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Internal Revenue Bulletin

Cumulative Bulletin XI-1

JANUARY-JUNE, 1932

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

Treasury Department : : : : : Bureau of Internal Revenue

Internal Revenue Bulletin

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

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

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

UNITED STATES GOVERNMENT PRINTING OFFICE, WASHINGTON : 1932

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The Internal Revenue Bulletin service for 1933 will consist of weekly bulletins and semiannual cumulative bulletins.

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

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

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

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

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Cumulative Bulletin X–1 (January–June, 1931)	65 cents
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Cumulative Bulletin XI–1 (January–June, 1932)	30 cents

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

INTRODUCTORY NOTES.

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

Income Tax rulings are printed in four parts. Rulings under the Revenue Act of 1928 are published as Part I, the section headings corresponding with the sections of that law and the article headings corresponding with the article headings of Regulations 74. Rulings under the Revenue Act of 1926 are published as Part II, the section and article headings corresponding with the section and article headings of the Revenue Act of 1926 and Regulations 69. Rulings under the Revenue Act of 1924 are printed as Part III, the section and article headings corresponding with the section and article headings of the Revenue Act of 1924 and Regulations 65. Rulings under the Revenue Act of 1921 or earlier Acts are printed as Part IV, the section and article headings corresponding with the section and article headings of the Revenue Act of 1921 and Regulations 62.

ABBREVIATIONS.

The following abbreviations are used throughout the Bulletin:

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

S. M.—Solicitor's memorandum.
Sol. Op.—Solicitor's opinion.
S. R.—Solicitor's recommendation.
T.—Tobacco Division.
T. B. M.—Advisory Tax Board memorandum.
T. B. R.—Advisory Tax Board recommendation.
T. D.—Treasury decision.
x and y are used to represent certain numbers, and when used with the word "dollars" represent sums of money.

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

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

ANNOUNCEMENT RELATING TO BOARD OF TAX APPEALS DECISIONS.

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

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46058	XI-9-5398	2
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BOARD OF TAX APPEALS.

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

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

[a] XI–26–5524

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

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A.			
Abeles, Charles T	40546	24	435
Abeles, Clifford	37695	24	435
Abeles, Francis, estate of	37693	24	435
Abeles, John T	37694	24	435
Abeles, Katherine	37696	24	435
Abeles, Williemene H	41034	24	435
Acme Manifolding Co., Inc	25194 38687	24	429
Adelaide Park Land et al., trustees	39980	25	211
Albert Lea Packing Co., Inc	20765	24	376
American Cigar Co	16229	21	464
American Feature Film Co	27623	24	18
American Security & Trust Co. et al., executors [1]	39167	24	334
B.			
Baldwin, Florence G	32387	23	512
Balfour, Sir Robert	40230	25	154
Barber, Arthur	26747	25	513
Barber, Philip C	26755	25	513
Barber, St. George	26757	25	513
Barber Trusts, Sarah P	26747–26757	25	513
Beaumont, Louis D	31931 46569 49422	25	474
Bellows Falls Power Co	18592 29104	25	195

[a] Ruling No. 5524 includes all acquiescence and nonacquiescence notices published in the Internal Revenue Bulletin service from January 1 to June 30, 1932.

[1] Estate tax decision.

ACQUIESCENCES—Continued.

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Birdneck Realty Corporation	46079	25	1084
Biscayne Bay Islands Co	27616, 35098, 40147	23	731
Bloodgood, Edith B	26750	25	513
Blum, Julius, trustee	39242, 40939, 45741, 51507	25	119
Borg & Beck Co	24223, 34964	24	995
Buck, John A., estate of [1]	32584, 44153, 44684	25	780
Buck et al., Mary M., executors [1]	32584, 44153, 44684	25	780
Bullock, George [2]	31209	23	710
Butler, U. H	46055	24	506
C.			
Camp Manufacturing Co	35955	25	537
Carman, F. J	44321, 44939, 50178	25	162
Carnie-Goudie Manufacturing Co	20074, 27095	24	679
Cathey, George	46056	24	506
Cathey, Luke	46057	24	506
Central Market Street Co.[3]	24837	25	499
Central Rendering Corporation	20776	24	376
City Bank Farmers Trust Co. et al., executors [4]	31869	23	663
Clark et al., James, executors	34499	24	1235
Clements, W. L	46058	24	506
Clinchfield Securities Co	40554	25	446
Columbian Carbon Co.[5]	42743	25	456
Connecticut River Power Co	18591, 29106	25	195
Cooke, Beatrice B	26751	25	513
Coombs, Elizabeth M	44768	25	1320
Coombs, J. Howard	44769	25	1320
Cooper, John I	32610, 40115	24	216
Cornwell, F. L	30303	24	915
Cotton, G. E	59655	25	866
Cromwell et al., William Nelson, executors [6]	42619	24	461
Crowley, Joseph J., estate of [4]	35472	25	340
Crowninshield Shipbuilding Co	18987	24	925
Culver, Wilmer T	37574	24	1013

[1] Estate tax decision; acquiescence relates to value of certain real estate in San Francisco and value of stock of Langendorf Baking Co. for estate tax purposes; and reasonableness of Commissioner's allowance for support of the widow.
[2] Acquiescence relates to issue 2 of decision.
[3] Acquiescence relates to issue regarding apportionment of taxes among affiliated corporations.
[4] Estate tax decision.
[5] Nonacquiescence published in Bulletin XI-14, page 1, revoked.
[6] Estate tax decision; nonacquiescence published in Cumulative Bulletin X-2, pages 84, 88, revoked.

AOQUIESCENCES—Continued.

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D.			
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Dahl et al., Julia, executors	44845	24	1167
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Detroit Trust Co. et al., executors [1]	35472	25	340
Dickinson, Albert G	35015, 43176	23	1211
Dirksen, Anna L., executrix	17717	24	1152
Dirksen, Theodore H., estate of	17717	24	1152
Douglas Co., John	38726	23	1307
Drexel Packing Co	20775	24	376
Duff, Robert C. [2]	37552	23	1342
E.			
Eagle Pass & Piedras Negras Bridge Co	42460	23	1337
Enameled Metals Co	19011	25	186
Evergreen Cemetery Association	30726	25	544
F.			
Fame Canning Co	20774	24	376
Federal Street & Pleasant Valley Passenger Ry. Co	29758	24	262
Fidelity Savings & Loan Association	14862, 31801, 39406, 45215	23	1059
First National Bank of Boston, administrator	36438, 46583	25	252
Folk, H. B	28396, 31018	25	599
Forres, Lord	40229, 43973	25	154
Foster, N. C., estate of [1]	32984	25	414
Foster et al., Willard, executor [1]	32984	25	414
G.			
Ginsberg, Albert A	27628	24	18
Ginsberg, Nathan A	27629	24	18
Golden, Edward A	27625	24	18
Goldman, Maxwell	30302	24	915
Grand River Gravel Co	23085	22	1124
Green, Robert D. [3]	53647	24	719
Gulf Coast Irrigation Co. [4]	33694, 40081, 41343	24	958
Gurnee, Augustus Coe, estate of [5]	42619	24	461
H.			
Hailey-Ola Coal Co	30962	24	895
Halladay, Sarah P	26754	25	513
Hamburg, jr., Sam	30304	24	915
Hanscom, Edward E., estate of [1]	44992	24	173
Hanscom et al., Melville, executors [1]	44992	24	173

