to be insubstantial. If the bowling alleys are used primarily by employees who work in Corporation M's steel plant, the equipment used in the bowling alleys should be classified in Class 19(a) of Group Three (ferrous metals).

51. Question:

How should an item of production machinery or equipment be classified if it is used in the manufacture of products connected with two or more guideline classes?

Answer:

It should be classified according to its primary use. The primary use of an asset may be determined in any reasonable manner. This principle may be illustrated by the following example:

Corporation N makes metal stampings some of which are sold for use in the aerospace industry and some of which are sold for use in other activities. Corporation N has the following assets, excluding assets which fall in the guideline classes contained in Group One:

Assets used only in making component parts for the aerospace industry	$600,000
Assets used only in making other fabricated metal products	400,000
Assets used both in making component parts for the aerospace industry and other fabricated metal products	300,000
Total	1,300,000

The assets used in making component parts for the aerospace industry should be classified in guideline class 1 of Group Three (aerospace industry—8 years). The assets used in making other fabricated metal products should be classified in guideline class 6 of Group Three (fabricated metal products—12 years). The various assets used in both activities should be classified according to primary use either in guideline class 1 or 6 of Group Three.

52. Question:

How should equipment, such as power plant equipment, be classified if it services machinery falling in two or more different guideline classes?

Answer:

Such equipment should be classified according to its primary use. Thus, if power plant equipment services machinery identified with two different manufacturing activities, the total basis of the power plant equipment should be included in the guideline class which contains the production machinery which the power plant equipment primarily serves. The purimary use of such equipment may be determined in any reasonable manner.

53. Question:

What rules should be applied where the primary use of an asset changes?

Answer:

Once an asset has been properly classified in a guideline class according to its primary use, it will generally continue to be classified in the same guideline class throughout the period of its use in the taxpayer's trade or business. However, if the primary use of an asset changes, the taxpayer has the option of continuing to classify the asset according to its original classification or of reclassifying it according to its new primary use. If the asset is reclassified, the basis and depreciation reserve attributable to the asset should be removed from the first guideline class and added to the total basis and total depreciation reserve for the second guideline class.

54. Question:

May different groups of assets, each used in connection with a separate activity described in Group Two, Three, or Four be combined and treated as falling in one guideline class for the purpose of applying Revenue Procedure 62–21?

Answer:

Assets used in one substantial activity should not be combined with assets used in another substantial activity for the purpose of applying Revenue Procedure 62–21. The assets used in each substantial activity fall in a separate guideline class. As indicated in the answer to Question 50, however, the assets used in an insubstantial activity are to be classified in one guideline class with the assets used in a substantial activity.

55. Question:

What rules should be applied where an insubstantial activity becomes substantial or a substantial activity becomes insubstantial?

Answer:

If an insubstantial activity becomes substantial, the taxpayer has the option of continuing to classify the assets used in the activity in the same guideline class as theretofore, or he may establish a new guideline class for the activity by removing the basis of the assets used in that activity, and the depreciation reserves attributable to those assets, from the guideline class in which they have been classified and placing them in a separate guideline class.

Similarly, if a substantial activity becomes insubstantial, the taxpayer has the option of continuing to maintain a separate guideline class for the activity, or of transferring the assets used in that activity to the guideline class for the activity which the insubstantial activity primarily serves or with which it is most closely associated.

56. Question.

If a building is constructed so that it is useful in only one particular industry, is it a special-purpose structure?

Answer:

The fact that the use of a building is restricted by the manner in which it is constructed does not in itself make the building a special-purpose structure. A special-purpose structure is one which is an integral part of the production process, and which is so closely associated with the equipment which it houses, supports, or serves that it would normally be replaced (entirely or in large part) contemporaneously with that equipment.

59. Question:

What activities are considered "mining" for the purpose of applying Revenue Procedure 62–21?

Answer:

The activities which are considered to be "mining" for the purpose of computing percentage depletion will be considered to be "mining" for the purpose of classifying machinery and equipment in guideline class 5 of Group Two (mining). Assets used in an activity of a type considered as mining shall be included in guideline class 5 of Group Two even though the taxpayer is not entitled to a depletion allowance with respect to that activity. For example, if a taxpayer is operating a concentrating plant, the assets used in that activity should be classified in guideline class 5 even though the taxpayer does not have an economic interest in the mineral in place and thus is not entitled to a depletion allowance.

COMPUTATION OF CLASS LIFE

58. Question:

How is the class life used by a taxpayer to be computed where he uses the double-declining balance or the sum-of-the-years digits method of depreciation with respect to some or all of the assets in a guideline class?

Answer:

As indicated in Revenue Procedure 62–21, the class life is computed by dividing the total straight-line depreciation with respect to all assets in the guideline class into the total basis of all those assets. If the taxpayer is actually using the straight-line method of depreciation with respect to assets in the guideline class, the straight-line depreciation for the purpose of computing the class life is the same as the depreciation deduction claimed by the taxpayer. If the taxpayer is using the double declining balance method of depreciation with respect to any asset or multiple-asset account falling in the guideline class, the straight-line depreciation with respect to that asset or account for the purpose of computing the class life is obtained by multiplying the total basis of the asset or account by one-half the double declining balance rate used by the taxpayer. If the taxpayer is using the sum-of-the-years digits method of depreciation with respect to any asset or multiple-asset account falling in the guideline class, the straight-line depreciation with respect to that asset or account for the purpose of computing the class life is the amount of depreciation that would be claimed as a deduction under the straight-line method if the remaining balance in the account (computed as if the taxpayer had been using the straight-line method) were spread over the remaining life of the account used in computing depreciation under the sum-of-the-years digits method. For this purpose, the same amount of salvage (if any) should be used in computing the straight-line

depreciation as the taxpayer used in computing depreciation under the sum-of-the-years digits method.

The following examples illustrate the computation of the class life:

(1) Taxpayer A uses the straight-line method of depreciation with respect to all assets falling within a guideline class and estimates that such assets have no salvage value.

	Cost (or basis)	Life used (in years)	Depreciation rate	Actual depreciation taken
			Percent	
Machine A (item account)	$10,000	13	7.7	$770
Machine B (item account)	7,000	12	8.3	581
Multiple asset account C	30,000	11	9.1	2,730
Multiple asset account D	40,000	9	11.1	4,440
Totals	87,000			8,521

The class life is 10.2 years ($87,000 divided by $8,521).

(2) Taxpayer B uses the straight-line method of depreciation with respect to all assets falling within a guideline class and assigns estimated salvage values to such assets.

	Cost (or basis)	Life used (in years)	Salvage	Depreciation rate (times basis less salvage)	Actual depreciation taken
				Percent	
Machine A (item account)	$10,000	13	$1,000	7.7	$693
Machine B (item account)	7,000	12	500	8.3	540
Multiple asset account C	30,000	11	3,000	9.1	2,457
Multiple asset account D	40,000	9	4,000	11.1	3,996
Totals	87,000				7,686

The class life is 11.3 years ($87,000 divided by $7,686).

(3) Taxpayer C uses the double declining balance method of depreciation with respect to all assets falling within a guideline class.

	Cost (or basis)	Life used (in years)	Accumulated reserve (2 years)	Depreciation rate (times basis less reserve)	Actual depreciation taken	Straight line rate	Straight line depreciation
				Percent		*Percent*	
Machine A (item account)	$10,000	13	$2,843	15.4	$1,102	7.7	$770
Machine B (item account)	7,000	12	2,131	16.6	808	8.3	581
Multiple asset account C	30,000	11	9,926	18.2	3,653	9.1	2,730
Multiple asset account D	40,000	9	15,789	22.2	5,375	11.1	4,440
Totals	87,000				10,938		8,521

The class life is 10.2 years ($87,000 divided by $8,521).

(4) Taxpayer D uses the sum-of-the-years digits method of depreciation with respect to all assets falling within a guideline class and estimates that such assets have no salvage value.

	Cost (or basis)	Life used (in years)	Depreciation rate	Actual depreciation taken	Straight line rate	Straight line depreciation
					Percent	
Machine A (item account)	$10,000	13	10/91 (4th year)	$1,099	7.7	$770
Machine B (item account)	7,000	12	8/78 (5th year)	718	8.3	581
Multiple asset account C	30,000	11	.2000 (9 years remaining life)* accumulated reserve=$9,545.	*4,091	9.1	2,730
Multiple asset account D	40,000	9	.2500 (7 years remaining life)* accumulated reserve=$15,110.	*6,223	11.1	4,440
Totals	87,000			12,131		8,521

The class life is 10.2 years ($87,000 divided by $8,521).
*See Table I, Regulation section 1.167(b)-3(a)(2)(ii) for the rate for remaining useful life. The actual depreciation is obtained by applying the rate to the cost or basis less the accumulated reserve.

(5) Taxpayer E uses the sum-of-the-years digits method of depreciation with respect to all assets falling within a guideline class and assigns estimated salvage values to such assets.

	Cost (or basis)	Life used (in years)	Salvage	Depreciation rate	Actual depreciation taken	Straight line rate	Straight line depreciation
						Percent	
Machine A (item account)	$10,000	13	$1,000	10/91 (4th year)	$989	7.7	$693
Machine B (item account)	7,000	12	500	8/78 (5th year)	667	8.3	540
Multiple asset account C	30,000	11	3,000	.2000 (9 years remaining life) accumulated reserve=$8,591.	*3,682	9.1	2,457
Multiple asset account D	40,000	9	4,000	.2500 (7 years remaining life) accumulated reserve=$13,600.	*5,600	11.1	3,996
Totals	87,000				10,938		7,686

The class life is 11.3 years ($87,000 divided by $7,686).
*The actual depreciation is obtained by applying the rate to the cost or basis less salvage and accumulated reserve.

(6) Assume the same facts as in example (5), except that taxpayer E revises the useful life of multiple-asset account D so that the account has a remaining life of 5 years rather than 7 years as shown in example (5).

	Cost (or basis)	Life used (in years)	Salvage	Depreciation rate	Actual depreciation taken	Straight line rate	Straight line depreciation
						Percent	
Machine A (item account)	$10,000	13	$1,000	10/91 (4th year)	$989	7.7	$693
Machine B (item account)	7,000	12	500	8/78 (5th year)	667	8.3	540
Multiple asset account C	30,000	11	3,000	.2000 (9 years remaining life) accumulated reserve=$8,591	*3,682	9.1	2,457
Multiple asset account D	40,000	5 (remaining life).	4,000	.3333 (5 years remaining life) accumulated reserve=$13,600.	*7,467		**5,602
Totals	87,000				12,805		9,292

The class life is 9.4 years ($87,000 divided by $9,292).
* The actual depreciation is obtained by applying the rate to the cost or basis less salvage and accumulated reserve.
** The straight-line depreciation is obtained by dividing the basis less salvage and straight-line reserve ($36,000-$7,992) by the remaining life of the account (5 years). The reserve of $7,992 is the straight-line reserve accumulated over a two-year period while E was using a life of 9 years.

(7) Taxpayer F uses different methods of depreciation with respect to the assets falling within a guideline class and estimates that such assets have no salvage value.

Method of depreciation	Cost (or basis)	Life used (in years)	Salvage	Reserve	Depreciation rate	Actual depreciation taken	Straight line rate	Straight line depreciation
					percent		*percent*	
Account 1* Straight line	$12,000	14	None	$5,964	7.1	$852	7.1	$852
Account 2 Double declining balance.	15,000	13		2,310	15.4	1,954	7.7	1,155
Account 3 150% declining balance.	8,000	10		1,200	15	1,020	10	800
Account 4 Sum-of-the-years digits (remaining life plan).	24,000	10	None	8,290	.2222 (8 years remaining life).	3,491	10	2,400
Totals	59,000					7,317		5,207

The class life is 11.3 years ($59,000 divided by $5,207).

*The word "account" as used in this example and example (8) represents either an item account or a multiple-asset account. Hence, these examples apply equally to taxpayers using more than one method of depreciation with respect to item accounts or multiple-asset accounts.

(8) Taxpayer G uses different methods of depreciation with respect to the assets falling within a guideline class and assigns estimated salvage values to some of the assets.

Method of depreciation	Cost (or basis)	Life used (in years)	Salvage	Reserve*	Depreciation rate	Actual depreciation taken	Straight line rate	Straight line depreciation
					percent		*percent*	
Account 1 Straight line	$12,000	14	None		7.1	$852	7.1	$852
Account 2 Straight line	12,000	14	$2,000		7.1	710	7.1	710
Account 3 Double declining balance.	15,000	13		$2,310	15.4	1,954	7.7	1,155
Account 4 150% declining balance.	8,000	10		1,200	15	1,020	10	800
Account 5 Sum-of-the-years digits.	10,000	13	None		10/91 (4th year).	1,099	7.7	770
Account 6 Sum-of-the-years digits.	10,000	13	$1,000		10/91 (4th year).	989	7.7	693
Account 7 Sum-of-the-years digits (remaining life plan).	24,000	10	None	8,290	.2222 (8 years remaining life).	3,491	10	2,400
Account 8 Sum-of-the-years digits (remaining life plan).	24,000	10	$4,000	6,909	.2222 (8 years remaining life).	2,909	10	2,000
Totals	115,000					13,024		9,380

The class life is 12.3 years ($115,000 divided by $9,380).

*Reserve figures are given only where necessary to the computation of depreciation.

The following examples illustrate the use by a taxpayer of a class life equal to the guideline life, assuming in each case that the guideline life is 10 years:

(9) Taxpayer H uses the straight-line method of depreciation with respect to all the assets falling within a guideline class. The total basis of all the assets in the class is $100,000 and the total depreciation reserve is $50,000. If H wishes to group all the assets in a single account corresponding to the guideline class and use a class life equal to the guideline life, he may take depreciation of $10,000 since the total basis ($100,000) divided by the total straight-line depreciation ($10,000) would produce a class life of 10 years.

(10) Taxpayer J uses the double-declining balance method of depreciation with respect to all the assets falling within a guideline class. The total basis of all the assets in the class is $100,000 and the total depreciation reserve is $60,000. If J wishes to group all the assets in a single account corresponding to the guideline class and use a class life equal to the guideline life, he may take depreciation of $8,000 (20% × ($100,000 − $60,000)). This is equal to twice the straight-line rate which is the reciprocal of the guideline life times the remaining balance of the account.

(11) Taxpayer K uses the sum-of-the-years digits method of depreciation with respect to all the assets falling within a guideline class. The total basis of all assets in the class is $100,000 and the total depreciation reserve is $66,000. However, the depreciation reserve if K had been using the straight-line method of depreciation would be $50,000. If K wishes to group all the assets in a single account corresponding to the guideline class and use a class life equal to the guideline life, he may take depreciation of $11,333.33. This is computed as follows: K must first compute what the remaining life of the account would be if he used a class life equal to the guideline life and the straight-line method of depreciation. The remaining life based on these assumptions is 5 years (the remaining balance in the account using the straight-line method ($50,000) divided by the amount of straight-line depreciation which would be allowable to a person using a class life equal to the guideline life ($10,000)). Table I in Regulation Section 1.167(b)–3(a)(2)(ii) provides decimal equivalents for each remaining life of a sum-of-the-years digits account. To determine the amount of allowable depreciation, it is necessary to multiply the decimal equivalent for a 5-year remaining life (.3333) times the remaining balance in the account ($34,000), thus obtaining a depreciation allowance of $11,333.33.

(12) Taxpayer L has four assets falling in a single guideline class. He has been using item accounts and has been depreciating the accounts under different methods of depreciation. He wishes to continue this practice. If L computed his depreciation in the current year without changing his rates from those used in the past, it would be computed as follows:

	Method of depreciation	Cost (or basis)	Life used (in years)	Salvage	Reserve	Depreciation rate	Actual depreciation taken	Straight-line depreciation
Machine A	Straight-line	$10,000	10	$1,000	$6,300	10% (times basis less salvage)	$900	$900
Machine B	Straight-line	5,000	8	1,000	2,500	12½% (times basis less salvage)	500	500
Machine C	Double declining balance.	6,000	20		1,626	10% (times basis less reserve)	437	*300
Machine D	Sum-of-the-years digits.	15,000	15	2,000	4,550	12/120 (times basis less salvage)	1,300	**867
Total		36,000					3,137	2,567

*Determined by applying one-half the double-declining balance rate to the basis of the asset (5% × $6,000).
**Determined by spreading the basis of the asset less salvage over its useful life ($13,000/15).

Under these circumstances, L would be using a class life of 14 years ($36,000 total basis) / ($2,567 total straight-line depreciation). If L wishes to use a class life equal to the guideline life, he may adjust the lives or salvage assigned to the individual assets in any manner he thinks is reasonable so that the total straight-line depreciation is increased to $3,600. An example illustrating one way in which L might adopt a class life equal to the guideline life of 10 years is as follows:

	Basis Less salvage	Life used (in years)	Reserve	Straight-line rate	Straight-line depreciation	Actual depreciation rate	Actual depreciation taken
				Percent		*Percent*	
Machine A	$9,000	9	$6,300	11⅑	$1,000	11⅑	$1,000
Machine B	4,000	5	2,500	20	800	20	800
Machine C	6,000	12	1,626	8⅓	500	16⅔ (times basis less reserve).	729
Machine D	13,000	10	4,550	10	1,300	.2222—8 year remaining life (times basis less salvage and reserve).***	1,878
Total					3,600		4,407

***The 8-year remaining life is determined by dividing $10,400, the remaining balance in the account on a straight-line basis ($13,000−(3×$867)), by the annual straight-line depreciation ($1,300).

59. Question:

Under Revenue Procedure 62–21, in computing the class life used by a taxpayer, the total straight-line depreciation with respect to all assets in a guideline class is divided into the total basis of those assets. In the case of additions to the guideline class during the taxable year, the basis of each addition will generally be included in the depreciation accounts of the taxpayer at the close of the year, but less than a full year's depreciation will generally have been claimed with respect to these additions. In the case of retirements from the guideline class during the year, some depreciation will generally have been claimed as to each retirement, but the basis of the assets retired will have been removed from the taxpayer's depreciation accounts. How are additions and retirements during the year to be taken into account in computing the class life so as to avoid distortion?

Answer:

In computing the class life, the basis of each addition and retirement during the taxable year must be apportioned consistent with the amount of depreciation claimed with respect to each

addition and retirement. The proper portion of the basis of each asset added or retired during the taxable year to be taken into account is that portion which bears the same relationship to the total basis of the asset as the amount of depreciation taken for the taxable year with respect to the asset bears to the amount of depreciation that would be taken for a full taxable year. Thus, for the purpose of computing the class life, the total basis of the assets in a guideline class means the basis of each asset in the class on which a full year's depreciation is claimed plus a proportionate part of the basis of each asset acquired or retired during the year on which less than a full year's depreciation is claimed. This system for the handling of additions and retirements provides for an accurate relationship between depreciation and basis and also prevents an overweighting of additions and retirements in relation to the other assets in the guideline class.

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26 CFR 601.311: Imposition of taxes; regulations. Rev. Proc. 62–22 [1] (Also Part I, Section 5704; 290.198).

Preparation and disposition of notice of removal by manufacturers of tobacco products when tax-exempt tobacco products are removed from the factory to replace products previously removed and lost, damaged, or destroyed in transit for exportation.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to outline the procedure for the preparation and distribution by manufacturers of tobacco products of Form 2149. Notice of Removal of Tobacco, Tobacco Products, or Cigarette Papers or Tubes, from Factory for Export, covering shipments of tax-exempt tobacco products, replacing products lost, damaged, or destroyed in transit for exportation.

SEC. 2. BACKGROUND.

.01 Sections 290.198 and 290.199 of the Regulations relating to the Exportation of Tobacco Materials, Tobacco Products and Cigarette Papers and Tubes, Without Payment of Tax, or With Drawback of Tax, provide for the preparation and distribution of the several copies of Form 2149, and section 290.203 of the Regulations provides for the filing of two copies of the form with the Collector of Customs at the port of exportation, for each shipment removed for exportation.

.02 Where tobacco products are lost, damaged, or destroyed in transit for exportation (either the total shipment or a part of the shipment) and the manufacturer of tobacco products makes a replacement shipment, the two sets of Form 2149 will, in the aggregate, indicate the removal for exportation of more products than are entered on the export declaration and ship's manifest. Since the Collector of Customs certifies to only the actual quantity exported, the additional Form 2149 covering a replacement shipment often creates confusion and additional work in his office. Therefore, the following procedure should be used when replacement shipments are made.

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[1] Based on Industry Circular 62–23, dated June 26, 1962.

SEC. 3. PROCEDURE.

.01 *Preparation and Disposition of Forms 2149 Covering Replacement Shipments.*—When tax-exempt tobacco products are removed from the factory to replace products lost, damaged, or destroyed in transit for exportation, Form 2149 should be prepared in accordance with the regulations. This Form 2149 should contain a statement to the effect that the products listed thereon were removed from the factory to replace products removed under Form 2149, serial number —, which were lost, damaged, or destroyed, as applicable. It should also contain an explanation of the loss, damage, or destruction. Only two copies of the form need be prepared, one copy to be retained by the manufacturer as a part of his records and one copy to be forwarded to the Assistant Regional Commissioner, Alcohol and Tobacco Tax. No copy should be sent to the Collector of Customs for the reason stated in section 2.02 above.

.02 *Accounting for Lost, Damaged, or Destroyed Tobacco Products.*—Manufacturers are reminded that lost, damaged, or destroyed tobacco products must be accounted for by taxpayment, by return to the factory, or by the filing of a claim for remission of the tax liability with the Assistant Regional Commissioner, Alcohol and Tobacco Tax.

SEC. 4. INQUIRIES.

Inquiries in regard to this Revenue Procedure should refer to its number and be addressed to the office of the Assistant Regional Commissioner, Alcohol and Tobacco Tax.

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26 CFR 601.602: Forms and instructions. Rev. Proc. 62–23
(Also Part I, Section 6109; 1.6109–1.)

A fiduciary for ten or more estates or trusts needing employer identification numbers for income tax purposes may file a consolidated application for such numbers in lieu of separate applications on Form SS–4, Application For Employer Identification Number.

SECTION 1. BACKGROUND AND PURPOSE.

.01 Public Law 87–397, October 5, 1961, C.B. 1961–2, 348, added section 6109 to the Internal Revenue Code of 1954. Section 6109 authorizes the use of identifying numbers for Federal tax purposes. Regulations issued under this new legislation require that the fiduciary for an estate or trust shall, under certain circumstances, obtain for it an employer identification number to be included in returns, statements, and other documents filed on its behalf and to be furnished to other persons for inclusion in returns, statements, or other documents filed by such other persons with respect to the estate or trust. See section 1.6109–1(c)(3) of the Income Tax Regulations, Treasury Decision 6606, page 311, this Bulletin.

.02 Many estates and trusts have been assigned employer identification numbers in connection with the reporting of employment and excise taxes. An estate or trust which has had an employer identification number assigned to it for employment or excise tax purposes will use such number for all tax purposes.

.03 The attention of the Internal Revenue Service has been called to the fact that a fiduciary, including a bank or trust company, may

act for numerous estates and trusts, and it would be burdensome for such a fiduciary to file a separate application on Form SS–4, Application For Employer Identification Number, for an employer identification number for each such estate and trust. In order to minimize this burden, the Service has determined that a fiduciary acting for ten or more estates or trusts needing employer identification numbers (other than an estate or trust needing an employer identification number in connection with the reporting of employment or excise taxes) may file a consolidated application for such numbers in lieu of separate applications on Forms SS–4. Each consolidated application shall be in the format prescribed in section 2 of this Revenue Procedure. A fiduciary applying for employer identification numbers on behalf of estates or trusts required to file returns of employment taxes must file a separate application on Form SS–4 for each estate or trust.

SEC. 2. FORM OF APPLICATION.

Each consolidated application filed in accordance with this Revenue Procedure shall be filed in duplicate with the District Director of Internal Revenue for the district in which the fiduciary resides or has his principal place of business and shall be in substantially the following format:

In accordance with the provisions of Revenue Procedure 62–23 the undersigned hereby makes application for an employer identification number for each of the estates or trusts named below. None of the estates or trusts named below has previously applied for or been assigned an employer identification number and none of such estates or trusts is an employer for Federal employment tax purposes.

Name of Estate or Trust (As shown on Fiduciary Income Tax Return, Form 1041)	Estate or Trust (Specify)	Employer Identification Number

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(Date)

(Signature of Fiduciary)

(Address of Fiduciary)

SEC. 3. ASSIGNMENT OF NUMBERS.

.01 Upon receipt of the consolidated application, the District Director will assign a separate employer identification number to each of the estates or trusts named therein, will enter such numbers on the original and duplicate copies of the application, and will return the duplicate copy to the fiduciary as notice of the numbers assigned.

.02 In the event an estate or trust subsequently needs a number for employment or excise tax purposes, the number issued on the basis of the consolidated application will be used. A separate application on Form SS–4 need not be filed on behalf of such estate or trust.

SEC. 4. INQUIRIES.

Inquiries in regard to this Revenue Procedure should refer to its number and be addressed to the office of the Assistant Commissioner (Data Processing), Attention: D:O:M, Internal Revenue Service, Washington 25, D.C.

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26 CFR 601.311: Imposition of taxes; regulations.
(Also Part I, Section 7805; 301.7805–1.)

Rev. Proc. 62–24

Program for review of Revenue Rulings and Revenue Procedures issued under the provisions of Chapter 15 of the Internal Revenue Code of 1939 and Chapter 52 of the Internal Revenue Code of 1954 to identify those needing revision to conform to current provisions of the pertinent law and regulations and to prepare and publish the required revisions.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to announce a program for (1) the review of Revenue Rulings and Revenue Procedures issued under the provisions of Chapter 15 of the Internal Revenue Code of 1939 and Chapter 52 of the Internal Revenue Code of 1954 and (2) the issuance of revisions to reflect current provisions of the law and related regulations.

SEC. 2. BACKGROUND.

.01 Public Law 591, 83d Cong., approved August 16, 1954, and Public Law 85–859, 85th Cong., C.B. 1958–3, 92, approved September 2, 1958, made many changes in the laws administered by the Alcohol and Tobacco Tax Division.

.02 All Revenue Rulings and Revenue Procedures issued under the provisions of Chapter 52 of the 1954 Code and corresponding provisions of the 1939 Code have been reviewed to identify those that are considered to be obsolete either because they have no application to the law and regulations now in effect or are unnecessary because the subject matter of the ruling is now specifically covered by regulations. Revenue Ruling 62–172, page 352, contains a list of those Revenue Rulings and Revenue Procedures which are no longer in effect and declares them to be obsolete.

SEC. 3. REVENUE RULINGS AND REVENUE PROCEDURES TO BE REPUBLISHED.

A current study is being made of the remaining Revenue Rulings and Revenue Procedures to identify those that require revision to reflect present law and regulations and to prepare and publish the ensuing revisions.

SEC. 4. INQUIRIES.

Inquiries regarding this Revenue Procedure, as well as comments regarding any particular Revenue Ruling or Revenue Procedure issued under Chapter 15 of the 1939 Code or Chapter 52 of the 1954 Code should refer to its number and be addressed to the Director, Alcohol and Tobacco Tax Division, Washington 25, D.C.

26 CFR 601.602: Forms and instructions. Rev. Proc. 62–25
(Also Part I, Section 6051; 31.6051–1.)

Substitutes for Form W–2, Withholding Tax Statement—1963, may be privately printed with slight variations in format and used without specific approval of the Internal Revenue Service, only in the circumstances set forth below, provided they meet specified conditions with respect to physical characteristics, use of additional copies, and additional information, if any, to state and local taxing authorities.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to state the requirements of the Internal Revenue Service relating to the preparation of acceptable substitutes for Form W–2, Withholding Tax Statement—1963, for filing purposes in lieu of the official form.

SEC. 2. SPECIFICATIONS.

.01 *Substitutes.*—Substitutes for Form W–2 may be privately printed. The substitute forms should follow the format of the official form except in those circumstances where the employer's data processing system will not accommodate this type of form. In these cases they may be printed with slight variations in format and used without requesting approval of the Internal Revenue Service if the conditions enumerated in section 3 are met. For proposed substitutes which do not meet such conditions, specific approval must be requested as provided by section 5, below. In any rearrangement of the information, care should be taken to prevent disclosure of wage and tax information if a window envelope is used for mailing.

.02. *Design for mailing.*—The official form is designed for mailing in a standard window envelope. This feature will be found desirable in most of the privately printed substitutes.

.03 *Copy D.*—Copy D is included in the official assembly for the convenience of the employer. Although there is no requirement that privately printed substitute forms include Copy D, employers may find it desirable to make and retain such copy.

SEC. 3. CONDITIONS.

.01 *Color and quality of ink and paper.*—The substitute forms, except for authorized punch card substitutes, must be printed in blue ink on white paper, both of quality as good as that used by the Government. The paper must be of substantially the same weight and texture as that used in the official form which is printed on substance 32-pound chemical wood bond or its equivalent—basis 17 x 22–1000.

.02 *Typography.*—Type may not be smaller than the corresponding type on the official form and as nearly as possible of the same font.

.03 *Format.*—The substitute forms must provide the same spaces as the official form for showing wages paid and tax withheld. In any rearrangement of such spaces, the block headed "INCOME TAX INFORMATION" is to be placed in a prominent position on the form, preferably in the right-center position, the spaces for showing social security information to be either to the left or above such block.

.04 *Dimensions.*—The official form is eight inches wide by three and one-half inches deep, exclusive of a half inch snap-stub on the left side of the form. The substitute forms may vary in width from seven inches to eight inches and in depth from three and one-sixth

inches to three and two-thirds inches. The snap feature is not required on substitutes.

.05 *Carbonized forms or "spot carbons."*—Carbonized forms and "spot carbons" are not permissible. Interleaved carbon, if used, must be of good quality to preclude smudging and, preferably, black.

.06 *Special identification.*—Copy B must show the full-face dots, arranged vertically on the upper right side.

.07 *The Government Printing Office symbols.*—The Government Printing Office symbols must be omitted.

SEC. 4. ADDITIONAL INSTRUCTIONS.

.01 *Arrangement of assembly.*—Except as provided in paragraph .02 below, the parts of the assembly shall be arranged, from top to bottom, as follows: Copy A, "For District Director"; Copy B, "To be filed with employee's tax return"; Copy C, "For employee's records"; Copy D, "For employer." All references to the various parts shall be to "Copy A," "Copy B," "Copy C," or "Copy D."

.02 *Additional copies.*—Additional copies may be prepared for the use of employers in connection with taxes or deductions other than Federal income tax and Federal Insurance Contributions Act taxes. Such additional copies may not be placed ahead of Copy C in the assembly except that if a copy or copies for a state or local taxing authority are prepared only *one* such copy may be placed ahead of Copy C in the assembly, for better legibility. Forms for delivery to state or local taxing authorities should be clearly labeled to indicate the purpose for which they are intended and should not bear any part of the designation, "Form W–2—U.S. Treasury Department, Internal Revenue Service."

.03 *Excludable sick pay.*—If desired, a block may be shown on Form W–2 for excludable sick pay. However, if such a block is provided and no amount is entered, the word "None" or "0" should be shown.

.04 *Statement to support excludable sick pay.*—A statement from the employer to support sick pay excludable from gross income may be made a part of the assembly, provided it is not placed ahead of Copies A and B in the assembly and is printed on paper of distinctive color. Such statement should substantially conform with the statement set forth in Revenue Procedure 57–1, C.B. 1957–1, 721. It should be clearly indicated on such statement that it is to be attached to page 2 of the taxpayer's Federal income tax return, Form 1040.

.05 *Instructions.*—No deviation from the instructions on either the front or back of Copies A, B, or C will be permitted.

.06 *State or local taxing authorities.*—Additional wage or tax information for state or local taxing authorities may be shown on Copy C, but not on Copies A and B.

.07 *Other information.*—Payroll deductions other than those required to be reported on Form W–2 may not be shown on Copies A and B, except as provided in paragraph .08 below.

.08 *State agencies.*—The amounts of wages paid and employee contributions withheld under a State-Federal agreement, entered into pursuant to section 218 of the Social Security Act, may be shown in the spaces on Form W–2 for Federal Insurance Contributions Act wages and employee tax, provided appropriate distinguishing captions are used to identify such amounts. The identification number

assigned by the Social Security Administration to the state (prefix 69) should be shown in addition to the employer identification number assigned by the Internal Revenue Service for income tax withholding purposes.

SEC. 5. SUBSTITUTES NOT MEETING ABOVE CONDITIONS.

Proposed substitute forms which do not meet the conditions stated above and requests for submission of punched card Forms W–2 should be forwarded by letter to the Commissioner of Internal Revenue, Attention: D:S:T, Washington 25, D.C., for consideration.

SEC. 6. REPRODUCTION PROOFS.

Reproduction proofs of the official Form W–2 are available upon the request of any employer who desires to use reproductions of such form. Requests for reproduction proofs should be addressed to the Commissioner of Internal Revenue, Attention: A:FM:P, Washington 25, D.C.

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26 CFR 601.602: Forms and instructions. (Also Part I, Sections 6001, 6011, 6018, 6019; 1.6001–1, 1.6011–1, 20.6018–1, 25.6019–1.) Rev. Proc. 62–26

Reproduced copies of certain Federal tax return forms and schedules may be used for filing purposes in lieu of the applicable official forms, subject, however, to prescribed conditions. Revenue Procedure 61–31, C.B. 1961–2, 569, superseded.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to restate the requirements of the Internal Revenue Service relating to the preparation of acceptable reproductions of Federal tax return forms and schedules for filing purposes in lieu of the official forms and schedules.

SEC. 2. SPECIFICATIONS.

Subject to the conditions enumerated in section 3 below, the Service will accept, for filing purposes, reproduced copies of any of the following tax return forms and schedules:

Employee's Withholding Exemption Certificate, Form W–4
U.S. Estate Tax Return, Form 706
U.S. Gift Tax Return, Form 709
Life Insurance Statement, Form 712
Claim, Form 843
U.S. Exempt Cooperative Association Income Tax Return, Form 990–C
U.S. Return of Employees' Trust Described in Section 401(a) and Exempt Under Section 501(a) of the Internal Revenue Code of 1954, Form 990–P
U.S. Individual Income Tax Return, Form 1040
Supplemental Schedule of Income and Credits, Schedule B (Form 1040)
Profit (or loss) From Business or Profession, Schedule C (Form 1040)
Gains and Losses from Sales or Exchanges of Property, Schedule D, (Form 1040)
U.S. Departing Alien Income Tax Return, Form 1040C
Declaration of Estimated Tax, Form 1040–ES

Schedule of Farm Income and Expenses, Schedule F (Form 1040)
U.S. Fiduciary Income Tax Return, Form 1041
Allocation of Accumulation Distribution, Schedule J (Form 1041)
U.S. Partnership Return of Income, Form 1065
Gains and Losses from Sales or Exchanges of Property, Schedule D (Form 1065)
Statement in Support of Credit Claimed by Domestic Corporation for Taxes Paid or Accrued to a Foreign Country or a Possession of the United States, Form 1118
U.S. Corporation Income Tax Return, Form 1120
Schedule of Gains and Losses From Sales or Exchanges of Property, Schedule D (Form 1120)
U.S. Small Business Corporation Return of Income, Form 1120–S
Gains and Losses from Sales or Exchanges of Property, Schedule D (Form 1120–S)
Return of Information and Authorization and Consent of Subsidiary Corporation Included in a United States Consolidated Income Tax Return, Form 1122
Statement for the Purpose of Extending Time for Payment of Taxes by Corporations Expecting Carrybacks, Form 1138
Application for Tentative Carryback Adjustment, Form 1139

SEC. 3. CONDITIONS.