[1] Estate tax decision.
[2] Acquiescence relates to issue 1 of decision.
[3] Acquiescence relates to transactions 1, 2, 3, and 4.
[4] Acquiescence relates to all issues except affiliation issue.
[5] Estate tax decision; nonacquiescence published in Cumulative Bulletin X-2, pages 84, 88, revoked.

ACQUIESCENCES—Continued.

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Hayman Co., B	16552	25	736
Hess, Nathaniel J	33279	24	475
Hoffer, Anita Owens	33374	24	22
Hoffer, T. B	33375	24	22
Houston Bros.[1]	12052	22	51
Houston, George T.[1]	13104, 22008	22	51
Houston, Horace K.[1]	22009	22	51
Houston, Philip D.[1]	22007	22	51
Huyler's, Inc	28369, 29154, 39841	24	425
I.			
Ingalls, Charles C., estate of[2]	57835	25	773
Interstate Realty Co	46272, 50981	25	728
Iten Biscuit Co	16429, 20899	25	880
K.			
Kasch, Ed	48293	25	284
Kasch, Theodora	48293	25	284
Kraemer, Samuel	37822	25	686
Kuhn, Ida L	32609, 40267	24	216
L.			
Lake Charles Naval Stores	34630, 36940	25	173
Landers, Douglas J., estate of[2]	35443	21	1347
Lawson, John	40232	25	154
Liberty Farms Co	26717, 29899	22	1298
Lincoln, Robert Todd, estate of[2]	39167	24	334
Littauer, Eugene, estate of[3]	51858	25	21
Littauer et al., Lucius N., executors[3]	51858	25	21
Logel, Joseph F	37762, 40071	24	798
Longyear, Mary B., estate of	36438, 46583	25	252
Lourie, David A	27630	24	18
M.			
Markham Irrigation Co.[4]	41344	24	958
Martin Hotel Co. and affiliated corporations	16275	24	899
Martin et al., J. Earle, trustees	44583	24	862
Martin, T. S., estate of	44583	24	862
Matagarda Canal Co.[4]	40082, 41345	24	958

[1] Acquiescence relates only to deduction for business expenses in 1920 and to number of feet of timber cut during 1919.
[2] Estate tax decision.
[3] Estate tax decision; acquiescence relates to issues 4, 5, and 7 of decision.
[4] Acquiescence relates to all issues except affiliation issue.

ACQUIESCENCES—Continued.

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Mauldin, I. M	26239	22	858
McCool, Bess	46059	24	506
McGrew, Elizabeth W	26753	25	513
Mercantile-Commerce National Bank in St. Louis et al., executors and trustees [1]	35443	21	1347
Metropolitan Properties Corporation	45032	24	220
Milgrim & Bros., Inc., H.[2]	33177	24	853
Mississippi Packing Co., Inc	20772	24	376
Mobile Light & Railroad Co.[3]	41026 42062	23	543
Moorehead, William A	25853	22	858
Murtha & Schmohl Co	17911	17	442
N.			
National Contracting Co.[4]	24520	25	407
National Mill Supply Co	37001	23	1362
National Packing Corporation	31668 33971	24	952
Newell et al., Sterling, executors [1]	57835	25	773
New England Power Co	18593 29105	25	195
New York, Chicago & St. Louis R. R. Co	21047	23	177
Northern Coal Co.[5]	34945	24	307
O.			
Oakley, Richard H	45778	24	1082
P.			
Paine et al., Francis Ward, executors	34113	25	764
Paine, William A., estate of	34113	25	764
Palm Beach Mather Co	43850	24	536
Peavy-Byrnes Lumber Co	15824 16354 25984	25	223
Peavy-Moore Lumber Co	15823 16355 25986	25	223
Peavy-Wilson Lumber Co	15822 16356 25985	25	223
Pennsylvania Investors Co	20766	24	376
Pershouse, Alice E	26749	25	513
Pershouse, Mabel B	26748	25	513
Pizitz Dry Goods Co., Louis	46585	22	161

[1] Estate tax decision.
[2] Acquiescence relates to issue 1 of decision.
[3] Acquiescence relates to following issues: 1. Whether payments received by a trustee on behalf of petitioner in the taxable years in accordance with a written agreement entered into by and between petitioner and another in 1906 constitute taxable payments of rent or nontaxable payments on the selling price of assets. 2. Whether petitioner sustained statutory net losses for 1924 and 1926 which can be deducted from its income for 1925 and 1926, respectively.
[4] Acquiescence in Board's decision that petitioner had the right to allocate overhead expenses to each contract on completed basis and that formula used by petitioner was permissible; and issue relative to negligence.
[5] Acquiescence relates to inventory issue.

ACQUIESCENCES—Continued.

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Price, Laura M	40659	24	216
Price, W. E	41072	24	216
Prosser, Constance B	26752	25	513
R.			
Rapp, John W., estate of	28618	24	1061
Reardon & Sons Co., John	20773	24	376
Rialto Mining Corporation	48692, 56877	25	980
Richards & Hirschfeld, Inc	21715	24	1289
Rodeo-Vallejo Ferry Co.[1]	36411, 48528	24	936
Rosenberg, Louis	27626	24	18
Roy & Titcomb, Inc	29138	24	969
Russell, C. C	46060	24	506
Russell, Mrs. C. C	46061	24	506
S.			
San Carlos Milling Co., Ltd.[2]	39525	24	1132
San Martinez Oil Co	37447, 43121	25	218
Schepp Co., L	42908	25	419
Scruggs, Gross R	33610	24	1174
Scruggs Investment Co	46270	24	1174
Scruggs, Marian P	38711	24	1174
Seaconnet Coal Co.[3]	18089	24	307
Searles Real Estate Trust	24489	25	1115
Securities Co	40553	25	446
Sells Sporting Goods Co	20771	24	376
Shand, Gadsden	26238	22	858
Shaw, David, estate of	34499	24	1235
Shea, R. P	37835, 40034	24	798
Smith et al., Elizabeth D., executors	39291, 49668	25	291
Smith, I. N., estate of	39291, 49668	25	291
Smith, Jessie, executrix	18876	24	807
Smith, Mrs. Jessie	22313	24	807
Smith, Louis, estate of	18876	24	807
Sprague & Son Co., C. H.[3]	34946	24	307
Sprunt & Son, Inc., Alexander	38408	24	599
Standard Beef Co	20770	24	376
Standard Conveyor Co	33159, 36393, 40873	25	281
Stauffen, Theodora B	26756	25	513
Stearns, Robert L	37573	24	1013
Stevens, John H	29685	24	52
Stoneman, David	27627	24	18
Sunburst Oil & Refining Co	45979	23	829