.01 Reproductions must be facsimiles of the official form produced by photo-offset. photoengraving, photocopying, or other similar reproduction process.

.02 Reproductions must be on paper of substantially the same weight and texture and of a quality at least as good as that used in the official form.

.03 Reproductions must substantially duplicate the colors of the paper and ink of the official form in order to be acceptable.

.04 Reproductions must have a high standard of legibility, both as to original form and as to filled-in matter. The Internal Revenue Service reserves the right to reject any reproductions with poor legibility, to withdraw the benefits of this Revenue Procedure from any firm or individual, and to reject any process which fails to meet these standards.

.05 Reproductions of Schedule C–3 and Schedule F–1, Form 1040, which contain Schedule SE, U.S. Report of Self-Employment Income, must be on properly perforated paper of substantially the same weight and texture as that used in the official form.

.06 Reproductions can be the same size as that of the official form. However, the standard commercial size of 8½ x 11 (as noted in columns 2 and 3 of table in section 5 below) will be accepted, but no tolerances will be permitted in the image size of printed material.

SEC. 4. ADDITIONAL INSTRUCTIONS.

.01 The Service ordinarily does not undertake to approve or disapprove the specific equipment or process used in reproducing official forms, but requires only that the reproduced forms and schedules satisfy the stated conditions.

.02 While it is preferred that both sides of the paper be used in making reproductions, resulting in the same page arrangement as that of the official form, the Service will not object if only one side of the paper is used or if the reproduction has a different fold than that provided on the official form.

.03 Reproductions of forms may be made after insertion of the tax computations and other required information. However, all signatures on forms to be filed with the District Director of Internal Revenue must be original signatures, affixed subsequent to the reproduction process.

.04 Reproductions of forms and schedules meeting the above conditions may be used without the prior approval of the Service. However, if specific approval of a reproduction of any such form or schedule is desired, or if the use of a reproduction of any form or schedule not listed herein or otherwise specifically authorized is desired, a sample of the proposed reproduction should be forwarded, by letter, to the Commissioner of Internal Revenue, Attention: D:S:T, Washington 25, D.C., for consideration.

SEC. 5. PHYSICAL ASPECTS.

The conditions with respect to size, number of printed pages, and color of both paper and ink are as follows:

Form No.	Official IRS Trim size [1]	Tolerances permitted in size [2]	Number of printed pages	Color of	
				Paper [3]	Ink
(1)	(2)	(3)	(4)	(5)	(6)
W-4	7⅞ x 3⁷⁄₁₆	8 x 3½	2	White	Black
706	8⅜ x 11	8½ x 11	40	White	Black
709	8½ x 11		2	Buff	Black
712	8 x 10½	8½ x 11	1	White	Black
843	8 x 10½	8½ x 11	2	White	Black
990-C	8½ x 13⅜	8½ x 14	4	White	Black
990-P	8 x 10½	8½ x 11	3	White	Black
1040	8 x 11	8½ x 11	2	White	Black
Schedule B, 1040	8 x 11	8½ x 11	2	White	Black
Schedule C, 1040	7⅞ x 11	8½ x 11	4	White	Black
Schedule D, 1040	8 x 11	8½ x 11	4	White	Black
1040C	7⅞ x 11	8½ x 11	4	White	Black
1963 1040-ES	7⅞ x 10½	8½ x 11	2	White	Black
Schedule F, 1040	7⅞ x 11	8½ x 11	4	White	Black
1041	7⅞ x 11	8½ x 11	4	Pink	Black
Schedule J, 1041	7⅞ x 11	8½ x 11	2	Pink	Black
1065	8 x 11	8½ x 11	4	Yellow	Black
Schedule D, 1065	8 x 11	8½ x 11	2	Yellow	Black
1118	11 x 8½		2	White	Black
1120	8½ x 11		4	Blue	Black
Schedule D, 1120	8½ x 11		4	Blue	Black
1120S	8½ x 11		4	Green	Black
Schedule D, 1120S	8½ x 11		2	Green	Black
1122	8 x 10½	8½ x 11	1	Blue	Black
1138	8 x 10½	8½ x 11	2	White	Black
1139	8 x 11	8½ x 11	3	White	Black

[1] Sizes shown are for single forms furnished by Internal Revenue Service offices; forms supplied in Income Tax Packages are 8⅜" x 11".

[2] Forms cannot exceed sizes shown, nor be less than size of official forms.

[3] All forms MUST be reproduced on CW Bond or its equivalent.

SEC. 6. BLACK AND WHITE PROOFS.

The Service, upon application, will furnish one set of black and white proofs to be used as the reproducible media in the printing of forms. These proofs, for which separate requests must be received annually, will be supplied free of charge to all concerns in the forms reproduction business. Reproduction proofs are available only for the following forms:

W–4	1065
1040	Schedule D (1065)
Schedule B (1040)	1096
Schedule C (1040)	1099
Schedule D (1040)	1099L
1040–ES	1120
Schedule F (1040)	Schedule D (1120)
1041	1120S
Schedule J (1041)	Schedule D (1120S)

Requests for reproduction proofs should be addressed to the Commissioner of Internal Revenue, Attention: A:FM:P, Washington 25, D.C.

SEC. 7. EFFECT ON OTHER DOCUMENTS.

This Revenue Procedure supersedes Revenue Procedure 61–31, C.B. 1961–2, 569.

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26 CFR 601.104: Collection functions. Rev. Proc. 62–27
(Also Part I, Sections 6601, 6611; 301.6601–1, 301.6611–1.)
(Also Part II, Sections 292, 294, 3771; Regulations 118, Section 39.294–1.)

Where the credit claimed on a tax return was for accrued foreign taxes which have since been abated, the provisions of section 6601 of the Internal Revenue Code of 1954 are applicable to the computation of interest on the deficiency arising because of the abatement. Revenue Procedure 60–17, C.B. 1960–2, 942, modified.

The purpose of this Revenue Procedure is to amend section 6.03(2) of Revenue Procedure 60–17, C.B. 1960–2, 942.

Section 6.03(2) of Revenue Procedure 60–17 provides that if the credit claimed on a return was for accrued taxes which have since been abated by the foreign country or possession of the United States, interest is computed on the increase in tax resulting from the reduction in the credit allowable, from the date such adjustment was made by the foreign country to the date of payment of the tax.

Section 6601(a) of the Internal Revenue Code of 1954 provides that if any amount of tax imposed by this title (whether required to be shown on a return, or to be paid by stamp or by some other method) is not paid on or before the last date prescribed for payment, interest on such amount at the rate of six percent per annum shall be paid for the period from such last date to the date paid.

Section 301.6601–1 of the Regulations on Procedure and Administration provides that interest at the rate of six percent per annum shall be paid on any unpaid amount of tax from the last date pre-

scribed for payment of the tax (determined without regard to any extension of time for payment) to the date on which payment is received.

Section 905(c) of the Code, relating to adjustments on payment of accrued foreign taxes, provides, in part, that no interest shall be assessed or collected on any amount of tax due on any redetermination by the Secretary of the Treasury or his delegate, resulting from a *refund* to the taxpayer, for any period before the receipt of such *refund*, except to the extent interest was paid by the foreign country or possession of the United States on such *refund* for such period.

Thus, in reading the applicable law and regulations, there is an inconsistency between the provisions of such law and regulations and section 6.03(2) of Revenue Procedure 60–17. The exception to the general rule as to interest on tax deficiencies provided by section 905(c) of the Code deals only with cases in which there has been a refund of a paid foreign tax. See H.R. Report No. 920, Eighty-first Congress, C.B. 1949–2, 285; Senate Report No. 831, Eighty-first Congress, C.B. 1949–2, 289. There is no provision either in the Internal Revenue Code of 1954 or the regulations thereunder for a waiver of interest with respect to accrued foreign taxes which have been adjusted.

Accordingly, section 6.03(2) of Revenue Procedure 60–17 is modified to read as follows:

(2) *Accrued foreign tax abated.*—If the credit claimed on the return was for *accrued* taxes which have since been *abated*, the provisions of section 6601 of the Code are applicable to the computation of interest on the deficiency arising because of the abatement.

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26 CFR 601.201: Rulings and determination letters. Rev. Proc. 62–28

Outline of the general procedures of the Internal Revenue Service relating to issuing rulings and determination letters to taxpayers and entering into closing agreements as to specific issues, and an explanation of the rights and responsibilities of taxpayers under these procedures.

Revenue Ruling 54–172, C.B. 1954–1, 394; Revenue Procedure 55–14, C.B. 1955–2, 918; and Revenue Procedure 59–22, C.B. 1959–1, 834: superseded.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to describe the general procedures of the Internal Revenue Service in issuing rulings and determination letters to taxpayers and in entering into closing agreements on specific issues as to the interpretation or application of the Federal tax laws (other than those under the jurisdiction of the Alcohol and Tobacco Tax Division). This Revenue Procedure is intended to inform taxpayers and their representatives where they may direct requests for rulings, determination letters, or closing agreements, and the procedures to be followed in order to promote the efficient handling of their inquiries.

SEC. 2. GENERAL PRACTICE AND DEFINITIONS.

.01 It is the practice of the Service to answer inquiries of individuals and organizations, whenever appropriate in the interest of sound tax administration, as to their status for tax purposes and as to the tax effects of their acts or transactions. One of the functions of the National Office of the Service is to issue rulings in such matters.

District Directors of Internal Revenue apply the statutes, regulations, Revenue Rulings and other precedents published in the Internal Revenue Bulletin in the determination of tax liability, the collection of taxes, and the issuance of determination letters in answer to taxpayers' inquiries or requests. For purposes of this Revenue Procedure any reference to district director or district office, also includes the office of the Director, Office of International Operations, where appropriate.

.02 A "ruling" is a written statement issued to a taxpayer or his authorized representative by the National Office which interprets and applies the tax laws to a specific set of facts. Rulings are issued only by the National Office. The issuance of rulings is under the general supervision of the Assistant Commissioner (Technical) and has been largely redelegated to the Tax Rulings Division.

.03 A "determination letter" is a written statement issued by a District Director in response to an inquiry by an individual or an organization, which applies to the particular facts involved the principles and precedents previously announced by the National Office. Determination letters are issued only where a determination can be made on the basis of clearly established rules as set forth in the statutes, Treasury Decisions or regulations, or by rulings, opinions, or court decisions published in the Internal Revenue Bulletin. Where such a determination cannot be made, such as where the question presented involves a novel issue or the matter is excluded from the jurisdiction of a District Director by the provisions of section 4 of this Revenue Procedure, a determination letter will not be issued.

.04 An "information letter" is a statement issued either by the National Office or by a District Director which does no more than call attention to a well established interpretation or principle of tax law, without applying it to a specific set of facts. An information letter may be issued when the nature of the request from the individual or the organization suggests that it is seeking general information, or where the request does not meet all the requirements of section 6 of this Revenue Procedure, and it is believed that such general information will assist the individual or organization.

.05 A "Revenue Ruling" is an official interpretation by the Service which has been published in the Internal Revenue Bulletin. Revenue Rulings are issued only by the National Office and are published for the information and guidance of taxpayers, Internal Revenue Service officials, and others concerned.

.06 A "closing agreement", as the term is used herein, is an agreement between the Commissioner of Internal Revenue and a taxpayer with respect to a specific issue or issues entered into pursuant to the authority contained in section 7121 of the Internal Revenue Code of 1954. Such a closing agreement is based on a ruling which has been signed by the Commissioner and in which the Commissioner indicates that he will enter into a closing agreement on the basis of the holding of the ruling letter. Closing agreements are final and conclusive except upon a showing of fraud, malfeasance, or misrepresentation of a material fact. They may be entered into where it is advantageous to have the matter permanently and conclusively closed, or where a taxpayer can show good and sufficient reasons for an agreement and the Government will sustain no disadvantage by its consummation.

SEC. 3. RULINGS ISSUED BY THE NATIONAL OFFICE.

.01 *In income, profits, and gift tax* matters, the National Office issues rulings on prospective transactions and on completed transactions before the return is filed. However, rulings will not ordinarily be issued if the identical issue is also involved in a return of the taxpayer already filed for a taxable period with respect to which the statutory period of limitation on assessment or refund of tax has not expired. The National Office issues rulings involving qualifications of plans under section 401 of the Code or the exempt status of organizations under sections 501 or 521 of the Code, only to the extent provided in Revenue Procedure 62–31, page 517, this Bulletin, and Revenue Procedure 62–30, page 512, this Bulletin, respectively. The National Office will not issue rulings with respect to the replacement of involuntarily converted property, even though replacement has not been made, if the taxpayer has filed a return for the taxable year in which the property was converted. However, see section 4.06 of this Revenue Procedure as to the authority of District Directors to issue determination letters in this connection.

.02 *In estate tax* matters, the National Office issues rulings with respect to transactions affecting the estate tax of a decedent before the estate tax return is filed. It will not rule with respect to such matters after the estate tax return has been filed, nor will it rule on matters relating to the application of the estate tax to property or the estate of a living person.

.03 *In employment and excise tax* matters, the National Office issues rulings with respect to prospective transactions and to completed transactions either before or after the return is filed. However, the National Office will not rule with respect to an issue, whether related to a prospective or a completed transaction, if it knows or has reason to believe that the same or an identical issue is before any field office in an active examination or audit of the liability of the same taxpayer for a prior period.

.04 Ordinarily, the Service will not issue rulings to business, trade, or industrial associations, or to other similar groups, relating to the application of the tax laws to members of the groups. However, rulings may be issued to such groups or associations relating to their own tax status or liability.

SEC. 4. DETERMINATION LETTERS ISSUED BY DISTRICT DIRECTORS.

.01 *In income, profits, and gift tax* matters, District Directors issue determination letters in response to taxpayers' requests submitted to their offices involving *completed* transactions which affect returns required to be filed in their districts, but only if the question presented is covered specifically by statute, Treasury Decision or regulation, or specifically by a ruling, opinion, or court decision published in the Internal Revenue Bulletin. A determination letter will not usually be issued with respect to a question which involves a return to be filed by the taxpayer if the identical question is involved in a return or returns already filed by the taxpayer. District Directors may not issue determination letters as to the tax consequence of prospective or proposed transactions, except as provided in paragraphs .05 and .06, below.

.02 *In estate tax* matters, District Directors issue determination letters in response to requests submitted to their offices affecting the estate tax returns of decedents which will be filed in their districts, but only if the questions presented are specifically covered by statute, Treasury Decision, or regulations, or specifically by a ruling, opinion or court decision published in the Internal Revenue Bulletin. District Directors may not issue determination letters relating to matters involving the application of the estate tax to property or the estate of a living person.

.03 *In employment and excise tax* matters, District Directors issue determination letters in response to requests from taxpayers who have filed or who are required to file returns in their districts, but only if the questions presented are covered specifically by statute, Treasury Decision or regulations, or specifically by a ruling, opinion, or court decision published in the Internal Revenue Bulletin. Because of the impact of these taxes upon the business operation of the taxpayer and because of special problems of administration both to the Service and to the taxpayer, District Directors may take appropriate action in regard to such requests, whether they relate to completed or prospective transactions or returns previously filed or to be filed.

.04 Notwithstanding the provisions of paragraphs .01, .02, and .03 of this section, a District Director may not issue a determination letter in response to an inquiry, although presenting a question covered specifically by statute, regulations, rulings, etc., published in the Internal Revenue Bulletin, where (1) it appears that the taxpayer has directed a similar inquiry to the National Office, (2) the determination letter is requested by an industry, trade association, or similar group, or (3) the request involves an industry-wide problem. Under no circumstances will a District Director issue a determination letter unless it is clearly indicated that the inquiry is with regard to a taxpayer or taxpayers who have filed or are required to file returns in the district under his supervision. Notwithstanding the provisions of paragraph .03 of this section, a District Director may not issue a determination letter on an employment tax question when the specific question involved has been or is being considered by the National Office of the Social Security Administration. Nor may District Directors issue determination letters on excise tax questions if a request is for a determination of fair market price under sections 4216(b) and 4218 of the Code. However, the National Office will issue rulings in this area. See section 5.03.

.05 District Directors issue determination letters as to the qualification of plans under section 401 of the Code, and as to the exempt status of related trusts under section 501 of the Code, to the extent provided in Revenue Procedure 62–31, *supra*. They also issue determination letters as to the qualification of certain organizations for exemption from Federal income tax under sections 501 and 521 of the Code, to the extent provided in Revenue Procedure 62–30, *supra*.

.06 District Directors issue determination letters with regard to the replacement of involuntarily converted property under section 1033 of the Code even though the replacement has not been made, if the taxpayer has filed his income tax return for the year in which the property was involuntarily converted.

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.07 A request received by a District Director with respect to a question involved in an income, profits, estate, or gift tax return already filed will, in general, be considered in connection with the examination of the return. If response is made to such inquiry prior to an examination or audit, it will be considered a tentative finding in any subsequent examination or audit of the return.

SEC. 5. DISCRETIONARY AUTHORITY TO ISSUE RULINGS AND DETERMINATION LETTERS.

.01 It is the practice of the Service to answer inquiries of individuals and organizations, whenever appropriate in the interest of sound tax administration, as to their status for tax purposes and the tax effect of their acts or transactions.

.02 There are, however, certain areas where, because of the inherently factual nature of the problem involved, or for other reasons, the Service will not issue rulings or determination letters. A list of these areas is set forth in Revenue Procedure 62–32, page 527, this Bulletin. This list is not all inclusive since the Service may decline to issue rulings or determination letters on other questions whenever warranted by the facts or circumstances of a particular case. The National Office and District Directors may, when it is deemed appropriate and in the best interest of the Service, issue information letters calling attention to well established principles of tax law.

.03 The National Office will issue rulings in all cases on prospective or future transactions when the law or regulations require a determination of the effect of a proposed transaction for tax purposes, as in the case of a transfer coming within the provisions of sections 1491 and 1492 of the Code, or an exchange coming within the provisions of section 367 of the Code. The National Office will issue rulings in all cases involving the determination of a constructive sales price under section 4216(b) or 4218 of the Code.

SEC. 6. INSTRUCTIONS TO TAXPAYERS.

.01 A request for a determination letter or a ruling is to be submitted in duplicate if (1) it is a request for exemption under section 501(c) or 501(d) of the Code; (2) more than one issue is presented in the request; or (3) a closing agreement is requested with respect to the issue presented. It is not necessary to present requests in duplicate under other circumstances, including requests for exemption from tax under section 521 of the Code or with respect to the qualification of plans under section 401 of the Code. Requests relating to prospective transactions may not contain alternative plans.

.02 Each request for a determination letter or a ruling must contain a complete statement of facts relating to the transaction. This includes, but is not necessarily limited to, the names, addresses, and taxpayer account numbers of all interested parties; the district office where each files or will file its return or report; a full and precise statement of the business reasons for the transaction; and true copies of all contracts, wills, deeds, agreements, or other documents involved in the transaction. The request must contain a statement whether, to the best of the knowledge of the taxpayer or his representative, the identical issue is pending before any field office of the Service, and, if known, the office involved. Where the request pertains to only one step of a larger integrated transaction, the facts, circumstances, etc.,

must be submitted with respect to the entire transaction. (The term "all interested parties" is not to be construed as requiring a list of all shareholders of a widely held corporation requesting a ruling relating to a reorganization, or a list of employees where a large number may be involved in a plan.) As documents and exhibits become a part of the Internal Revenue Service file and cannot be returned, the original documents should not be submitted. When documents and exhibits are submitted, they must be accompanied by an analysis of their bearing on the issue or issues, specifying the pertinent provisions. If the request is with respect to a corporate distribution, reorganization, or other similar or related transaction, the corporate balance sheet nearest the date of the transaction should be submitted. (If the request relates to a prospective transaction, the most recent balance sheet should be submitted.)

.03 If the taxpayer is contending for a particular determination, he must furnish an explanation of the grounds for his contentions, together with a statement of relevant authorities in support of his views. Even though the taxpayer is urging no particular determination with regard to a proposed or prospective transaction, he must state his views as to the tax results of the proposed action and furnish a statement of relevant authorities to support such views.

.04 If the request is with respect to the qualification of a plan under section 401(a) of the Code, see Revenue Procedure 62–31, *supra*. If the request is with respect to the qualification of an organization for exemption from Federal income tax under section 501 or 521 of the Code, see Revenue Procedure 62–30, *supra*.

.05 A request by or for a taxpayer must be signed by the taxpayer or his authorized representative. If the request is signed by a representative of the taxpayer, or if the representative is to appear before the Internal Revenue Service in connection with the request, he must be currently enrolled to practice before the Internal Revenue Service. An individual who is not enrolled to practice before the Internal Revenue Service will ordinarily be permitted to represent his full-time employer. A corporation, trust, estate, association, or organized group may ordinarily be represented by a bona fide officer, administrator, trustee, etc., even though that individual is not enrolled to practice. An unenrolled preparer of a return who is not a full-time employee or a bona fide officer, administrator, trustee, etc., may not represent a taxpayer with respect to a ruling or a determination letter. Any authorized representative, whether or not he is enrolled to practice, must present to the Service a power of attorney, executed by the taxpayer, authorizing him to act in behalf of the taxpayer with respect to the request.

.06 A request for a ruling by the National Office should be addressed to the Commissioner of Internal Revenue, Washington 25, D.C. A request for a determination letter should be addressed to the District Director of Internal Revenue for the district with which the tax return of the taxpayer has been filed or is required to be filed. See also Revenue Procedure 62–30 and Revenue Procedure 62–31.

.07 Any request for a ruling or a determination letter which does not comply with all the provisions of this Revenue Procedure will be acknowledged, pointing out the requirements which have not been met.

.08 A taxpayer or his representative who desires an oral discussion of the issue or issues involved should indicate such desire in writing when filing the request or soon thereafter in order that the conference may be arranged at that stage of the consideration when it will be most helpful.

.09 It is the practice of the Service to process requests for rulings or determination letters in regular order and as expeditiously as possible. Compliance with a request for consideration of a particular matter ahead of its regular order, or by a specified time, tends to delay the disposition of other matters. Requests for processing ahead of the regular order, made in writing and showing clear need for such treatment, will be given consideration as the particular circumstances warrant. However, no assurance can be given that any ruling or determination letter will be processed by the time requested. Requests by telegram will be treated in the same manner as requests by letter. Rulings and determination letters ordinarily will not be issued by telegram. A taxpayer or his representative desiring to obtain information as to the status of his case may do so by contacting the Office of the Director, Tax Rulings Division, Washington 25, D.C. (Telephone number 964–4504 or 964–4505.)

.10 Where a taxpayer receives a determination letter or a ruling prior to the filing of his return he should attach to his return the determination letter or ruling (or a copy thereof) with respect to any transaction which has been consummated and which is relevant to the return being filed.

SEC. 7. CONFERENCES IN THE NATIONAL OFFICE.

.01 If a conference has been requested, the taxpayer will be notified of the time and place of the conference. In order to promote a free and open discussion of the vital issues, the conference will usually be held after the branch has had an opportunity to thoroughly study the issue. If conferences are being arranged with respect to more than one request for a ruling involving the same taxpayer, they will be so scheduled as to cause the least inconvenience to the taxpayer.

.02 A taxpayer is entitled, as a matter of right, to only one conference in the National Office unless one of the circumstances discussed in this section exists. This conference will usually be held at the branch level in the Tax Rulings Division and will usually be attended by a person who has authority to act for the branch chief. If more than one subject is to be discussed at the conference, the discussion will constitute a conference with respect to each subject. At the request of the taxpayer or his representative, the conference may be held at an earlier stage in the consideration of the case than the Service would ordinarily designate. No taxpayer has a "right" to appeal the action of a branch to a division director or to any other official of the Service.

.03 In the process of consideration, in the National Office, of a position proposed by a branch, it may appear that the position of the Service will involve a reversal of the position proposed by the branch with a result that will be less favorable to the taxpayer. Or it may appear that an adverse position proposed by a branch will be sustained and become the position of the Service, but on a new or different issue or on substantially different grounds than that on which the branch turned the case. Under either of these circumstances, the tax-

payer or his representative will be invited to another conference. The provisions of this Revenue Procedure limiting the number of conferences to which a taxpayer is entitled will not foreclose the invitation of a taxpayer to attend further conferences when, in the opinion of responsible National Office personnel, such need arises. All additional conferences of the type discussed in this paragraph are held only at the invitation of the Service.

.04 It is the responsibility of the taxpayer to add to the case file a written record of any additional data, lines of reasoning, precedents, etc., which are proposed by the taxpayer and discussed at the conference but which were not previously or adequately presented in writing.

SEC. 8. REFERENCE OF MATTERS TO THE NATIONAL OFFICE.

.01 Requests for determination letters received by District Directors which, in accordance with the provisions of section 4 of this Revenue Procedure, may not be acted upon by a district office shall be forwarded to the National Office for reply and the taxpayer advised accordingly. District Directors also may refer to the National Office any request for a determination letter which in their judgment warrants the attention of the National Office. See also the provisions of Revenue Procedure 62–31, *supra*, with respect to requests relating to qualification of a plan under section 401 of the Code, and Revenue Procedure 62–30, *supra*, with respect to applications for exemption from tax under sections 501 and 521 of the Code.

.02 If the request is with regard to an issue or an area with respect to which the Service will not issue a ruling or a determination letter, such request will not be forwarded to the National Office, but the district office will advise the taxpayer that the Service will not issue a ruling or a determination letter on the issue. See section 5.02 of this Revenue Procedure.

SEC. 9. REFERENCE OF MATTERS TO DISTRICT OFFICES.

Requests for rulings received in the National Office which, pursuant to the provisions of section 3 of this Revenue Procedure, may not be acted upon by the National Office, but which, under the authorities set out in section 4, may be acted upon by a district office will be forwarded for appropriate action to the district office in which the return has been or will be filed. If the request is with respect to an issue or an area of the type discussed in section 5.02, the taxpayer will be so advised and the request may be forwarded to the appropriate district office for association with the proper return or report of the taxpayer.

SEC. 10. REVIEW OF DETERMINATION LETTERS.

.01 Determination letters issued with respect to the types of inquiries authorized by sections 4.01, 4.02, and 4.03 are not generally reviewed by the National Office as they merely inform a taxpayer of a position of the Service which has been previously established either in the regulations or in a ruling, opinion, or court decision published in the Internal Revenue Bulletin. If a taxpayer believes that a determination letter of this type is in error, he may ask the District Director to reconsider the matter. He may also ask the District Director to request advice from the National Office. If the District Director, in

his discretion, decides to request such advice, the procedure in Revenue Procedure 62–29, page 507, this Bulletin, will be followed.

.02 The procedures for review of determination letters relating to the qualification of employers' plans under section 401(a) of the Code are provided in Revenue Procedure 62–31.

.03 The procedures for review of determination letters relating to the exemption from Federal income tax of certain organizations under sections 501 and 521 of the Code are provided in Revenue Procedure 62–30.

SEC. 11. WITHDRAWAL OF REQUESTS.

The taxpayer's request for a ruling or a determination letter may be withdrawn at any time prior to the signing of the letter of reply. However, in such a case, the National Office may furnish its views to the District Director in whose office the return has been or will be filed. The District Director will consider the information submitted in a subsequent audit or examination of the taxpayer's return. Even though a request is withdrawn, all correspondence and exhibits will be retained in the Service and may not be returned to the taxpayer.

SEC. 12. ORAL ADVICE TO TAXPAYERS.

.01 The Service does not issue rulings or determination letters upon oral requests. Furthermore, National Office officials and employees ordinarily will not discuss a substantive tax issue with a taxpayer or his representative prior to the receipt of a request for a ruling, since oral opinions or advice are not binding on the Service. This should not be construed as preventing a taxpayer or his representative from inquiring whether the Service will rule on a particular question, or from discussing questions relating to procedural matters with regard to submitting a request for a ruling.

.02 A taxpayer may, of course, seek oral technical assistance from a district office in the preparation of his return or report, pursuant to other established procedures. Such oral advice is advisory only and the Service is not bound to recognize it in the examination of the taxpayer's return.

SEC. 13. EFFECT OF RULINGS.

.01 A ruling, except to the extent incorporated in a closing agreement, may be revoked or modified at any time in the wise administration of the taxing statutes. See section 2.06 for the effect of a closing agreement. If a ruling is revoked or modified, the revocation or modification applies to all open years under the statutes, unless the Commissioner exercises the discretionary powers given to him under section 7805(b) of the Code to limit the retroactive effect of the ruling. The manner in which the Commissioner generally will exercise this power is set forth in this section. With reference to rulings relating to the sale or lease of articles subject to the manufacturers excise tax and the retailers excise tax, see specifically section 13.08.

.02 As part of the determination of a taxpayer's liability, it is the responsibility of the District Director to ascertain whether any ruling previously issued to the taxpayer has been properly applied. It should be determined whether the representations upon which the ruling was based reflected an accurate statement of the material facts and whether the transaction actually was carried out substantially as

proposed. If, in the course of the determination of the tax liability, it is the view of the District Director that a ruling previously issued to the taxpayer should be modified or revoked, the findings and recommendations of that office will be forwarded to the National Office for consideration prior to further action. Such reference to the National Office will be treated as a request for technical advice and the procedures of Revenue Procedure 62–29, *supra*, will be followed. Otherwise, the ruling is to be applied by the district office in its determination of the taxpayer's liability.

.03 Appropriate coordination with the National Office shall be undertaken in the event that any other field official having jurisdiction of a return or other matter proposes to reach a conclusion contrary to a ruling previously issued to the taxpayer.

.04 A ruling found to be in error or no longer in accord with the position of the Service may be modified or revoked. Modification or revocation may be effected by a notice to the taxpayer to whom the ruling originally was issued, or by a Revenue Ruling or other statement published in the Internal Revenue Bulletin.

.05 Except in rare or unusual circumstances, the revocation or modification of a ruling will not be applied retroactively with respect to the taxpayer to whom the ruling was originally issued or to a taxpayer whose tax liability was directly involved in such ruling if (1) there has been no misstatement or omission of material facts, (2) the facts subsequently developed are not materially different from the facts on which the ruling was based, (3) there has been no change in the applicable law, (4) the ruling was originally issued with respect to a prospective or proposed transaction, and (5) the taxpayer directly involved in the ruling acted in good faith in reliance upon the ruling and the retroactive revocation would be to his detriment. To illustrate, the tax liability of each employee covered by a ruling relating to a pension plan of an employer is directly involved in such ruling. Also, the tax liability of each shareholder is directly involved in a ruling related to the reorganization of a corporation. However, the tax liability of members of an industry is not directly involved in a ruling issued to one of the members, and the position taken in a revocation or modification of a ruling to one member of an industry may be retroactively applied to other members of that industry. By the same reasoning, a tax practitioner may not obtain the nonretroactive application to one client of a modification or revocation of a ruling previously issued to another client.

.06 A ruling issued to a taxpayer on a particular transaction applies to that transaction only. If the ruling is later found to be in error or no longer in accord with the position of the Service, it will afford the taxpayer no protection with respect to a like transaction in the same or subsequent year, except to the extent provided in Sections 13.07 and 13.08.

.07 If a ruling is issued covering a continuing action or a series of actions and it is determined that the ruling was in error or no longer in accord with the position of the Service, the Commissioner ordinarily will limit the retroactivity of the revocation or modification to a date not earlier than that on which the original ruling was modified or revoked. To illustrate, if a taxpayer rendered service or provided a facility which is subject to the excise tax on services or

facilities, and in reliance on a ruling issued to the same taxpayer did not pass the tax on to the user of the service or the facility, the Commissioner ordinarily will restrict the retroactive application of the revocation or modification of the ruling.

.08 A ruling holding that the sale or lease of a particular article is subject to the manufacturers excise tax or the retailers excise tax may not revoke or modify retroactively a prior ruling holding that the sale or lease of such article was not taxable, if the taxpayer to whom the ruling was issued, in reliance upon such prior ruling, parted with possession or ownership of the article without passing the tax on to his customer. Section 1108(b), Revenue Act of 1926.

.09 With respect to Revenue Rulings published in the Internal Revenue Bulletin, taxpayers generally may rely upon such rulings in determining the rule applicable to their own transactions and need not request a specific ruling applying the principles of a published Revenue Ruling to the facts of their particular cases where otherwise applicable. However, see section 13.10 below. Revenue Rulings published in the Internal Revenue Bulletin ordinarily are not revoked or modified retroactively.

.10 Since each Revenue Ruling represents the conclusion of the Service as to the application of the law to the entire state of facts involved, taxpayers, Service personnel, and others concerned are cautioned against reaching the same conclusion in other cases unless the facts and circumstances are substantially the same. Furthermore, they should consider the effect of subsequent legislation, regulations, court decisions, and Revenue Rulings.

SEC. 14. EFFECT OF DETERMINATION LETTERS.

.01 A determination letter issued by a District Director, in accordance with this Revenue Procedure, shall be given the same effect upon examination of the return of the taxpayer to whom the determination letter was issued as is described in section 13, in the case of a ruling issued to a taxpayer, except that reference to the National Office is not necessary where, upon the examination of the return, it is the opinion of the District Director that a conclusion contrary to that expressed in the determination letter is indicated. A District Director may not limit the modification or revocation of a determination letter but may refer the matter to the National Office for exercise by the Commissioner of his authority to limit the modification or revocation.

.02 In this connection see also Revenue Procedure 62–30 and Revenue Procedure 62–31, *supra*.

SEC. 15. EFFECT ON OTHER DOCUMENTS.

Revenue Ruling 54–172; C.B. 1954–1, 394; Revenue Procedure 55–14, C.B. 1955–2, 918; and Revenue Procedure 59–22, C.B. 1959–1, 834, are superseded by this Revenue Procedure.

SEC. 16. EFFECTIVE DATE.

This Revenue Procedure is effective November 19, 1962, the date it was published in the Internal Revenue Bulletin.

26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of correct tax liability. Rev. Proc. 62–29

Outline of general procedures of the Internal Revenue Service in furnishing technical advice to District Directors, and an explanation of the rights of taxpayers under these procedures.

Mimeograph 6293, C.B. 1948–2, 59, and Revenue Procedure 58–14, C.B. 1958–2, 1125, superseded.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to prescribe the general procedures of the Internal Revenue Service in furnishing technical advice to District Directors of Internal Revenue. It is also intended to inform taxpayers of their rights when a District Director requests such advice from the National Office. For purposes of this Revenue Procedure any reference to district director or district office, also includes the office of the Director, Office of International Operations, where appropriate.

SEC. 2. DEFINITION AND NATURE OF TECHNICAL ADVICE.

.01 "Technical advice," as used herein, means advice or guidance as to the interpretation and proper application of internal revenue laws, related statutes, and regulations, to a specific set of facts, furnished by the National Office upon request of a district office in connection with the examination or consideration of a taxpayer's return or claim for refund or credit. It is furnished as a means of assisting Service personnel in closing cases and establishing and maintaining consistent positions in the several districts. It does not include memorandums on matters of general technical application furnished to district offices where the issues are not raised in connection with the examination of the return of a specific taxpayer.

.02 The consideration or examination of the facts relating to a request for a determination letter is considered to be in connection with the examination or consideration of a return of the taxpayer. Thus, a District Director may, in his discretion, request technical advice with respect to the consideration of a request for a determination letter.