[1] Acquiescence relates to deduction of contribution to Victory Highway Association.
[2] Acquiescence relates to issue 2 of decision.
[3] Acquiescence relates to inventory issue.

ACQUIESCENCES—Continued.

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Tifft, Lewis E	31030, 33465, 42341, 45958	25	986
Tobey, Maurice	27624	24	18
Tolerton & Warfield Co.[2]	45320	23	892
Turrish, Henry	44742	24	913
U.			
Ulster & Delaware R. R. Co	28927	25	109
Union Lard Corporation	20769	24	376
United States Trust Co. of New York, trustee	26747–26757	25	513
W.			
Walker, George H., estate of [3]	31869	23	663
Ward Bros. Co	30992	24	989
Washington Market Co	43912	25	576
White Oak Transportation Co. [4]	18088	24	307
Whitson, Thomas J	40233	25	154
Williams, Ella J	29273	25	1161
Williams, W. W	46062	24	506
Williamson, Alexander B	40231, 43972	25	154
Williamson, Archibald (Lord Forres)	40229, 43973	25	154
Wilson & Co., Inc., of California	20768	24	376
Wilson Commission Co	20767	24	376
Wilson & Co., Lee	33826	25	840
Wray, Eliza J	25881	24	94
Wright, George M	25854	22	858
Y.			
Young, Ethel P	38868	24	815

[1] Acquiescence relates to all issues except affiliation issue.
[2] Acquiescence relates to issue regarding deduction of loss sustained by petitioner during nonaffiliated period.
[3] Estate tax decision.
[4] Acquiescence relates to inventory issue.

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

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Abelson's, Inc	53793	24	686
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Alameda Park Co	8355	25	850
Alker, Vera M. Kohler	36116	25	243
Allied Furriers Corporation	50059	24	457
B.			
Ballinger, Bessie M., executrix [1]	32177	23	1311
Ballinger, Walter F., estate of [1]	32177	23	1311
Bankers Trust Co., trustee	32459	24	10
Bell & Sons, Samuel	38056 41647 45616	22	793
Boca Ceiga Development Co	40446	25	941
Brackman, J. W	45714	24	259
Bradbury, I. C	45780	23	1351
Buck, John A., estate of [2]	32584 44153 44684	25	780
Buck et al., Mary M., executors [2]	32584 44153 44684	25	780
Bullock, George [3]	31209	23	710
Busche, F. C.[4]	9447 10202 10755	10	1345
Business Real Estate Trust of Boston	33469 42684 50305	25	191
Butler-Veitch Co	45169 45170	23	953
C.			
Central Market Street Co.[5]	24837	25	499
Cobleigh, Margaret Edwards, estate of [1]	40765	24	176
Commercial Garage Co	41646	22	793
Cross, Maurice	32735	24	1079
D.			
Davis, C. R.[4]	10299	10	1233
Davis, Frederick H	32950	20	931
Davis, Thomas L	37324	24	405
	37395	24	405
Dohrmann, Andrew B. C	20658	19	507
Duff, Robert C.[6]	23969	19	466
	37552	23	1342

[1] Estate tax decision.
[2] Estate tax decision; nonacquiescence relates to deduction of amount of a claim filed against the estate and allowed by probate court.
[3] Nonacquiescence relates to issue 1 of decision.
[4] Acquiescence published in Cumulative Bulletin X–1 withdrawn.
[5] Nonacquiescence relates to issue regarding Board's jurisdiction of subsidiaries.
[6] Nonacquiescence relates to issue 2 of decision.

NONACQUIESCENCES—Continued.

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F.			
Fifth Street Building	16627, 29264, 45537	24	876
Fletcher, Salathiel R	33041	24	75
G.			
Gassner, Louis [1]	4017	4	1071
Goldberg, Harry S.[1]	5389	4	1073
Green, Robert D.[2]	53647	24	719
Gulf Coast Irrigation Co.[3]	33694, 40081, 41343	24	958
H.			
Hancock, G. Allan	36867	25	607
Harris, Allen [1]	10980	10	1374
Harris, Simon	31632	24	512
Hawley Investment Co	45169, 45170	23	953
Hedrick, J. T	33533	24	444
Heller, B. G	40634	25	259
Henn, A. W	37102	20	1133
Hieronymus, Carl Richard, estate of	48930	24	269
Hill, D. F., estate of [4]	29399	24	1144
Hill et al., Paul F., executors [4]	29399	24	1144
Household Products, Inc	44809	24	594
Houston Baseball Association	43985, 45430	24	69
Houston Bros.[5]	12052	22	51
Houston, George T.[5]	13104, 22008	22	51
Houston, Horace K.[5]	22009	22	51
Houston, Philip D.[5]	22007	22	51
Hutchison Coal Co	34939	24	973
I.			
Imperial Investment Co	29291	23	1281
Iten Biscuit Co	43667, 45164	25	870
Ives Dairy, Inc	39873	23	579
J.			
Jackson-Wermich Trust	32307	24	150
Jamison Coal & Coke Co	31690, 34088	24	554

[1] Acquiescence published in Cumulative Bulletin X-1 withdrawn.
[2] Nonacquiescence relates to transaction 5.
[3] Nonacquiescence relates to affiliation issue.
[4] Estate tax decision.
[5] Nonacquiescence relates to March 1, 1913, value and to the basis for the deduction for depletion and for the computation of gain or loss upon subsequent sale of the timber.

NONACQUIESCENCES—Continued.