.03 If a District Director is of the opinion that a ruling letter previously issued to a taxpayer should be modified or revoked, and he requests the National Office to reconsider the ruling, the reference of the matter to the National Office is treated as a request for technical advice and the procedures set out herein will be followed. (For procedures relating to a request for a ruling see Revenue Procedure 62–28, page 496, this Bulletin.)

.04 The provisions of this Revenue Procedure apply only to a case under the jurisdiction of a District Director. They do not apply to a case under the jurisdiction of the Alcohol and Tobacco Tax Division or of the Appellate Division.

.05 The Assistant Commissioner (Technical), acting under a delegation of authority from the Commissioner of Internal Revenue, is exclusively responsible for providing technical advice in any issue involving the establishment of basic principles or policies for the uniform interpretation and application of substantive tax laws other than those which are under the jurisdiction of the Alcohol and Tobacco Tax

Division. This authority has been largely redelegated to subordinate officials.

SEC. 3. AREAS IN WHICH TECHNICAL ADVICE MAY BE REQUESTED.

.01 District Directors may request technical advice or assistance on any technical or procedural question which develops during the audit or examination of a return, or claim for refund or credit, of a taxpayer. These procedures are applicable as provided in section 2.

.02 District Directors are encouraged to request technical advice on any technical or procedural question arising in connection with any case of the type described in section 2, at any state of the proceedings in the district office, which cannot be resolved on the basis of law, regulations, or a clearly applicable Revenue Ruling or other precedent issued by the National Office.

SEC. 4. REQUESTING TECHNICAL ADVICE.

.01 It is the responsibility of the district office to determine whether technical advice is to be requested on any issue before that office. However, during the course of an examination or an informal conference in a district office, a taxpayer or his representative may request that an issue be referred to the National Office for technical advice on the grounds that a lack of uniformity exists as to the disposition of the issue, or that the issue is so unusual or complex as to warrant consideration by the National Office. If, in the opinion of the examining officer or conferee, the circumstances do not warrant such referral, he will so advise the taxpayer.

.02 The taxpayer may appeal from the decision of the examining officer or conferee not to request technical advice by submitting to that official, within 10 days (or such longer period as may be agreed upon), a statement of the facts, law, and arguments with respect to the issue, and the reasons why he believes the matter should be referred to the National Office for advice.

.03 The examining officer or conferee will submit the statement of the taxpayer through channels to the Chief, Audit Division, accompanied by a statement of his reasons why the issue should not be referred to the National Office. The Chief, Audit Division, will determine, on the basis of the statements submitted, whether technical advice will be requested. If he determines that technical advice is not warranted, he will so inform the taxpayer in writing. The taxpayer may not appeal the decision of the Chief, Audit Division, not to request technical advice from the National Office. The Service has other established procedures for reviewing the decisions of this official which are designed to insure that he has properly used this authority.

.04 When technical advice is to be requested, whether or not upon the request of the taxpayer, the taxpayer will be so advised, except as noted in section 4.09. If the examining officer or the conferee initiates the action, the taxpayer will be furnished a copy of the statement of the pertinent facts and the question or questions proposed for submission to the National Office. The request for advice submitted by the District Director should be so worded as to avoid possible misunderstanding, in the National Office, of the facts or of the specific point or points at issue.

.05 The taxpayer will be given 10 days (or such longer period as may be agreed upon) in which to indicate in writing the extent, if

any, to which he may not be in complete agreement with the statement of facts and specific questions presented to him by the district office. Every effort should be made to reach agreement as to the facts and the specific point at issue. If agreement cannot be reached, the taxpayer may submit a statement of his understanding as to the specific point or points at issue which will be forwarded to the National Office with the request for advice.

.06 If the taxpayer initiates the action to request advice, he may be requested to prepare a statement of facts and a statement as to the specific point or points at issue. If the statement of facts or the questions are not wholly acceptable to the district officials, the taxpayer will be advised in writing as to the areas of disagreement. If agreement cannot be reached, both the statement of the taxpayer and the statement of the district official will be forwarded to the National Office.

.07 The taxpayer may also submit a statement explaining his position on the issues, citing precedents which he believes will bear on the case. If this statement has been received, it should be forwarded to the National Office with the request for advice. If it is received at a later date, it should be forwarded for association with the case file.

.08 At the time the taxpayer is informed that the matter is being referred to the National Office, he will also be informed of his right to a conference in the National Office in the event an adverse decision is indicated, and will be asked to indicate whether he desires such a conference.

.09 The provisions of this section, relating to the referral of issues upon request of taxpayer, advising taxpayers of the referral of issues, and the granting of conferences in the National Office, are not applicable to matters primarily of internal concern or in instances where it would be prejudicial to the interests of the Internal Revenue Service (as for example in cases involving fraud or jeopardy assessments).

SEC. 5. PREPARATION OF TECHNICAL ADVICE MEMORANDUM BY THE NATIONAL OFFICE.

.01 Immediately upon receipt in the National Office, the technical assistant to whom the case is assigned will analyze the file to ascertain whether it meets all requirements of section 4. If the case is not complete, appropriate steps will be taken to complete the file.

.02 If the taxpayer has requested a conference in the National Office, the procedures in section 7 will be followed.

.03 Replies to requests for technical advice will be addressed to the District Director and will be drafted in two parts. Each part will identify the taxpayer by name, address, identification number, and year or years involved. The first part (hereafter called the "Technical Memorandum") will contain (1) a recitation of the pertinent facts having a bearing on the issue; (2) a discussion of the facts, precedents, and reasoning of the National Office; and (3) the conclusions of the National Office. The conclusions will give direct answers, whenever possible, to the specific questions of the district office. The discussion of the issues will be in such detail that the district officials are apprised of the reasoning underlying the conclusion.

.04 The second part of the reply will consist of a transmittal memorandum. In unusual cases it will serve as a vehicle for providing the district office administrative information or other informa-

tion which, under the nondisclosure statutes, or for other reasons, may not be discussed with the taxpayer.

.05 It is the general practice of the Service to furnish a copy of the technical memorandum to the taxpayer, upon his request, after it has been adopted by the District Director. See section 5.03. However, where no definitive answer is given to the specific question presented, where the factual submission is such as to indicate that the issue should be decided by the district office, or where it would not be in the interest of a wise administration of the tax laws, a copy of the technical memorandum will not be furnished the taxpayer. The National Office will specifically advise the District Director in those cases where it is determined that a copy of the technical memorandum is not to be made available to the taxpayer.

SEC. 6. ACTION ON TECHNICAL ADVICE IN DISTRICT OFFICES.

.01 Upon adoption of the technical advice by a District Director, the district office will proceed to process the taxpayer's case on the basis of the conclusions expressed in the technical advice memorandum. Except as provided in section 6.02, a copy of the technical memorandum will be furnished to the taxpayer, upon his request, for his information as to the position of the Service on the issue.

.02 In those cases in which the National Office advises the District Director that he should not furnish a copy of the technical memorandum to the taxpayer, the District Director will so inform the taxpayer, if he requests such a copy.

SEC. 7. CONFERENCE IN THE NATIONAL OFFICE.

.01 If, after a comprehensive study of the case file, it appears that advice which is adverse to the taxpayer should be given and a conference has been requested, the taxpayer will be notified of the time and place of the conference. If conferences are being arranged with respect to more than one request for advice involving the same taxpayer, they will be so scheduled as to cause the least inconvenience to the taxpayer.

.02 A taxpayer is entitled, as a matter of right, to only one conference in the National Office unless one of the circumstances discussed in this section exists. This conference will usually be held at the branch level in the Tax Ruling Division and will usually be attended by a person who has authority to act for the branch chief. If more than one subject is discussed at the conference, the discussion constitutes a conference with respect to each subject. At the request of the taxpayer or his representative, the conference may be held at an earlier stage in the consideration of the case than the Service would ordinarily designate. A taxpayer has no "right" of appeal from an action of a branch to the director of a division or to any other National Office official.

.03 In the process of consideration, in the National Office, of a position proposed by a branch, it may appear that the position of the Service will involve a reversal of the position proposed by the branch with a result that will be less favorable to the taxpayer or it may appear that an adverse position proposed by a branch will be sustained and become the position of the Service, but on a new or different issue or on substantially different grounds than those on which the branch turned the case. Under either of these circumstances, the

taxpayer or his representative will be invited to another conference. The provisions of this Revenue Procedure limiting the number of conferences to which a taxpayer is entitled will not foreclose inviting a taxpayer to attend further conferences when, in the opinion of responsible National Office personnel, such need arises. All additional conferences of the type discussed in this paragraph are held only at the invitation of the Service.

.04 It is the responsibilty of the taxpayer to furnish to the National Office, for addition to the case file, a written record of any additional data, lines of reasoning, precedents, etc., which are proposed by the taxpayer and discussed at the conference but which were not previously or adequately presented in writing. This additional record should be addressed to the National Office, but it should be sent to the appropriate District Director who will forward it for association with the case file. The District Director may verify the additional facts and data presented and comment upon it, to the extent he deems it appropriate, when he forwards it to the National Office.

.05 A taxpayer or his representative desiring to obtain information as to the status of his case may do so by contacting the Office of the Director, Tax Rulings Division, Washington 25, D.C. (Telephone number 964–4504 or 964–4505.)

SEC. 8. EFFECT OF TECHNICAL ADVICE.

.01 A technical advice memorandum represents an expression of the views of the Service as to the application of law, regulations, and precedents to the facts of a specific case, and is issued primarily as a means of assisting district officials in the examination and closing of the case involved.

.02 A technical memorandum given a taxpayer will, in general, be afforded the same effect as a ruling to the taxpayer on a closed and completed transaction. In this connection see section 13 of Revenue Procedure 62–28, *supra*. Since technical advice, in connection with cases of the type described in section 2.01 of this Revenue Procedure will always be issued with respect to a closed transaction, the taxpayer may not expect a modification or revocation of the position stated in the technical memorandum to be applied nonretroactively, except under circumstances of the type described in sections 13.07 and 13.08 of Revenue Procedure 62–28, relating to continuing transactions.

.03 A District Director may raise an issue in any taxable period, even though he may have asked for and been furnished, technical advice with regard to the same or a similar issue in any other taxable period.

SEC. 9. EFFECT ON OTHER DOCUMENTS.

Mimeograph 6293, C.B. 1948–2, 59, and Revenue Procedure 58–14, C.B. 1958–2, 1125, are superseded by this Revenue Procedure. However, cases forwarded to the National Office before the effective date of this Revenue Procedure will not be returned to a field office for compliance with the provisions of section 4 if the requirements of prior procedures were met, unless so requested by the district office.

SEC. 10. EFFECTIVE DATE.

This Revenue Procedure is effective November 19, 1962, the date of its publication in the Internal Revenue Bulletin.

26 CFR 601.201: Rulings and determination letters. Rev. Proc. 62–30 (Also Part I, Sections 501, 521; 1.501(a)–1, 1.521–1.)

Outline of the procedures with respect to requests for exemption from Federal income tax under sections 501 and 521 of the Internal Revenue Code of 1954. Revenue Ruling 54–164, C.B. 1954–1, 88, superseded, and Revenue Procedure 56–8, C.B. 1956–1, 1024, superseded in part.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to describe the procedures of the Internal Revenue Service with respect to requests of organizations for exemption from Federal income tax under sections 501 and 521 of the Internal Revenue Code of 1954. This Revenue Procedure is intended to inform those organizations and their representatives of the procedures to follow in applying for exemption in order to promote the efficient handling of their applications.

SEC. 2. FILING APPLICATIONS FOR EXEMPTION.

.01 *General Requirements.*—An organization claiming exemption under section 501 or section 521 of the Code is required to file an application for exemption with the District Director of Internal Revenue for the district where it would otherwise be required to file a tax return, unless it has already obtained a ruling or determination letter holding it exempt from Federal income tax. Any application received in the National Office or in a district office other than as provided above will be forwarded, without any action thereon, to the appropriate district office.

.02 *Requests other than in the form of an application for exemption,* involving the provisions of section 502 of the Code relating to feeder corporations, section 503 relating to prohibited transactions, section 504 relating to accumulation of income, or sections 511 through 515 relating to unrelated business income, should be forwarded to the Commissioner of Internal Revenue, Washington 25, D.C. In this connection see section 5 of this Revenue Procedure and Revenue Procedure 62–28, page 496, this Bulletin.

.03 *Organizations with less than 12 months' operation.*—A determination letter or a ruling will generally not be issued on the application of an organization until it has actively operated for a period of 12 months to an extent which will clearly demonstrate whether it is operated, in fact, for a purpose specified in the exemption statute. Thus, an organization should not file an application for exemption until it has been in active operation (not mere existence) for at least 12 months and can demonstrate that it has operated for the purposes for which it was created. Exceptions to this general rule are provided in section 4.

SEC. 3. CLASSIFICATION OF APPLICATIONS.

.01 *District Directors' cases.*—District Directors are authorized by Revenue Procedure 62–28, to issue determination letters involving the exempt status of organizations under sections 501 and 521 of the Code. That Revenue Procedure describes a determination letter as a statement issued by a District Director which applies the principles and precedents established by the Service to the facts involved in a particular inquiry. Thus, determination letters with respect to applica-

tions for exemption from Federal income tax are issued only with regard to cases in which the application of section 501 or section 521 of the Code to the facts presented in the applications is clear and which do not present involved or questionable issues. These cases will be classified as "District Director's cases."

.02 *National Office cases.*—Cases which present involved or questionable issues will be classified as "National Office cases." Exemption applications so classified will be forwarded to the National Office by the District Director for a ruling. The application will be processed in the National Office under the general procedures of Revenue Procedure 62–28, *supra*, and a ruling will be made directly to the organization.

.03 Applications for exemption which involve determinations under section 502 of the Code relating to feeder corporations, section 503 relating to prohibited transactions, section 504 relating to accumulations of income, or sections 511 through 515 relating to unrelated business income, are classified as "National Office cases."

.04 *Incomplete application cases.*—Exemption applications of organizations of the type described in section 2.03 of this Revenue Procedure, and other exemption applications which do not contain the required information, will be classified as "Incomplete application cases." In these cases the organization will be notified by appropriate letter as to the reason that a determination may not be made, but the application and related material will be retained.

SEC. 4. DETERMINATION LETTERS PRIOR TO 12 MONTHS OF OPERATION.

.01 A tentative determination letter or ruling will be issued to an organization with less than 12 months of active operation provided it is affirmatively shown in, or in connection with, its exemption application that the organization is of the community or public type and is organized for purposes within the purview of the exemption statute. Also, the details submitted in connection with its proposed activities should indicate that it will engage in activities clearly within the contemplation of the statute.

.02 In order to constitute an organization of the "community or public type," its governing board must be comprised of a cross section of persons of the community who represent interests of the community and it must be shown that it will also derive substantial financial support from the public rather than from a limited number of organizations or individuals.

.03 Where the facts establish that the organization meets the requirements of this section, the District Director is authorized to issue a tentative determination letter. This letter will contain a requirement that the organization shall submit a new application, together with complete supporting data as specified in the application form and in the regulations, at the end of its first full year of active operation (not mere existence). Where the facts, although persuasive of the conclusion that the requirements have been met, present involved or questionable issues, the application will be classified as a "National Office case."

.04 The provisions of this Revenue Procedure do not limit the authority of a District Director to make tentative determinations with respect to exemption of an organization from other Federal taxes (such as exemption from the admissions tax). Thus, a District Director

may make a tentative determination whether an organization is exempt from other Federal taxes even though a determination may not be made with respect to Federal income tax.

.05 Determination letters allowing exemption under section 501 (c) (14) of the Code will be issued to state chartered credit unions at any time after their formation if they operate under uniform bylaws approved by the state.

SEC. 5. PROHIBITED TRANSACTIONS.

.01 Section 503 of the Code denies exemption to certain organizations which engage in transactions of the type described therein. The National Office may issue a ruling as to whether an organization has entered into, or proposes to enter into, a prohibited transaction; but, except as provided in section 5.02, a ruling will not be issued where the determination is primarily one of fact, *e.g.*, market value of property, reasonableness of compensation, etc. Also, no rulings will be issued with respect to such transactions as sales and leasebacks, gifts and leasebacks, and other rental transactions of real or personal property directly or indirectly with the creator or a related or controlled interest.

.02 Where the adequacy of the security of a loan is involved, a ruling may be issued, but only if there is a clear indication of value which can be established by reference to recognized sources without requiring physical valuation or appraisal. The following are examples of transactions where the adequacy of security can be established by reference to recognized sources:

1 A surety bond issued by a recognized surety company doing a surety bond business under applicable state law;

2 An assignment of an insurance contract having a cash surrender value sufficient to cover the loan, interest, and possible costs of collection;

3 A first mortgage on real property in an amount not in excess of 50 percent of its assessed value for local tax purposes; or,

4 Collateral represented by securities listed on a recognized exchange of an aggregate value equal to twice the amount of the loan.

.03 District Directors do not issue determination letters where there is a question whether an organization has engaged in a transaction of the type prohibited by section 503 of the Code. However, District Directors are expected, in the course of examination of the returns of the organization, to ascertain whether it has entered into a prohibited transaction. In this connection, see section 9 relating to revocation of exemptions.

.04 If it is concluded that a prohibited transaction was entered into by the organization for the purpose of diverting corpus or income from its exempt purpose and if the transaction involved a substantial part of the corpus or income of the organization, its exemption under the provisions of section 501 (c) (3) of the Code is revoked and such revocation is effective as of the beginning of the taxable year during which the prohibited transaction was commenced. An organization is ordinarily notified of such revocation of exemption by regular mail.

.05 In all other prohibited-transaction cases, the exemption is revoked effective as of the beginning of the first taxable year after the

date of the revocation letter. In these cases the organization will be notified of the revocation of exemption by registered or certified mail, sent to its last known address.