Taxpayer.	Docket No.	Board of Tax Appeals. Volume.	Page.
K.			
Kountze, Charles T	37323	24	405
Kountze et al., Charles T., executors	37535	24	405
Kountze, Luther L., estate of	37535	24	405
Krull, Francis [1]	16985	10	1096
L.			
Leetonia Furnace Co	32272	23	979
Levine, Hyman [1]	7435	8	298
Liebes & Co., H	28544 35038	23	787
Littauer, Eugene, estate of [2]	51858	25	21
Littauer et al., Lucius N., executors [2]	51858	25	21
Livingood, Charles J., executor	40899	25	585
M.			
Manchester Coal Co	33392	24	577
Markham Irrigation Co. [3]	41344	24	958
Matagarda Canal Co. [3]	40082 41345	24	958
McCrory, Luke W., trustee	32444	25	994
Miglietta, Olga K	36379	25	243
Moore Bread Co	41645	22	793
Morganite Brush Co., Inc	26369	24	776
Morriss et al., Julia L	41023 41024 45863 45864	23	1076
Morriss Realty Co. Trust No. 1	41023 45863	23	1076
Morriss Realty Co. Trust No. 2	41024 45864	23	1076
Murphy et al., Fred T., trustees	43795	25	724
Murphy Personal Property Trust	43795	25	724
Mutual Life Insurance Co. of New York	9764	23	749
N.			
Nashville, Chattanooga & St. Louis Ry	33799	24	856
National Contracting Co. [4]	24520	25	407
National Pipe & Foundry Co. [5]	32997	19	242
Neill, James [1]	9290	8	299
New York Life Insurance Co	38880	24	1217
Nichols & Cox Lumber Co	23601	24	54
North American Investment Co	30183	24	419
Northern Coal Co. [6]	34945	24	307

[1] Acquiescence published in Cumulative Bulletin X-1 withdrawn.
[2] Estate tax decision; nonacquiescence in respect to that part of decision which holds that accrued interest paid on Federal income taxes for 1927 and 1928 from date of decedent's death to November 5, 1930, is a proper allowable administrative expense.
[3] Nonacquiescence relates to affiliation issue.
[4] Nonacquiescence relates to issue 1 of decision and issue regarding deductibility of overhead costs in 1925.
[5] Acquiescence published in Cumulative Bulletin IX-2, page 43, revoked. Revocation of prior acquiescence and present nonacquiescence are due to the failure of the Board's decision to limit the word "distributed" to the cash distributions made to the stockholders.
[6] Nonacquiescence relates to statute of limitations issue.

NONACQUIESCENCES—Continued.

Taxpayer.	Docket No.	Board of Tax Appeals. Volume.	Page.
O.			
Oakman et al., Mamie R	42917	24	84
Ogden, Hugh W	23943	24	1239
Old Mission Portland Cement Co	38853	25	305
Olinger Mortuary Association	36502	23	1281
P.			
Pacific Nash Motor Co	45169 45170	23	953
Peabody, Cornelia Haven, estate of [1]	39647	24	787
Peabody et al., Stephen, executors [1]	39647	24	787
Phillips, William S	24446 31769	24	98
R.			
Roberts, Walter B	37534	24	405
Rodeo-Vallejo Ferry Co.[2]	36411 48528	24	936
Rosser, E. M., executor [1]	40765	24	176
Roth, W. A.[3]	45065	22	587
S.			
St. Louis Southwestern Ry. Co	13319 27768 33938	24	917
Salomon, Leon [3]	3725 12231	4 8	1109 979
San Carlos Milling Co., Ltd.[2]	39525	24	1132
Sand Springs Ry. Co	32438 32439	21	1291
Seaconnet Coal Co.[4]	18089	24	307
Small's, Inc	53791	24	686
Sprague & Son Co., C. H.[4]	34946	24	307
Spring City Foundry Co	21169	25	822
Stearns, Marshall, administrator	48930	24	269
Stockholms Enskilda Bank	55755	25	1328
Sturgeon-Hubbard Trust	37095	25	368
Sturgeon et al, Rollin S., trustees	37095	25	368
Suncrest Lumber Co	33244	25	375
Swisky, Toby W	42032	25	259
T.			
Tennessee Consolidated Coal Co	33383	24	369
Texas Irrigation Co.[5]	40083 41346	24	958
Titus, C. Dickson	20705	24	36
Todd, Willis	37536	24	405
Tolerton & Warfield Co.[6]	45320	23	892

[1] Estate tax decision.
[2] Nonacquiescence relates to issue 1 of decision.
[3] Acquiescence published in Cumulative Bulletin X-1 withdrawn.
[4] Nonacquiescence relates to statute of limitations issue.
[5] Nonacquiescence relates to affiliation issue.
[6] Nonacquiescence relates to issue regarding deduction of loss sustained by two affiliated companies during fiscal year ended January 31, 1924, and the taxable period February 1 to April 25, 1924, in computing the consolidated net income for taxable period April 26 to December 31, 1924, and the year 1925.

NONACQUIESCENCES—Continued.

Taxpayer.	Docket No.	Board of Tax Appeals.	
		Volume.	Page.
U.			
Union Trust Co., trustee	42917	24	84
W.			
Waggoner, Ella	33517	24	657
Waggoner, W. T	33516	24	657
Wall, Frank E.[1]	7359	4	915
Wardman, Harry	22348	24	102
West Virginia-Pittsburgh Coal Co	20337 25030	24	234
White Oak Transportation Co.[2]	18088	24	307
White, Rita M. Kohler	36112	25	243
Wilson, Luke F., estate of	32444	25	994
Wood Furniture Co., J. A	40565	21	564
Z.			
Ziegler, Albert W	46291	23	1091
Ziegler, Clifford E	46292	23	1091

[1] Acquiescence published in Cumulative Bulletin X-1 withdrawn.
[2] Nonacquiescence relates to statute of limitations issue.

INCOME TAX RULINGS.—PART I.

REVENUE ACT OF 1928.

SUBTITLE B.—GENERAL PROVISIONS.

PART II.—COMPUTATION OF NET INCOME.

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

ARTICLE 51: What included in gross income. XI–4–5365
G. C. M. 9953

REVENUE ACT OF 1928.

Under section 161a of the Civil Code of California, which became effective July 29, 1927, a wife's earnings in California constitute community income. An agreement between husband and wife in California, entered into prior to the earning of income, which provided that the earnings of the wife, as well as those of the husband, should constitute the separate property of the spouse who performed the services, does not have the effect of shifting the burden of taxation from one to the other. As separate returns were filed, the salary of the wife (as well as that of the husband) should be treated as community income and one-half thereof taxed to each spouse.

An opinion is requested whether, where a husband and wife domiciled in California filed separate returns, a division of the personal earnings of each is required, even though there is a written agreement entered into between the two spouses prior to the earning of the income to the effect that such earnings are his or her separate property.

The husband and wife filed separate returns, the husband reporting in his return a salary of $3.78x$ dollars and the wife reporting in her return a salary of $1.62x$ dollars. In General Counsel's Memorandum 9938 (C. B. X–2, 115) the question was raised whether the earnings of a husband should be divided where separate returns were filed, whereas the instant case involves the question whether the earnings of both spouses should be divided. In the former case there was an agreement signed by the husband and wife to the effect that all the earnings of the husband should constitute his separate property. In the instant case there was an agreement to the effect that the earnings of the wife, as well as those of the husband, should constitute the separate property of the spouse who performed the services.

This office in General Counsel's Memorandum 9938, supra, held that, regardless of the agreement existing between the husband and wife, the husband's salary earned after July 29, 1927, the effective date of the amendment of the Civil Code of California, was taxable

one-half to the wife and one-half to the husband, and that the agreement was not effective to preclude the taxation of such salary as community income. The same question is involved in the instant case, except that in this case the agreement also provides that earnings of the wife should constitute her separate property. In accordance with General Counsel's Memorandum 9938, supra, and on authority of the decisions of the United States Supreme Court in *Lucas* v. *Earl* (281 U. S., 111) and by the Circuit Court of Appeals in *Blair* v. *Roth* (22 Fed. (2d), 932, T. D. 4152, C. B. VII–1, 215, certiorari denied 277 U. S., 588), it is believed that the agreement in the instant case was ineffective to shift the burden of tax from one spouse to another. In this connection it should be noted that in *Blair* v. *Roth*, supra, the court stated that it concurred in the view of the Commissioner that "the instant they were received, the salaries were, by the law, impressed with the status of community property, and were taxable with reference to that status." Under section 161a of the Civil Code of California, which became effective July 29, 1927, a wife's earnings in California became community property. Where separate returns are filed by husband and wife, community income in the form of salaries earned by either spouse on and after July 29, 1927, should be divided and one-half taxed to each. (See I. T. 2457, C. B. VIII–1, 89, and *U. S.* v. *Malcolm*, 282 U. S., 792.)

In view of the foregoing, it is the opinion of this office that even though the agreement in question may be valid for the purpose of changing property rights between the husband and wife, it does not have the effect of shifting the burden of taxation from one to the other. As separate returns were filed, the salary of the wife (as well as that of the husband) should be treated as community income and one-half thereof taxed to each spouse.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

ARTICLE 52: Compensation for personal services. XI–22–5492
G. C. M. 10486

REVENUE ACT OF 1928 AND PRIOR REVENUE ACTS.

The reason that the commission allowed an insurance agent on a policy taken out on his own life is considered income is that the relationship of employer and employee exists between the insurance company and the agent and, inasmuch as the insurance company is under contract to pay the agent commissions on all policies of insurance secured by him, no distinction can logically be made between a commission paid to the agent on account of a policy written on his own life and a commission paid to the agent on account of a policy written on the life of some one else.

Information is requested relative to the basis on which a ruling relating to insurance commissions was made.

The particular ruling, which is one of several rulings contained in Treasury Decision 2137, reads as follows:

Commission retained by agent on his own life insurance policy.—A commission retained by a life insurance agent on his own life insurance policy is held to be income accruing to the agent, and should be included in his return of income for the assessment of the income tax.

If a life insurance company reduces the standard charge of an insurance policy to a purchaser and the relationship of employer and employee does not exist, the amount by which the policy is reduced can not be considered income at the time of purchase for the reason that it is not "gain derived from capital, from labor, or from both combined," nor "profit gained through a sale or conversion of capital assets" within the meaning of the definition of income as stated in *Eisner* v. *Macomber* (252 U. S., 189, T. D. 3010, C. B. 3, 25). The Board of Tax Appeals has held that the purchase of property at a bargain price does not result in taxable income where the sale is consummated by two persons dealing at arms' length. (See *Appeal of Manomet Cranberry Co.*, 1 B. T. A., 706, C. B. IV–1, 3.)

The reason that the commission allowed an insurance agent on a policy taken out on his own life is considered income is that the relationship of employer and employee exists between the insurance company and the agent, and inasmuch as the insurance company is under contract to pay the agent commissions on all policies of insurance secured by him, no distinction can logically be made between a commission paid to the agent on account of a policy written on his own life and a commission paid to the agent on account of a policy written on the life of some one else. The commission is paid to the agent as compensation for services rendered as an employee, i. e., on account of business obtained, regardless of whose life is insured, and is "gain derived from labor," and therefore taxable income. Furthermore, it is immaterial whether the agent remits to the company the standard charge for such insurance (namely, the amount that would be charged any other person under like conditions) and receives a check for his commission, or whether he remits to the company the standard charge minus his commission. The net result is the same. The agent receives taxable income to the extent of the commission, either actually or constructively. It follows that the amount of commission paid by the insurance company should be reported as income by the insurance agent.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

ARTICLE 58: Sale of stock and rights. XI–6–5378
G. C. M. 10170

REVENUE ACT OF 1928.

The taxpayer should be held to be bound by the election, made as authorized by article 58 of Regulations 74, to report as income the entire proceeds derived from the sale of stock rights.

An opinion is requested whether a taxpayer, after having exercised the option to include the entire proceeds from the sale of stock rights in gross income, pursuant to article 58 of Regulations 74, may later require the Bureau to compute the profit derived from the sale of the stock rights upon the theory that a portion of the proceeds derived from the sale thereof constituted a return of capital to the taxpayer.

It appears that for the calendar year 1928 an original income tax return was filed by A. A died on July 18, 1929, and an original return for the calendar year 1929, in which there was reported income

received during the period January 1, 1929, to July 18, 1929, was filed by his executor. In both original returns the entire proceeds derived from the sale of stock rights were reported as income without any deduction therefrom on account of cost or other basis, and a capital net gain tax of 12½ per cent paid thereon. Subsequently, amended returns for 1928 and 1929 were filed by the executor of the estate of A, in which certain amounts were deducted from the proceeds derived from the sale of the stock rights, upon the theory that such amounts represented the cost or other basis of the stock rights. In this connection it is contended that taxable gain in smaller amounts was realized from the sale of the stock rights in question, and claims for refund of taxes paid with respect to the taxable years 1928 and 1929 have been filed, based upon the ground that a portion of the proceeds from the sale of stock rights represented a return of capital.