.06 While the organization will usually be permitted to submit its brief and to be heard in conference before the revocation notice is issued, the Service may, at its discretion, issue the revocation letter by registered or certified mail prior to the receipt of the brief or prior to granting a conference. If it is later determined that the revocation was in error, it will be rescinded as of the date it was issued.

07. An organization which is denied exemption under section 503 of the Code may file a new application for exemption for any taxable year following the taxable year in which the notice of denial was issued. But an organization may not be granted an exemption before the beginning of the first taxable year following the year in which its new application is filed. Thus, if a revocation notice was issued in 1961, the organization may not file a new application for exemption until 1962, and the new exemption may not be granted for a taxable year prior to 1963. If the organization does not file a new application until 1963, the new exemption may not be granted for a year prior to 1964.

SEC. 6. REVIEW OF DETERMINATION LETTERS.

.01 The National Office will review determination letters issued under the procedures set forth herein to the extent necessary to assure uniformity in the application of the principles and precedents of the Service. If it is believed that a determination letter does not conform to the interpretation and policies of the Service, the District Director will be advised of the exceptions noted. If the organization protests the exception taken, the matter will be returned to the National Office. The determination letter and the protest will be treated as a request for technical advice and the procedures in Revenue Procedure 62–29, page 507, this Bulletin, will be followed.

SEC. 7. REFERENCE OF MATTERS TO THE NATIONAL OFFICE.

.01 An organization may, within 30 days from the date of issuance of a determination letter, file a protest with the District Director. It may protest the denial of exemption or it may protest the determination as to subsection of the Code under which the exemption was granted. If, after considering the protest, the District Director maintains his adverse position and the organization does not agree, the case will be referred to the National Office.

.02 The matter will be handled as though the question of exemption had arisen in connection with the examination or consideration of the return of the organization and the District Director had requested technical advice. Thus, the procedures in Revenue Procedure 62–29 will be followed.

SEC. 8. EFFECT OF EXEMPTION RULINGS AND DETERMINATION LETTERS.

.01 Exemption is usually effective as of the date of formation of an organization if, during the period prior to the date of the ruling or determination letter, the purposes and activities of the organization were entirely consistent with the facts constituting the basis for the exemption. If the organization is required to curtail or alter its activities, or to make substantive amendments to its enabling instrument,

the exemption will be effective only for the period subsequent to the time the organization meets the statutory requirements.

.02 A ruling or a determination letter holding an organization to be exempt is effective only as long as there has been no material change in the character, the purpose, or the method of operation of the organization. The exemption may be revoked by a ruling or a determination letter addressed to the organization, or by a Revenue Ruling or other statement published in the Internal Revenue Bulletin applicable to the type of organization involved. See section 9 relating to revocation of exemptions.

.03 A ruling or a determination letter issued to an organization holding it to qualify for exemption under section 501 or section 521 of the Code may be revoked retroactively if there has been an omission or a misstatement of a material fact, if the organization operated in a manner materially different from that originally represented, or if the organization engaged in a prohibited transaction of the type described in section 5 of this Revenue Procedure. A ruling or a determination letter may also be revoked for failure to file an annual information return.

SEC. 9. REVOKING AN EXEMPTION RULING OR DETERMINATION LETTER.

.01 If a district office concludes, in the course of examining an information return, or from any other source, that a ruling or a determination letter holding an organization to be exempt should be revoked or modified, the organization will be advised in writing of the proposed action and the reasons therefor. The district office will also advise the organization of its rights to protest the proposed action by submitting a statement of the facts, law, and arguments in support of its continued exemption, and of its rights to an informal conference in the district office.

.02 If the organization agrees with the proposed action, either before or after an informal conference, or if no protest is filed, the District Director will advise the organization in writing of the revocation or modification of the exemption status.

.03 If, after considering the information submitted by the organization, both in writing and in conference, the district office is still of the opinion that the exemption letter should be modified or revoked, and the organization is not in agreement with such determination, the findings of that office will be forwarded to the National Office for consideration prior to further action. Such reference to the National Office will be considered a request for technical advice and the procedures of Revenue Procedure 62–29, will be followed.

SEC. 10. EFFECT ON OTHER PUBLICATIONS.

.01 The procedures of Revenue Procedure 62–28, *supra*, relating to the issuance of rulings and determination letters, are applicable to requests for exemption from Federal income tax, except to the extent inconsistent with the specific procedures and instructions of this Revenue Procedure.

.02 Revenue Ruling 54–164, C.B. 1954–1, 88, is superseded. Sections 1(e) and 1(f) of Revenue Procedure 56–8, C.B. 1956–1, 1024, are superseded.

SEC. 11. EFFECTIVE DATE.

The provisions of this Revenue Procedure became effective November 19, 1962, the date they were published in the Internal Revenue Bulletin.

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26 CFR 601.201: Rulings and determination letters. Rev. Proc. 62–31 (Also Part I, Section 401; 1.401–1.)

Outline of procedures of the Internal Revenue Service with respect to requests as to the qualification of pension, annuity, profit-sharing, and stock bonus plans under section 401(a) of the Internal Revenue Code of 1954 and the status for exemption of related trusts under section 501(a) of the Code.

Revenue Procedure 56–12, C.B. 1956–1, 1029; Revenue Procedure 56–33, C.B. 1956–2, 1394; Revenue Procedure 57–5, C.B. 1957–1, 727; Revenue Procedure 60–1, C.B. 1960–1, 874; and Revenue Procedure 61–11, C.B. 1961–1, 897, are superseded. Revenue Procedure 56–8, C.B. 1956–1, 1024, is superseded in part.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to describe the general procedures of the various offices of the Internal Revenue Service for issuing determination letters relating to the qualification of pension, annuity, profit-sharing, and stock bonus plans under section 401(a) of the Internal Revenue Code of 1954 and for issuing rulings and determination letters relating to the status for exemption of related trusts under section 501(a) of the Code.

SEC. 2. BACKGROUND AND GENERAL INFORMATION.

.01 A trust created or organized in the United States and forming a part of a stock bonus, pension, or profit-sharing plan of an employer for the exclusive benefit of his employees or their beneficiaries, which meets the requirements of section 401(a) of the Code, is a qualified trust and is exempt from Federal income tax under section 501(a) unless the exemption is denied under section 502, relating to feeder organizations, or section 503, relating to prohibited transactions.

.02 An exempt employees' trust is required to file an annual return as provided by section 6033 of the Code. Form 990–P, Return of Employees' Trust Exempt from Tax, is used for this purpose. An exempt trust may, however, be subject to tax under section 511 of the Code on unrelated business income. Unrelated business income is reported on Form 990–T, Exempt Organization Business Income Tax Return.

.03 A nontrusteed annuity plan which meets the requirements of section 401(a) (3), (4), (5), and (6) of the Code may confer special tax treatments provided for under other sections of the Code, such as section 403(a)(2) (long term capital gain treatment) and section 404(a)(2) (deductions for employer contributions for the purchase of retirement annuities), if the additional provisions of such other sections are also met.

.04 A ruling or a determination letter approving a pension, annuity, profit-sharing, or stock bonus plan, and the exempt status of a related trust, if any, is not required as a condition for obtaining the benefits pertaining to the plan or trust. However, section 4.05 of

Revenue Procedure 62–28, page 496, this Bulletin, permits District Directors to issue determination letters relating to the qualification of plans and the exempt status of related trusts.

SEC. 3. DETERMINATION LETTERS.

.01 Determination letters authorized by section 4.05 of Revenue Procedure 62–28, are limited to the qualification of plans or trusts under section 401(a) of the Code and to the exempt status of trusts under section 501(a). This includes consummated and proposed transactions relating to the following:

1 The initial qualification of a plan and, if trusteed, the status for exemption of a trust;

2 Compliance with the applicable requirements of foreign situs trusts as to taxability of beneficiaries (section 402(c)) and deductions for employer contributions (section 404(a)(4));

3 Amendments to plans and trusts;

4 Curtailment of plans;

5 Termination of plans and trusts; and

6 The effect of the qualification of the plan, and status for exemption of the trust, of an investment of trust funds in the stock or securities of the employer or controlled corporation (ownership of 50 percent or more of all voting stock or 50 percent or more of the total value of shares of all classes of stock).

.02 Determination letters authorized in the preceding paragraph do not include determinations or opinions relating to other inquiries with respect to plans or trusts. Thus, except as provided in section 3.012, above, District Directors may not issue determination letters relating to issues under other sections of the Code, such as sections 72, 402 through 404, 502, 503, and 511 through 515, unless such determination letters are otherwise authorized under section 4 of Revenue Procedure 62–28.

.03 Employees' trusts must be maintained and operated for the exclusive benefit of the employees or their beneficiaries, and investments by such trusts must be consistent with that purpose. See part 2(r)(1) of Revenue Ruling 61–157, C.B. 1961–2, 67. District Directors are authorized to issue determination letters with respect to the investments of such trusts in the stocks or securities of corporations of the type described in section 3.016, relating to the compliance with these requirements. However, they may not issue determination letters with regard to the fair market value of the investment or with respect to the adequacy of security behind a loan. These issues are within the prohibited transactions area. In this connection, see section 5 of this Revenue Procedure.

SEC. 4. INSTRUCTIONS TO TAXPAYERS.

.01 All of the provisions of section 6 of Revenue Procedure 62–28, are applicable with respect to requests for determination letters of the type discussed in this Revenue Procedure. In addition, the information required by paragraphs .02 through .05 below, must also be furnished in requesting a determination letter with respect to the qualification of an employee plan or trust.

.02 If the request relates to the initial qualification of a plan or the compliance with the requirements for a foreign situs trust, the following information must be submitted:

1 The information required by section 1.404(a)-2 of the Income Tax Regulations;

2 Type of organization of employer;

3 Date incorporated, if a corporation, or date business commenced, if other type of organization;

4 Nature of business of employer; and

5 Name of predecessor business, if any, type of organization of predecessor, and when transfer took place.

.03 If the request relates to an amendment to a plan, the following information must be submitted:

1 A copy of the amendment;

2 The information required by section 1.404(a)-2 of the regulations unless it was furnished with a request for a determination letter for the same year for which the amendment is to become effective. (However, if the amendment changes the requirements for coverage, contributions, or benefits, the information must be submitted even though previously submitted with a prior request.);

3 The information required by section 4.022 through 4.025 above, unless it was previously furnished with a request for a determination letter.

.04 If the request relates to a curtailment or termination of the plan, the following information must be submitted:

1 The date the plan was, or is proposed to be, terminated or curtailed;

2 A statement of the reasons and circumstances for the termination or curtailment;

3 A statement whether any of the funds under the plan will revert to or become available to the employer; if so, details must be furnished;

4 A statement, with full particulars, as to any funds under the plan which at any time were contributed in the form of, or invested in, obligations or property of the employer or related companies;

5 The information specified below, in columnar form, with respect to each of the 25 highest paid employees covered by the plan at the time of termination or curtailment (the most recent anniversary date of the plan if the action is proposed), listed in the order of their compensation, and with respect to all other employees covered by the plan (as a group) and showing the number in the group:

a Name and whether or not an officer;

b Percentage of each class of stock owned directly or indirectly by the employee or members of his family;

c Data, separately for the year of termination or curtailment and for each of the five preceding years of the plan's operation (if more are required they will be requested) with respect to (1) Total compensation other than deferred compensation, (2) Employer's contribution, (3) Employee's contribution, and (4) Employee's share of forfeitures,

d Totals for each of the columns under subparagraph c for each year;

e Summary columns aggregating for all years (totaled horizontally) with respect to each employee listed and for all others, data similar to that required by subparagraph c; and

f Total value of benefits distributed or to be distributed to each employee listed, and to all others;

6 A schedule showing separately for the year of termination or curtailment and for each of the five preceding years of the plan (if more are required they will be requested):

a Number of participants at beginning of year;

b Number of participants added in year;

c Number of participants dropped in year; and

d Number of participants remaining at end of year.

.05 If the request relates to an investment of trust funds in the stock or securities of the employer, the following information, without duplicating information previously furnished, must be submitted:

1 Balance sheets of the employer (and controlled corporation, if involved) as of the close of the last two taxable years;

2 Comparative statements of income and profit and loss for the last five taxable years;

3 Analysis of surplus for the last five years, specifically showing the amount and rate of dividends paid on each class of stock;

4 A statement accounting for all material changes from the latest dates of the information in 1, 2, and 3 to the date of filing the information;

5 A schedule showing the nature and amounts of the various assets in the trust fund; and

6 A statement setting forth the amount to be invested in the stock or securities of the employer or a controlled corporation (or both), the nature of the investment, the present rate of return, collateral or type of security for the loan, if any, and the reasons for the investment.

(The information called for under paragraphs 1, 2, and 6, and related data, may be submitted in composite form as shown in Exhibit "A," page 526.) A full disclosure must be made where trust funds are invested in stock or securities of, or loaned to, the employer, whether or not a determination letter is requested. The above information must in all cases be furnished to the appropriate District Director. See section 4.07, below.

.06 Where, in connection with the request for a determination as to the qualification of the plan, it is necessary to determine whether an organization is an association, taxable as a corporation under the provisions of section 7701 of the Code, and that an employer-employee relationship exists between it and its associates, the request shall also be accompanied by copies of the articles of association or agreement establishing the organization, bylaws, and all other data relevant to the formation and operation of the association, and should show all pertinent dates. The organization should also support its request by furnishing copies of the applicable local law relating to its status, copies of contracts of employment with its associates, and a

brief of its position with respect to its status for taxation of the organization, and its relationship with its associates.

.07 Requests for determination letters with respect to matters authorized by section 3.01 and the necessary supporting data, are to be addressed to the District Director specified below:

1 A single employer will address his request to the District Director for the district in which its principal place of business is located.

2 If a parent company and its subsidiaries have a single plan, the request will be addressed to the District Director for the district in which the principal place of business of the parent company is located, whether separate or consolidated returns are filed.

3 If the plan is established or proposed for an industry by all subscribing employers, whose principal places of business are located within the jurisdiction of more than one District Director, the request will be addressed to the District Director for the district in which is located the principal place of business of the trustee, or if more than one trustee, the usual meeting place of the trustees.

4 In the case of a pooled fund arrangement (individual trusts under separate plans pooling their funds for investment purposes through a master trust), the request on behalf of the master trust will be addressed to the District Director for the district where the principal place of business of such trust is located. Requests on behalf of the participating trusts and related plans will be addressed as otherwise herein provided.

5 In the case of a plan of multiple employers not otherwise herein provided for, the request will be addressed to the District Director for the district in which is located the principal place of business of the trustee, or if not trusteed, or if more than one trustee, the principal or usual meeting place of the trustees or plan supervisors.

6 If the plan is with respect to an organization of the type described in section 4.06, above, the association will address its request to the District Director with whom it is required to file its tax returns.

SEC. 5. PROHIBITED TRANSACTIONS.

.01 Section 503 of the Code denies exemption to certain organizations which engage in transactions of the type described therein. The National Office may issue a ruling as to whether a trust has entered into, or proposes to enter into, a prohibited transaction, but, except as provided in section 5.02, a ruling will not be issued where the determination is primarily one of fact, *e.g.* market value of property, reasonableness of compensation, etc. Also, no rulings or determination letters will be issued with respect to such transactions as sales and leasebacks, gifts and leasebacks, and other rental transactions of real or personal property directly or indirectly with the creator, or a related or controlled interest.

.02 Where the adequacy of the security of a loan is involved, a ruling may be issued, but only if there is a clear indication of value which can be established by reference to recognized sources without

requiring physical valuation or appraisal. The following are examples of transactions where the adequacy of security can be established by reference to recognized sources:

1 A surety bond issued by a recognized surety company doing a surety bond business under applicable state law;

2 An assignment of an insurance contract having a cash surrender value sufficient to cover the loan, interest, and possible costs of collection;

3 A first mortgage on real property in an amount not in excess of 50 percent of its assessed value for local tax purposes; or

4 Collateral represented by securities listed on a recognized exchange of an aggregate value equal to twice the amount of the loan.

Such rulings may be issued only with respect to proposed transactions and with respect to completed transactions where the return for the first year for which the transaction is effective has not been filed or the filing date has not passed. This section does not preclude the National Office from ruling as to whether a transaction is within the purview of sections 503 (c), (h), or (i) of the Code.

.03 If, upon examination of the return or returns of a trust, or from other sources, a District Director is of the opinion that a trust has entered into a prohibited transaction, the trust will be advised in writing that it is proposed to revoke its exemption, and the reasons for such proposed action. The district office will also advise the trust of its rights to protest the proposed action by submitting a statement of the facts, law, and arguments in support of its continued exemption, and of its rights to an informal conference in the district office.

.04 If the trust agrees with the proposed action, either before or after an informal conference, or if no protest is filed, the District Director will advise the organization in writing of the revocation of the exempt-status.

.05 If, after considering the information submitted by the trust, both in writing and in conference, the district office is still of the opinion that the exemption should be revoked, and the trust does not agree, the findings of the district office will be forwarded to the National Office for consideration prior to further action. Such reference to the National Office will be considered a request for Technical Advice and the procedures of Revenue Procedure 62–29, page 507, this Bulletin, will be followed.

.06 If it is concluded that a prohibited transaction was entered into for the purpose of diverting corpus or income from its exempt purpose and if the transaction involved a substantial part of the corpus or income of the trust, its exemption is revoked, effective as of the beginning of the taxable year during which the prohibited transaction was commenced. No notification to the trust of the loss of its exemption is required under these circumstances. In all other cases, however, its exemption is revoked, effective as of the beginning of the first taxable year after the date of the revocation letter. Under these circumstances, a revocation letter is sent by registered or certified mail to the last known address of the organization.

.07 The trust will usually be permitted to submit its brief and to be heard in conference before final action is taken. However, the Service may, at its discretion, issue the revocation letter prior to the receipt

of the brief or prior to granting a conference. If it is later determined that the revocation was in error, it will be rescinded as of the date it was issued.