The field officers recommend disallowance of the claims upon the ground that the taxpayer, having exercised his option to include the entire proceeds from the sale of the stock rights in gross income, pursuant to the provisions of article 58 of Regulations 74, is bound by the election in this respect. The pertinent provisions of article 58, Regulations 74, read as follows:

(1) If the shareholder does not exercise, but sells his rights to subscribe, the cost or other basis of the stock in respect of which the rights are issued shall be apportioned between the rights and the stock in proportion to the respective values thereof at the time the rights are issued, and the basis for determining gain or loss from the sale of a right on one hand or a share of stock on the other will be the quotient of the cost or other basis assigned to the rights or the stock, divided, as the case may be, by the number of rights issued or by the number of shares held.

* * * * * * *

The taxpayer may at his option include the entire proceeds from the sale of stock rights in gross income, in which case the basis for determining gain or loss from the subsequent sale of the stock in respect of which the rights were issued shall be the same as though the rights had not been issued.

From the foregoing, it is to be noted that under article 58 of Regulations 74 the taxpayer had the option of reporting the income in question upon either of two prescribed methods. In *Lebolt & Co.* v. *United States* (67 Ct. Cl., 422, Ct. D. 129, C. B. VIII–2, 247) it was held that where there are two methods prescribed by regulations for the making of an income tax return, either one of which is legal and proper, and the taxpayer has made his return in accordance with one of these methods, then if the return is accepted and the taxes paid accordingly the taxpayer can not subsequently change to the other method of making a return and thereby become entitled to a refund. (See also *Grant* v. *Rose*, 24 Fed. (2d), 115, affirmed on appeal, 39 Fed. (2d), 340.) It is, therefore, the opinion of this office that the taxpayer in the instant case is bound by the election to report as income the entire proceeds derived from the sale of the stock rights, and that the claims for refund should be denied.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

ARTICLE 62: Annuities and insurance policies. XI–5–5372
G. C. M. 10168

REVENUE ACT OF 1928.

In determining the cash value or present worth of annuities, the uniform rate of 4 per cent should, in general, be employed in accordance with Table A in article 13 of Estate Tax Regulations 70 (1929 edition). The ruling published as I. T. 2397 (C. B. VII–1, 90), in which the rate of 5 per cent was used, should be followed as a precedent only in cases involving identical facts.

An opinion is requested relative to the interpretation to be placed upon I. T. 2397, in which the rate of 5 per cent is used in determining the present worth of an annuity instead of the rate of 4 per cent contained in Table A of article 13(10 of Estate Tax Regulations 70 (1929 edition).

In the case considered in I. T. 2397 the taxpayer transferred $50,000 to the M College upon the agreement that he should receive an annuity of $2,500 for life. The question there presented was whether any portion of the amount transferred should be considered as a contribution to the M College, an exempt organization, and hence deductible to the extent provided in section 214(a)10 of the Revenue Act of 1926.

In that case it was apparent that the taxpayer had a double motive in making the contribution—that is, he wished to assure himself an annuity and also make a gift to the college. The conclusion necessitated the determination of what part of the amount actually received by the college represented a gift to it and what part represented the purchase price of the annuity it undertook to pay the donor. In determining the value of the gift to the college it was necessary to reduce the amount actually received by the college by the present value of the amount it undertook to return to the donor in annual payments during his lifetime. The parties to the undertaking having adopted a presumed earning of 5 per cent per annum, there was, in the opinion of the Bureau, no justification for presuming that the fund would earn a lesser rate per annum for the purpose of determining the present worth of the annuity.

On reconsideration of the facts involved in the ruling published as I. T. 2397, in which the rate of 5 per cent was used in determining the value of the donor's life estate, it is believed that the ruling is sound and should be adhered to. However, that ruling should be followed as a precedent only in cases involving identical facts.

The cash value or present worth of annuities should, in general, be determined in accordance with Table A in article 13 of Estate Tax Regulations 70 (1929 edition), using the uniform rate of 4 per cent therein employed.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

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

ARTICLE 84: Interest upon State obligations. XI–23–5499
G. C. M. 10452

REVENUE ACT OF 1928.

Cities and towns in the State of X meet expenses by the sale of notes. The notes are issued at a discount and are noninterest bearing.

Held, that discount received in connection with State or municipal securities issued at a discount should be treated in the same manner as discount on Treasury bills is treated in Treasury Decision 4276 (C. B. VIII–2, 83). General Counsel's Memorandum 1455 (C. B. VI–1, 87) is revoked in so far as it holds that discount on municipal securities issued at a discount may not be treated as tax-exempt income in the case of holders of the securities at maturity who were not the original purchasers of such securities, or in the case of original or subsequent purchasers selling such securities before maturity.

An opinion is requested regarding the treatment for Federal income tax purposes of the discount paid on noninterest-bearing municipal securities in the hands of persons other than the original purchasers.

Cities and towns in the State of X frequently meet their current operating expenses by the sale of notes which are liquidated when taxes are subsequently collected. These notes are noninterest bearing and are issued at a discount. The amount of discount is controlled, to some extent, by the condition of the current money market. These notes are purchased by the public and dealt in by the local banks. The question presented is whether the discount when paid may, in all cases, be considered as interest upon the obligation of a political subdivision of a State, and, therefore, exempt from taxation under section 23(b)4 of the Revenue Act of 1928, or whether the discount is exempt only if and to the extent that it is paid to the original purchasers.

The position of the Bureau regarding the status for Federal income tax purposes of discount received in connection with municipal bonds up to the present time is set out in the following extract from General Counsel's Memorandum 1455:

> The position originally taken by the Bureau was that discount was to be distinguished from interest in all cases, the excess of the amount received upon the maturity of a municipal bond over the purchase price being taxable profit whether or not the holder of the bond was the original purchaser. (O. D. 238, C. B. 1, 68.) A fortiori, the excess was held to be taxable profit where the municipal bond was sold instead of being held to maturity. (O. D. 21, C. B. 1, 67; O. D. 737, C. B. 3, 49; O. D. 774, C. B. 4, 31.)
>
> This position was later modified to hold that the profit derived by purchasing municipal bonds at a discount and holding them to maturity was nontaxable where the profit was "in lieu of interest for the use of the taxpayer's money." It was considered immaterial whether or not the taxpayer was the original purchaser of the bonds, but the exempted amount could in no case exceed the total discount at which the securities were originally sold by the municipality. (O. D. 647, C. B. 3, 123; O. D. 856, C. B. 4, 110.) But where the bonds instead of being held to maturity were sold by one other than the original purchaser (or even by the original purchaser) at a profit, the profit was taxable income and not exempt interest, even though the bonds were originally issued at a discount. (O. D. 762, C. B. 4, 31; I. T. 1187, C. B. I–1, 27.)
>
> The modification, it will be noted, related solely to the situation where the bonds were held to maturity, the first holding being that the discount was not

to be treated as interest and the subsequent holding being that the discount should be considered as equivalent to interest, without regard to whether the taxpayer was the original purchaser of the bonds.

The final position taken made no change in the rule as to original purchasers but reverted to the position first taken in so far as taxpayers who were not original purchasers were concerned. Thus, I. T. 1637 (C. B. II-1, 36) holds that where noninterest-bearing municipal bonds were issued at a discount, the profit realized upon payment at maturity by a holder who was not the original purchaser was taxable. The prevailing rule as to holders other than original purchasers—and that is the classification which includes the banks in the instant case—is that discount (and by analogy premium) is not to be treated as interest (or as an offset against interest in the case of premium) whether the bonds are sold or held to maturity. The amount for which the bonds are purchased without regard to any discount or premium element therein is to be taken as the basis for determining gain or loss on their sale or redemption (O. D. 726, C. B. 3, 49), any profit realized being a profit resulting from the conversion of a capital asset and any loss sustained being deductible.

Accordingly, under General Counsel's Memorandum 1455 discount on municipal securities issued at a discount is treated as tax-exempt income only in the case of original purchasers of such securities, from a State or municipality, who hold the securities to maturity. Such discount, however, is not treated as tax-exempt income in the case of holders of such securities at maturity who were not the original purchasers of the securities, or in the case of original or subsequent purchasers selling such securities before maturity.

It will be noted that the treatment of discount on municipal securities under the Bureau's rulings differs greatly from the treatment of discount on Treasury bills in Treasury Decision 4276, under which, pursuant to the provisions of the Act approved June 17, 1929 (Public, No. 11, Seventy-first Congress, H. R. 1648), discount on Treasury bills issued before June 17, 1930, is declared to be tax-exempt interest and is apportioned among the holders of the securities according to the periods of their holdings, just as the interest on interest-bearing obligations is apportioned.

As interest on State or municipal securities is exempt from Federal taxation under section 23(b)4 of the Revenue Act of 1928, since such taxation would affect the borrowing power of the State or municipality, and as the discount paid by a State or municipality on securities issued by it at a discount is paid by it, in lieu of interest, for the use of the purchaser's money, it is difficult to justify the distinction now being made between the treatment of discount on State or municipal securities and the treatment of discount on Treasury bills. Moreover, the distinction made in General Counsel's Memorandum 1455 between discount received by original purchasers of municipal securities who hold them to maturity and discount on such securities received at maturity by persons other than the original purchasers is not in harmony with the position taken in Treasury Decision 4276 with respect to the exemption of discount on Treasury bills.

The exempt status, for Federal income tax purposes, of discount received in connection with State or municipal securities issued at a discount has, therefore, been reconsidered and it is now the opinion of this office that discount received on such securities should be treated in the same manner as discount on Treasury bills. In this respect Treasury Decision 4276 provides in part as follows:

Accordingly, in the case of an original purchaser from the Government who holds a Treasury bill to maturity, the entire amount of the discount at which the bill was issued is exempt from income tax. If a bill is sold before ma-

turity, each respective holder is entitled to treat as exempt from income tax that proportion of the amount of the discount at which the bill was issued which the number of days (computed on an actual calendar-day basis) the bill was owned by him bears to the total number of days (computed on an actual calendar-day basis) from the date of the issuance of the bill to the date of its maturity. In other words, the amount of the discount at which the bill was issued is to be apportioned among the holders according to the periods of their holdings. The gain from the sale or other disposition of a Treasury bill (that is, the excess of the amount realized therefrom less discount from the date of acquisition to the date of its disposition over the cost or other basis of the bill) is taxable as ordinary income. A loss from the sale or other disposition of a Treasury bill (that is, the excess of the cost or other basis of the bill over the amount realized therefrom less discount from the date of acquisition to the date of its disposition) is allowable as a deduction. * * *

General Counsel's Memorandum 1455 is hereby revoked in so far as it holds that discount on municipal securities issued at a discount may not be treated as tax-exempt income in the case of holders of the securities at maturity who were not the original purchasers of such securities, or in the case of original or subsequent purchasers selling such securities before maturity.

The Supreme Court of the United States in the case of *Willcuts, Collector*, v. *Bunn* (282 U. S., 216, Ct. D. 280, C. B. X–1, 309) specifically stated that it did not appear that the securities under consideration in that case were issued at a *discount*, so that the gain derived could be considered to be in lieu of interest, and that whatever questions might arise in cases of that sort were not before it. This office accordingly is of the opinion that the decision in *Willcuts, Collector*, v. *Bunn*, supra, does not affect the question of the treatment, for Federal income taxes, of discount received in connection with State or municipal securities issued at a discount, which is here under consideration.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

ARTICLE 84: Interest upon State obligations. XI–23–5500
I. T. 2629

REVENUE ACT OF 1928.

The city of Y sells 4 per cent bonds direct to the public. The bonds are sold at a discount to yield 4.5 per cent.

Held, that the discount received in connection with State or municipal interest-bearing securities issued at a discount should be treated for income tax purposes in the same manner as discount on Treasury bills is treated in Treasury Decision 4276 (C. B. VIII–2, 83).

The city of Y sells 4 per cent bonds direct to the public, and due to the market conditions at the present time the bonds are sold at a discount to yield 4.5 per cent.

The question is raised whether, at the time these bonds mature and are paid at par, the owners will be subject to a tax because of having purchased them at a discount.

The discount received in connection with State or municipal interest-bearing securities issued at a discount should be treated for income tax purposes in the same manner as discount on Treasury bills

is treated in Treasury Decision 4276, which provides in part as follows:

Accordingly, in the case of an original purchaser from the Government who holds a Treasury bill to maturity, the entire amount of the discount at which the bill was issued is exempt from income tax. If a bill is sold before maturity, each respective holder is entitled to treat as exempt from income tax that proportion of the amount of the discount at which the bill was issued which the number of days (computed on an actual calendar-day basis) the bill was owned by him bears to the total number of days (computed on an actual calendar-day basis) from the date of the issuance of the bill to the date of its maturity. In other words, the amount of the discount at which the bill was issued is to be apportioned among the holders according to the periods of their holdings. The gain from the sale or other disposition of a Treasury bill (that is, the excess of the amount realized therefrom less discount from the date of acquisition to the date of its disposition over the cost or other basis of the bill) is taxable as ordinary income. A loss from the sale or other disposition of a Treasury bill (that is, the excess of the cost or other basis of the bill over the amount realized therefrom less discount from the date of acquisition to the date of its disposition) is allowable as a deduction. * * *

In this connection see General Counsel's Memorandum 10452 [page 18], relating to the exempt status of discount received on noninterest-bearing municipal securities.