.08 A trust which is denied exemption under section 503 of the Code may file a new claim for exemption in any taxable year following the taxable year in which the notice of denial was issued. But it may not be granted a new exemption before the beginning of the first taxable year following the year in which its new claim is filed. Thus, if a revocation notice is issued in 1961, the trust may not file a new claim for exemption until 1962, and the new exemption may not be granted for a taxable year prior to 1963. If the trust does not file a new claim until 1963, the new exemption may not be granted for a year prior to 1964.

SEC. 6. REFERENCE OF MATTERS TO THE NATIONAL OFFICE.

.01 Revenue Procedure 62–29, *supra*, defines technical advice as advice or guidance furnished upon request of a field official in connection with the examination or consideration of a return of a taxpayer. Although a taxpayer may request a determination letter with respect to the qualification of its plan or trust under section 401(a) of the Code, prior to the filing of any return affected by the plan or trust, the consideration or examination of the facts relating to the qualification, amendment, curtailment, or termination of the plan or relating to the exempt status of the trust will be considered to be in connection with the examination or consideration of a return of the taxpayer. Thus, a District Director may request technical advice with respect to issues which arise as the result of requests for determination letters of the type discussed in this Revenue Procedure.

.02 Where issues arise in a District Director's office with respect to matters within the contemplation of section 3.01, and the district office does not request technical advice from the National Office, the organization may notify the District Director that it intends to request National Office consideration. The notice will consist of a copy of the request which the organization intends to file with the National Office. See section 6.04. Should the District Director make an adverse determination, or should no action be taken within 30 days after the notice is filed with the District Director, the request may be filed with the National Office.

.03 Requests for National Office consideration will be entertained upon a clear showing—

1 That the position of the district office is contrary to the law or regulations on the points at issue;

2 That the position of the district office is contrary to the position of the Service as set forth in a Revenue Ruling currently in effect;

3 That the position of the district office is contrary to a court decision which is followed by the Service, *i.e.*, acquiescence in an adverse Tax Court decision;

4 That the contemplated district office action is in conflict with a determination made in a similar case in the same or another district; or

5 That the issues arise because of unique or novel facts which had not previously been passed upon, in any published Revenue Ruling or announcement.

.04 The request to the National Office must show the following:

1 Date of request;

2 Name and address of taxpayer (employer) and name and address of representative, if any, who has been authorized to represent taxpayer (see section 6.05 of Revenue Procedure 62–28);

3 District office in which the case is pending;

4 Type of plan (pension, annuity, profit sharing, stock bonus) and type of action involved (initial qualification, amendment, curtailment, termination, or investment);

5 Date of filing a copy of this request with the District Director and the date and symbols of determination letter, if any;

6 A concise statement of the issues without presentation of the facts or argumentation (*e.g.*, whether a limitation may be imposed on employer contributions used to provide benefits for stockholder-employees);

7 Grounds for requesting National Office consideration, *e.g.*, action of the district office contrary to law or regulations (cite sections involved), contrary to published precedent (cite), conflict between districts or in same district (give name and district of case in conflict), unique or novel facts (describe briefly);

8 Whether the applicable information required by section 4 has been filed with the District Director;

9 Whether a conference is desired in the National Office.

.05 Upon receipt of the request in the National Office, a determination will be made as to whether the case is to be considered at the National Office, and the taxpayer will be advised as to this determination. If the National Office determines that it will consider the case, the file will be called in from the district office and the taxpayer will be afforded an opportunity to furnish a statement on the points at issue and to a conference in Washington, if such a conference was requested. Copies of all written submissions are to be furnished the District Director. The District Director will have an opportunity to make such comments to the National Office as he deems appropriate. After full consideration of the entire file, including any conference discussion, the National Office will notify the taxpayer of its determination, and the case file will be returned to the district office for appropriate disposition in accordance with the National Office determination. The procedures of Revenue Procedure 62–28, *supra*, will control, to the extent they are not inconsistent with the provisions of this section.

.06 Should a District Director determine that an organization of the type described in section 4.06 is not an association taxable as a corporation or that the proper employer-employee relationship does not exist between the organization and its associates, the District Director will so advise the organization. Inasmuch as the primary issue here is not the qualification of the plan under section 401(a) of the Code, the appeals procedures of sections 6.02 through 6.05 are not applicable. If the District Director is of the opinion that the organization is an association taxable as a corporation and that the proper employer-employee relationship exists, he will refer the case file to the National Office with his recommendations. The National Office will determine the status of the organization and of its associates and will return the file to the district office. If the National Office finds that the proper relationship does not exist between the organization and its associ-

ates, the organization will be so advised. If the National Office finds that the proper relationship does exist, the District Director will consider the qualification of the plan under the procedures of this Revenue Procedure. A conference in the National Office will be granted only under the conditions prescribed in Revenue Procedure 62–28, *supra*.

SEC. 7. REVIEW OF DETERMINATION LETTERS.

All determination letters issued by District Directors under the procedures herein are subject to post review in the National Office under the jurisdiction of the Assistant Commissioner (Technical). If, during the course of review, a determination letter does not appear to conform to the interpretations and policies of the Service, the District Director will be advised of the exceptions noted. If the taxpayer protests the exceptions taken by the National Office, the matter will be returned to the National Office. The determination letter and the protest will be treated as a request for technical advice. The procedures in Revenue Procedure 62–29, *supra*, will be followed.

SEC. 8. ORAL ADVICE TO TAXPAYERS.

.01 In conformity with the general principle announced in section 12 of Revenue Procedure 62–28, district officials will not ordinarily confer with taxpayers or their representatives on matters regarding the formation or qualification of pension or similar plans, or related matters, including amendments or curtailments to approved plans, prior to the submission of a plan, amendment, or curtailment for a determination.

.02 A District Director may grant such a conference upon written request from a taxpayer or his representative, provided the request shows that a substantive plan, amendment, etc., has been developed for submission to the Service, but that special problems or issues are involved, and the District Director concludes that such a conference would be warranted in the interest of facilitating review and determination when the plan, etc., is formally submitted.

.03 The furnishing of advice or assistance, whether requested by personal appearance, telephone, or correspondence, except as otherwise provided in section 8.02, will be limited to general procedures, or will direct the inquirer to source material, such as pertinent Code provisions, regulations, Revenue Procedures, and Revenue Rulings which may aid the inquirer in resolving his question or problem.

SEC. 9. EFFECT OF PENSION TRUST DETERMINATION LETTERS.

Determination letters issued pursuant to the provisions of this Revenue Procedure have the effect, generally, of any other determination letter as provided in section 13, Revenue Procedure 62–28, *supra*. Determination letters issued under the provisions of this Revenue Procedure contain only opinions as to the qualification of plans under section 401(a) of the Code and the status of related trusts under section 501(a). While a favorable determination letter may serve as a basis for determining deductions for employer contributions thereunder, it is not to be taken as an indication that contributions are necessarily deductible as made. Such determinations can be made only upon an examination of the employer's tax return, in accordance

with the limitations and subject to the conditions of section 404 of the Code.

SEC. 10. EFFECT ON OTHER DOCUMENTS.

.01 Revenue Procedure 56–12, C.B. 1956–1, 1029; Revenue Procedure 56–33, C.B. 1956–2, 1394; Revenue Procedure 57–5, C.B. 1957–1, 727; Revenue Procedure 60–1, C.B. 1960–1, 874; Revenue Procedure 61–11, C.B. 1961–1, 897, are superseded. Sections 1(a) through 1(d) of Revenue Procedure 56–8, C.B. 1956–1, 1024, is also superseded.

.02 The general procedures of Revenue Procedure 62–28, *supra*, relating to the issuance of rulings and determination letters, are applicable to requests relating to the qualification of plans under section 401(a) of the Code and the status of related trusts under section 501(a), and related problems of the type discussed herein, except that specific procedures and instructions of this Revenue Procedure take precedence over general procedures of Revenue Procedure 62–28, *supra*.

SEC. 11. EFFECTIVE DATE.

The procedures of this Revenue Procedure became effective November 19, 1962, the date they were published in the Internal Revenue Bulletin.

EXHIBIT "A"

Composite Schedule Showing Data Called for Under Items 1, 2, and 6 of Section 4.05

1. Name and address of employer:	2. Name of plan:
3. District in which processed:	4. Date of favorable ruling or determination letter on qualification of plan:
5. Nature of investment:	6. Year of investment:
7. Amount of investment:	8. Annual yield:
9. Restrictions on marketability, if any:	10. Collateral, if any:
11. Total trust assets:	12. Total invested in stock or securities (including promissory notes) of employer (or controlled corporation):
13. Percentage of total assets invested (including current investment) in stock or securities of employer (and controlled corporation, if involved):	14. Nature of employer's business:
	15. Reasons for the investment:

EXHIBIT "A"—Continued

EMPLOYER'S FINANCIAL DATA

(and separately of controlled corporation, if involved)

16. Balance Sheets	Latest year ended_____	Prior year ended____
(a) Total current assets		
(b) Total current liabilities		
(c) Working capital [excess of (a) over (b)]		
(d) Current ratio [(a) divided by (b) to 1]		
(e) Total assets		
(f) Total liabilities		
(g) Capital		
(h) Analysis of capital:		
Preferred stock_____ Number of shares issued and outstanding		
Amount		
Common stock_____ Number of shares issued and outstanding		
Amount		
Surplus_____ Paid-in		
Earned		

17. Profit and loss	Year ended——	Year ended——	Year ended——	Year ended——
(a) Net sales or total receipts_____				
(b) Cost of goods sold___				
(c) Gross profit_____				
(d) Other Income_____				
(e) Total profit_____				
(f) Operating expenses__				
(g) Other deductions____				
(h) Net profit_____				
(i) Federal income and excess profits taxes__				
(j) Dividends paid_____				
(k) Other surplus charges_				
(l) Surplus credits_____				
(m) Net transfer to surplus_____				

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26 CFR 601.201: Rulings and determination letters. Rev. Proc. 62–32

Areas of the Internal Revenue Code of 1954, in which the Internal Revenue Service generally will not issue advance rulings or determination letters because of the inherently factual nature of the problems involved.

Revenue Procedure 60–6, C.B. 1960–1, 880, superseded.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to supersede Revenue Procedure 60–6, C.B. 1960–1, 880, and to set forth an up-to-date, section-by-section list of those areas of the Internal Revenue Code of 1954 in which the Internal Revenue Service will not issue advance rulings or determination letters.

SEC. 2. BACKGROUND.

It is the policy of the Service to answer inquiries of individuals and organizations, whenever appropriate in the interest of sound tax administration, as to their status for tax purposes and as to the tax

effects of their acts or transactions, prior to their filing of returns or reports as required by the revenue laws.

There are, however, certain areas where, because of the inherently factual nature of the problems involved, or for other reasons, the Service will not issue advance rulings or determination letters. These areas are set forth in two sections of this Revenue Procedure. Section 3 reflects those areas in which advance rulings and determinations will not be issued. Section 4 sets forth those areas in which they will not ordinarily be issued. Each section reflects a number of specific questions and problems as well as the general areas.

With respect to the items here listed, however, Revenue Rulings or Revenue Procedures may be published in the Internal Revenue Bulletin from time to time in order to provide general guidelines as to the position of the Service.

This list should not be considered as all inclusive since the Service may decline to rule in advance on other questions whenever warranted by the facts or circumstances. Whenever a particular item is added to or deleted from this list, however, appropriate notice thereof will be published in the Internal Revenue Bulletin.

The authority and general procedures of the National Office of the Internal Revenue Service and of the offices of the District Directors of Internal Revenue with respect to the issuance of advance rulings and determination letters are outlined in Revenue Procedure 62–28, page 496, this Bulletin.

SEC. 3. AREAS IN WHICH RULINGS WILL NOT BE ISSUED.

.01 *Specific questions and problems.*

1. Section 61.—Gross Income.—(a) Whether an amount paid by an employer to an employee under specific factual circumstances is a gift or compensation for services rendered.

(b) Whether stockholders who waive their rights to future dividends for a specified period of time will be in receipt of income should the corporation subsequently declare and pay a dividend during the waiver period.

2. Section 106.—Contributions by Employer to Accident and Health Plans.—Whether an employee-stockholder of a corporation may exclude from his gross income, under the provisions of section 106, amounts paid by the corporation to provide accident or health benefits to the employee-stockholder.

3. Section 119.—Meals or Lodgings Furnished by an Employer.—Whether meals and lodging furnished to an employee are for the convenience of the employer. Also, whether cash allowances for meals constitute compensation.

4. Section 162.—Trade or Business Expenses.—Whether compensation is reasonable in amount.

5. Section 163.—Interest.—Whether advances to thin corporations constitute loans or are equity investments.

6. Section 264(b).—Certain Amounts Paid in Connection With Insurance Contracts.—Whether "substantially all" the premiums of a contract of insurance are paid within a period of four years from the date on which the contract is purchased. Also, whether an amount deposited is in payment of a "substantial number" of future premiums on such a contract.

7. Section 269.—Acquisitions Made To Evade or Avoid Income Tax.—Whether an acquisition is within the meaning of section 269.

8. Section 302.—Redemption of Stock.—(a) Whether a distributee ceases to have an interest in the corporation after the redemption of stock, within the meaning of section 302(c)(2)(A)(i), where the spouse of the distributee is the sole or principal stockholder after the redemption.

(b) Whether a distributee ceases to have an interest in the corporation, within the meaning of section 302(c)(2)(A)(i), after the redemption of his stock, where business properties are distributed in kind and the distributee forms a joint venture with the distributing corporation to operate both the properties distributed to him and the properties retained by the corporation.

(c) Whether section 302(b) applies where the consideration given in redemption by the corporation consists entirely or partly of its notes payable, and the shareholder's stock is held in escrow or as security for payment of the notes with the possibility that the stock may or will be returned to him in the future, upon the happening of specified defaults by the corporation.

(d) The tax effect of a redemption of stock to be consummated at some indefinite future time.

9. Sections 311 and 336.—Taxability of Corporation on Distribution; General Rule.—Upon the distribution of property in kind by a corporation to its shareholders, in complete liquidation under section 331 (where under the facts a sale of the property by the corporation would not qualify under section 337), in partial liquidation under section 346, or in redemption of stock under section 302(a), followed by a sale of the property, whether the sale can be deemed to have been made by the corporation under the doctrine of *Commissioner* v. *Court Holding Company*, 324 U.S. 331, Ct.D. 1636, C.B. 1945, 58.

10. Sections 312 and 316.—Earnings Available for Dividends.—The determination of earnings and profits of a corporation available for the distribution of dividends to its shareholders.

11. Section 331.—Gain or Loss to Shareholders in Corporate Liquidations.—The tax effect of the liquidation of a corporation, preceded or followed by the reincorporation of all or a part of the business and assets, where the shareholders of the liquidating corporation own more than a nominal amount of the stock of the new transferee corporation; or where a liquidation is followed by the sale of the corporate assets by the shareholders to another corporation in which such shareholders own more than a nominal amount of the stock.

12. Section 337.—Gain or Loss; Certain Liquidations.—(a) The application of this section to gains realized by a corporation upon the sale of property, in connection with its liquidation, to another corporation, where more than a nominal amount of the stock of both the selling corporation and the purchasing corporation are owned by the same persons.

13. Section 346.—Partial Liquidation.—The amount of working capital attributable to the business or portion of the business terminated which may be distributed in partial liquidation.

14. Section 351.—Transfer to Controlled Corporation.—(a) What will constitute stock or securities where part of the consideration received by the transferors consists of bonds, debentures or long-term

notes of the transferee in an amount, which when compared to the capital stock of the corporation, gives rise to the question of a "thin corporation."

(b) Whether the transfer of appreciated stocks or securities to a newly organized investment company in exchange for shares of the stock of such investment company, as a result of solicitation by promoters, brokers or investment houses, will constitute nontaxable exchanges within the meaning of this section.

(c) Whether the transfer of appreciated real estate, or interests therein, to a newly organized real estate investment trust, within the meaning of section 856(a) of the Code, in exchange for shares or interests in such trust, as a result of solicitation by promoters, brokers, or investment houses, will constitute nontaxable exchanges within the meaning of this section.

15. Section 368.—Definitions Relating to Reorganizations.—(a) The tax effect of a merger or other transaction meeting the literal statutory requirements of section 368(a)(1) involving a loss corporation, where the sole or principal purpose appears to be to offset the loss carryover of such corporation against the income of another corporation.

(b) Whether this section is applicable to the acquisition by an investment company of the stock or assets of another investment company where, as a result of such acquisition, the shareholders of either company, or both companies, thereby achieve a substantially wider diversification of the investment assets underlying their stock holdings.

16. Section 401.—Qualified Pension, Profit-Sharing, and Stock Bonus Plans.—(a) Amendments to qualified profit-sharing and stock bonus plans merely removing definite contribution formula. (These do not affect qualification; advance determination letters are unnecessary. See Rev. Proc. 56–22, C.B. 1956–2, 1380.)

(b) Amendments to qualified pension and profit-sharing plans designed only to permit such plans to participate in a common pension fund or group trust. (These do not affect qualification; advance determination letters are unnecessary. See Rev. Proc. 56–42, C.B. 1956–2, 1409.)

(c) Profit-sharing plans weighted by units of retirement benefits. See Rev. Rul. 57–77, C.B. 1957–1, 158.

(d) Qualification of pension or annuity plans which provide for disability benefits integrated with disability benefits under the Social Security Act unless (1) the plan provides that its "integrated" disability benefits will be payable only to employees entitled to disability benefits under the Act, or (2) the plan is of the offset type and provides for payment of the full disability benefits (without offset) when disability benefits are not payable under the Social Security Act. See Rev. Rul. 62–152, page 126.

(e) Qualification of pension or annuity plans which provide disability benefits designed to integrate under the provisions relating to early retirement benefits, but which uses a disabled life mortality table for the purpose of determining the amount of such "disability" benefits. See Rev. Rul. 62–152, page 126.

17. Section 451.—General Rule for Taxable Year of Inclusion.—Year of taxability of amounts realized pursuant to arrangements

designed to defer the time of receipt to a date later than that upon which the right to the amount becomes vested.

18. Section 503 (h) and (i).—Prohibited Transactions; Section 401(a) Trusts.—Whether a transaction involving the application of section 503(h) or section 503(i) of the Code will be considered a prohibited transaction or will otherwise affect the exempt status of a trust described in section 401(a) (as distinguished from whether or not the transaction comes within the purview of section 503(h) or section 503(i)).

19. Section 532.—Corporations Subject to Accumulated Earnings Tax.—Whether retention of earnings and profits by a corporation is for the purpose of avoiding surtax on its shareholders.

20. Section 642(c).—Deduction for Amounts Paid or Permanently Set Aside for a Charitable Purpose.—Allowance of an unlimited deduction for amounts set aside by a trust or estate for charitable purposes where there is a possibility that the corpus of the estate or trust may be invaded.

21. Section 704(e).—Family Partnerships.—Matters relating to the validity of a family partnership.

22. Section 911(a)(1).—Foreign Residence.—Whether an individual citizen of the United States is or has been a bona fide resident of a foreign country or countries.

23. Section 921.—Western Hemisphere Trade Corporations.—Whether a corporation qualifies as a Western Hemisphere Trade Corporation.

24. Section 931.—Income From Sources Within Possessions of the United States.—Whether a domestic corporation is entitled to the benefits of this section.

25. Section 1551.—Disallowance of Surtax Exemption and Accumulated Earnings Credit.—Whether a transfer is within section 1551 of the Code.

26. Section 2035.—Transactions in Contemplation of Death.—Whether a transaction is one in contemplation of death.

.02 *General areas.*

1. The results of transactions which lack bona fide business purpose and have as their principal purpose the reduction of Federal taxes.

2. A matter upon which a court decision adverse to the Government has been handed down and the question of following the decision or litigating further has not yet been resolved.

3. A matter involving the prospective application of the estate tax to the property or the estate of a living person.

4. Transactions such as sales and leasebacks, gifts and leasebacks, and other rental transactions of real or personal property directly or indirectly with the creator or a related or controlled interest. See Rev. Proc. 62–30, page 512, this Bulletin.

SEC. 4. AREAS IN WHICH RULINGS WILL NOT ORDINARILY BE ISSUED.

.01 *Specific questions and problems.*

1. Section 167.—Depreciation.

(a) Useful lives of assets.

(b) Depreciation rates.

2. Section 302.—Redemption of Stock.—The tax effect of the redemption of stock for notes, or the liquidation of a corporation by a

series of distributions, where the distributions in liquidation or the payments on the notes are to be made over an excessively long future period.

3. Section 306.—Disposition of Certain Stock.—Whether the distribution and/or disposition or redemption of "section 306 stock" is in pursuance of a plan having as one of its principal purposes the avoidance of Federal income taxes within the meaning of section 306(b)(4).

4. Section 341.—Collapsible Corporations.—Whether a corporation will be considered as a "collapsible corporation," that is, whether it was "formed or availed of" with the view of certain tax consequences.

5. Section 351.—Transfer to Controlled Corporation.—The tax effect of the transfer where part of the consideration received by the transferors consists of bonds, debentures or any other evidences of indebtedness of the transferee.

6. Section 401.—Qualified Pension, Profit-Sharing, and Stock Bonus Plans.—Whether a combination cash and trusteed profit-sharing plan qualifies. See Rev. Rul. 56–497, C.B. 1956–2, 284.

7. Section 501 (c) and (d).—List of Exempt Organizations; Religious and Apostolic Organizations.—Exempt status of an organization with less than 12 months of operation, unless such organization is of the community or public type is organized for purposes within the purview of the exemption statute and the details submitted in connection with its proposed activities indicate that it will engage in activities clearly within the contemplation of the statute, or is a state chartered credit union. See Revenue Procedure 62–30, page 512, this Bulletin.

8. Section 503(c).—Prohibited Transactions.—Whether an organization described in section 401(a) or section 501(c)(3) and exempt under section 501(a) of the Code proposes to enter into a prohibited transaction within the purview of section 503(c) of the Code where the determination is primarily one of fact. See Revenue Procedures 62–30, page 512, this Bulletin and 62–31, page 517, this Bulletin.

9. Section 521.—Exemption of Farmers' Cooperatives From Tax.—Exempt status of an organization with less than 12 months of operation. See Rev. Proc. 62–30, page 512, this Bulletin.

10. Section 1221.—Capital Assets.—Whether an individual is a dealer in real estate for the purpose of determining whether property held by him may be classified as a capital asset or as property held for sale to customers.

.02 *General areas.*

1. Any other matter where the determination requested is primarily one of fact, e.g., market value of property.

SEC. 5. SCOPE OF APPLICATION.

This Revenue Procedure is not to be considered as precluding the submission of requests for technical advice in any of the above areas from the office of a District Director of Internal Revenue to the National Office.

SEC. 6. EFFECT ON OTHER DOCUMENTS.

Revenue Procedure 60–6, C.B. 1960–1, 880, is hereby superseded.

26 CFR 601.702: Publication and public inspection. Rev. Proc. 62–33

Procedures concerning permissible inspection of Forms 11 and 11–B, Special Tax Returns, filed under the Internal Revenue Code of 1954, and procuring copies thereof by State governments.

SECTION 1. PURPOSE.

This Revenue Procedure sets forth the procedure whereby District Directors of Internal Revenue and the Director of International Operations may permit inspection or furnish copies of Form 11, Special Tax Return (Wholesale Dealer or Retail Dealer, in Liquor, Beer, Wine, Beer and Wine; Manufacturers. Importers or Dealers in Firearms) and of Form 11–B, Special Tax Return (Coin-Operated Amusement or Gaming Devices, Bowling Alleys, or Pool or Billiard Tables) to certain officials of States, Territories, political subdivisions, or the District of Columbia.

SEC. 2. AUTHORITY.

District Directors and the Director of International Operations are authorized, pursuant to section 601.702 of the Statement of Procedural Rules, to permit inspection of Form 11 on taxes imposed by subparts D, and E, Part II, subchapter A, chapter 51, and Part I, subchapter A, chapter 53, subtitle E, of the Internal Revenue Code of 1954, and of Form 11–B, on taxes imposed by subchapters B and C, chapter 36, subtitle D of the Code, by an official of a State, Territory, political subdivision, or the District of Columbia, for use in connection with the enforcement of its tax or police laws or regulations, provided a request is made in the manner prescribed below. In response to requests for copies, they may furnish copies of such returns, including copies under seal.

SEC. 3. APPLICATION FOR INSPECTION.

.01 Applications for inspection or for copies of returns shall be addressed to the District Director, or the Director of International Operations, with whom the return is on file. The application shall be signed by the chief governing officer, or the chief prosecuting attorney, of the State, Territory, political subdivision, or the District of Columbia, and by the officer or employee designated to make the inspection.

.02 The application shall show:

1 The name and address of the taxpayer;

2 The information desired and the periods involved;

3 That the information is desired and will be used solely in connection with the enforcement of tax or police laws and regulations;

4 That none of the information so acquired will be used or disclosed in any manner, except as required in preparation for a proceeding, or in the proceeding itself, in connection with the enforcement of tax or police laws and regulations; and,

5 The name and title of the officer or employee designated to make the inspection.

SEC. 4. TIME AND PLACE OF INSPECTION.

Inspection of the returns, after permission has been granted, shall be made by the requesting official, or his representative designated for

such purpose, in the office of the District Director, or the Director of International Operations, having custody of the returns. Inspection will be permitted only in the presence of an internal revenue officer or employee designated by the District Director, or the Director of International Operations, for that purpose and during the regular hours of business of such office. The inspection of returns shall be arranged for a time mutually agreeable and which will not interfere with the normal work-flow of the district or division office.

SEC. 5. INSPECTION.

.01 Permission to inspect the returns, when granted, shall extend only to the returns themselves and to information as to the corrected tax due if that figure has been determined.

.02 Permission will not be granted for inspection of Forms 11–B which are under active examination or investigation, or on which a recommendation for prosecution has been made and the case is under consideration, except as may be specifically authorized.

SEC. 6. CHARGES.

Fees for the furnishing of copies of 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 document.

.02 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.

.03 For each certification, a charge of 50 cents will be made.

.04 A bill for the cost of furnishing copies and preparing certifications will be made at the time the documents are furnished.

SEC. 7. CROSS REFERENCES.

For the procedures concerning permissible inspection of other Federal tax returns by State governments, see Revenue Procedure 62–18, page 408, this Bulletin.

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26 CFR 601.301: Imposition of taxes, qualification requirements, and regulations.
(Also, Part III–A, Sections 5367, 5382; 240.908, 240.1051)

Rev. Proc. 62–34

The quantity of water added to wine by bentonite slurries must be reflected in appropriate records and reports.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to outline the procedure for reporting the quantity of water added to wine by bentonite slurry treatments.

SEC. 2. BACKGROUND.

.01 Section 240.1051 of the Wine Regulations provides that bentonite slurry may be used by proprietors of bonded wine cellars for the purpose of clarifying wine. One pound of bentonite may be added

to not more than two gallons of water. Total quantity of water may not exceed one percent of the volume of wine treated.

.02 It has been found that substantial overages in winemakers' accounts have resulted from the use of bentonite slurry in the treatment of wine. Therefore, the quantity of water used in bentonite slurries must be reflected in appropriate records and reports.

SEC. 3. PROCEDURE.

.01 In addition to entering the quantities of wine as required by columns (c) through (h) of Form 2056, Record of Still Wine, proprietors of bonded wine cellars shall enter in an unused column of the form the quantity of water added to the wines by bentonite slurry treatments. The column heading should be appropriately revised to identify the entries made.

0.2 The total quantity of water used in bentonite slurries as shown on Form 2056 shall be reported at line 8 or 9 in Part 1 of Form 702, Monthly Report of Wine Cellar Operations. A notation descriptive of the entry will be made on the line used.

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.

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26 CFR 601.602: Forms and instructions. Rev. Proc. 62–35
(Also Part I, Section 6011; 31.6011(a)–1.

Substitutes for Form 941c, Statement to Correct Information Previously Reported Under the Federal Insurance Contributions Act, may be used in lieu of the official form, subject, however, to prescribed conditions.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to state the position of the Internal Revenue Service relating to acceptance of substitutes for Form 941c, Statement to Correct Information Previously Reported Under The Federal Insurance Contributions Act, for filing purposes in lieu of the official form.

SEC. 2. SPECIFICATIONS.

.01 Substitutes for Form 941c may be privately printed with slight variation of format and used without specific approval of the Service if the specifications enumerated in this section are met. For proposed substitutes which do not meet such conditions, specific approval must be requested as provided by section 4 below.

.02 Basic form. The latest revision of the prescribed Form 941c should be used as the basis for the privately printed form. A copy of the latest revision of Form 941c may be obtained from any District Director of Internal Revenue.

.03 Color and quality of ink and paper. Substitute forms are to be printed in black ink on white paper, both of quality as good as that used by the Government; the paper to be of substantially the same weight and texture as that used in the official form which is printed

on substance 32-pound chemical wood bond or its equivalent—basis 17 x 22—1000.

.04 Typography. Type to be not smaller than the corresponding type of the official form and as nearly as possible of the same font.

.05 Dimensions. The official Form 941c is 8 inches wide by 10½ inches deep. The substitute forms may vary in width from 8 inches to 9 inches and in depth from 10½ inches to 11 inches.

.06 Column widths. The columns (numbered 1 through 5) of the substitute form may be wider or narrower than the corresponding columns of the prescribed Form 941c; however, each column must be wide enough for adequate reporting of the information called for therein. The last column (Do Not Use—For Office Use Only) must be the same as the prescribed Form 941c.

.07 Additional columns. If one or more additional columns are included on the form for reporting information not called for on the official Form 941c, such columns should be blocked out on the two forms required to be sent to the District Director of Internal Revenue (original and one copy).

.08 Vertical lines. The "heavy" vertical lines which separate the six columns of the prescribed Form 941c may be, on the substitute form, either omitted or replaced by lighter lines, provided the required information is entered under the appropriate column headings. The "dotted" vertical lines in columns 1, 4, and 5 may be, on the substitute form, either retained or omitted, provided the required information is entered in a suitable manner under the appropriate column headings.

.09 Omission of instructions. The following instructions appearing on the prescribed Form 941c may be omitted, but such instructions should be followed in the preparation of the substitute forms:

a. The instructions in the upper right portion on the front of Form 941c.

b. The asterisk (*) instructions related to column 3 (Period Covered by Return to be Corrected) on the front of Form 941c.

c. The instructions on the back of Form 941c.

.10 The Government Printing Office symbols. To be omitted.

SEC. 3. ADDITIONAL INSTRUCTIONS.

.01 The original (in addition to the required copy) should be filed with the District Director of Internal Revenue; carbon copies in lieu of the original are not acceptable.

.02 If the forms are printed in continuous style, they must be separated before filing. Marginal holes for pin feed devices and stubs at the top or bottom of the form must be removed before filing with the District Director. The forms as filed must be within the dimensions specified in section 2.05 above.

.03 The account number and name of the employee must be entered in the prescribed columns for each listed line of an adjustment entry.

SEC. 4. SUBSTITUTES NOT MEETING STATED CONDITIONS.

Proposed substitutes for Form 941c which do not meet the conditions stated in section 2, above, should be forwarded by letter to the Commissioner of Internal Revenue, Attention D:S:T, Washington 25, D.C., for consideration.

(Also Part I, Sections 1385, 1388.) Rev. Proc. 62–36 [1]

The following guidelines apply to cooperative organizations subject to the provisions of subchapter T, chapter 1 of the Internal Revenue Code of 1954, as added by section 17 of the Revenue Act of 1962, Public Law 87–834, approved October 16, 1962, C.B. 1962–3, page 111. The new subchapter T is effective for taxable years of cooperative organizations beginning after December 31, 1962, and is applicable to distributions made by such organizations attributable to patronage occurring during such taxable years. The guidelines relate to the notification which such cooperatives must furnish their members in cases where section 1388(c)(2)(B) (also added by section 17 of the Revenue Act of 1962) is applicable.

Section 1388(c)(2)(B) provides that one method by which a patron may consent to take the stated dollar amount of a written notice of allocation into account as provided in the new section 1385 is by becoming, or continuing as, a member of the cooperative association after such association has adopted a bylaw, after October 16, 1962, which provides that membership constitutes such consent. However, in order for such consent to be effective, the member, or prospective member, must be furnished a written notice which informs him that the bylaw has been adopted and of its significance. In addition, he must be furnished a copy of the bylaw. This form of consent is effective only with respect to patronage occurring after the bylaw has been adopted and members have been notified and furnished a copy of the bylaw.

The written notice and the copy of the bylaw must be given to each individual separately and thus may not be a notice which is published in a newspaper or posted at the cooperative's place of business. The notice and copy of the bylaw may be sent by ordinary mail to the patron's last known address.

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26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of correct tax liability. Rev. Proc. 62–37

Although revenue agents of the Office of International Operations may participate in examinations of returns of domestic taxpayers engaged in international activities, jurisdiction over these returns remains with the District Director. Informal conferences in such cases will be granted by the appropriate District Director's office, not by the Office of International Operations.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to explain the role of the Office of International Operations in the international enforcement program of the Internal Revenue Service.

SEC. 2. PROCEDURE.

.01 The Service has instituted an international enforcement program to provide comprehensive audit coverage of the returns of domestic taxpayers engaged in substantial international activities.

[1] Based on Technical Information Release 418, dated November 23, 1962.

District Directors have jurisdiction over all returns examined under this program. The Office of International Operations, in addition to its regular examination program covering returns filed by nonresident citizens and aliens, resident foreign corporations, and other jurisdictional matters, acts solely as a service organization in this new role, *i.e.*, it provides assistance by specialists in this tax area to the district having jurisdiction over the particular case. Its agents assist district agents in developing the facts bearing on international activity and in determining whether any change in reported taxable income should be recommended as a result of the inquiry.

.02 Generally, the Office of International Operations agent and the district office agent will jointly participate in the examination of a taxpayer. At the conclusion of their examination, the agents will usually discuss the issues and their proposed findings with the taxpayer. At this time the district agent may solicit an agreement to such findings. Thereafter, whether or not an agreement was solicited, the Office of International Operations agent will prepare and submit an information report on the "international issues" which will be furnished to the appropriate District Director. The district agent, after consideration of the information report, will determine those adjustments that are to be made to the taxpayer's income. After making such a determination, the district agent will solicit agreement from the taxpayer to any proposed adjustments, unless one has already been submitted by the taxpayer which conforms to the proposed determinations of the district agent.

.03 The participation of an Office of International Operations agent in an examination and the submission of his information report for the use of a District Director's office does not constitute National Office technical or legal advice. When such advice is required in a case involving "international issues," the request will be made by the District Director in conformity with the established procedures announced in Revenue Procedure 62–28, page 496, and Revenue Procedure 62–29, page 507.

.04 Informal conference invitations and procedures in cases involving "international issues" follow the regular procedures prescribed in Revenue Procedure 60–24, C.B. 1960–2, 998. The conference invitation will be issued by the Conference Coordinator of the district office having jurisdiction over the return. However, the Office of International Operations agent will be invited to attend any informal conference where the international issues are unagreed. At such a conference, his function is to assist the district agent in explaining the bases of the proposed adjustments resulting from international issues.

.05 The Office of International Operations may not grant informal conferences in domestic taxpayer cases involving "international issues" since the district office retains complete jurisdiction of such cases.

Sec. 3. INQUIRIES.

Inquiries relating to this Revenue Procedure should be addressed to the Assistant Commissioner (Compliance) for the attention of CP:A:P.

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