ARTICLE 84: Interest upon State obligations. XI–26–5525
G. C. M. 10557

REVENUE ACT OF 1928.

The University of the State of R has been held by the Supreme Court of the State to constitute an integral part of the free public school system of the State. The bonds here in question are issued by the trustees of the university and are regarded as instrumentalities of the State issued for the purpose of carrying out an essential governmental function of the State. The interest on such bonds is not subject to Federal income tax.

An opinion is requested whether the interest on the 4½ per cent first mortgage union building bonds issued by the trustees of the University of the State of R is subject to Federal income tax.

The issue has been thoroughly considered in connection with the decision of the United States Supreme Court in *Burnet* v. *Coronado Oil & Gas Co.* (52 S. Ct., 443 [Ct. D. 485, page 265]). In that case it was held that the income of a lessee of public school lands of the State of Oklahoma, derived from oil produced by the lessee from such school lands, was exempt from Federal income tax.

The following statements were made by the court:

When Oklahoma undertook to lease her public lands for the benefit of the public schools she exercised a function strictly governmental in character. * * *

* * * * * * *

Here the lease to the respondent was an instrumentality of the State for the purpose of carrying out her duty in respect of public schools. To tax the income of the lessee arising therefrom would amount to an imposition upon the lease itself.

The same reasoning is applicable with respect to interest upon bonds issued by the trustees of the University of the State of R. The university has been held by the Supreme Court of the State to be an integral part of the free public-school system of the State.

The bonds here in question are issued by the trustees of the university and are regarded as instrumentalities of the State issued for the purpose of carrying out an essential governmental function of the State.

It is, therefore, the opinion of this office, in view of the decision of the United States Supreme Court in the case of *Burnet* v. *Coronado Oil & Gas Co.*, supra, that the interest on the bonds in question is not subject to Federal income tax.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

SECTION 22(c).—GROSS INCOME: INVENTORIES.

ARTICLE 105: Inventories by dealers in securities. XI–12–5417
I. T. 2618

REVENUE ACT OF 1928.

In 1929 the taxpayer, through his duly authorized brokers, acquired securities by purchases on stock exchanges and from individuals through the exercise of options. He also participated in syndicate operations. He claims classification as a dealer in securities and the use of inventories of securities in his 1929 return.

The taxpayer's trading is done primarily on his own account through the medium of stock exchanges. He is not a merchant who buys for and sells to customers, and does not, therefore, qualify as a dealer in securities within the meaning of that term as used in article 105 of Regulations 74. He is not entitled to inventory his securities.

A ruling is requested as to what constitutes a "dealer in securities" within the meaning of article 105 of Regulations 74.

In treating of this question attention is invited to section 22(c) of the Revenue Act of 1928, which provides:

Inventories.—Whenever in the opinion of the Commissioner the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer upon such basis as the Commissioner, with the approval of the Secretary, may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income.

Article 105 of Regulations 74, promulgated with respect to section 22(c), supra, provides:

Inventories by dealers in securities.—A dealer in securities, who in his books of account regularly inventories unsold securities on hand either—

(a) At cost;
(b) At cost or market, whichever is lower; or
(c) At market value,

may make his return upon the basis upon which his accounts are kept; provided that a description of the method employed shall be included in or attached to the return, that all the securities must be inventoried by the same method, and that such method must be adhered to in subsequent years, unless another be authorized by the Commissioner. For the purpose of this rule a dealer in securities is a merchant of securities, whether an individual, partnership, or corporation, with an established place of business, regularly engaged in the purchase of securities and their resale to customers; that is, one who as a merchant buys securities and sells them to customers with a view to the gains and profits that may be derived therefrom. If such business is simply a branch of the activities carried on by such person, the securities inventoried as here provided may include only those held for purposes of resale and not for investment. Taxpayers who buy and sell or hold securities for investment or speculation

and not in the course of an established business, and officers of corporations and members of partnerships who in their individual capacities buy and sell securities, are not dealers in securities within the meaning of this rule.

The method of conducting the business, the manner in which a taxpayer holds himself out to the public, and the object of his transactions determine whether a taxpayer is a " merchant " or a " dealer " for the special purpose set out in the law and regulations. It will therefore be seen that each case must necessarily be determined on its own merits.

In order to show the trend of decisions in this matter attention is invited to *In re Marston* (16 Fed. Cas., No. 9142) and *In re Woodward* (30 Fed. Cas., No. 18001), in which it was held that one who bought and sold securities for speculation through brokers, even though in an established business, is not a merchant or tradesman, and in *In re Moss* (17 Fed. Cas., No. 9877) a broker, who conducts his business exclusively through other brokers, was denied the classification.

If a taxpayer buys and sells for his own account rather than for the account of others, he is more a " customer " than a " dealer." He occupies in the marketing of securities the same relative position as the " ultimate consumer " in trade. The volume of his transactions, the fact that some of his brokers consider him a trader, or the maintenance of a place of business, does not make him either a " merchant " or a " dealer."

I. T. 1818 (C. B. II–2, 39) contains a full treatment of the subject and cites abundant authority for denying the classification to one who buys and sells only for his own account. The decisions and rulings of the courts and of the United States Board of Tax Appeals made subsequent to I. T. 1818, supra, fully support that ruling rather than weaken it. A recent decision is *Adirondack Securities Corporation* v. *Commissioner* (23 B. T. A., 61), where the classification was denied solely because of the purchase and sale for the petitioner's account only. (See also G. C. M. 9958, C. B. X–2, 158.)

In summary, the Bureau holds that a merchant is one who buys and sells primarily for what may be called a handling or distributing profit, and that a person whose primary object is investment or speculation is not properly described as a merchant. The Bureau further holds that only such taxpayers as qualify as " merchants " engaged in the purchase of securities and their resale to customers can qualify as " dealers in securities " within the meaning of that term as used in article 105 of Regulations 74.

In the instant case it is stated that A acquires securities by purchase through his duly authorized brokers and through exercise of options on stock held by other individuals; that he participates in operations through a syndicate which acquires stock in the open market or on option from individuals, and markets such stock; and that at times the holdings of the syndicate are such that virtual control of the stock is in the hands of the syndicate.

It is stated that the taxpayer is a merchant in securities with an established place of business at ———. The statement that the taxpayer is a merchant in securities was obviously a conclusion of fact, or of mixed law and fact. A has no clientele, patrons, or customers. The only evidence in the record clearly points to the conclusion that

the taxpayer is not a *merchant* in securities, but rather an individu trader or speculator on the stock market whose purchases and sal are large. It is difficult to consider that an active trader on th stock market has " an established place of business " at the regula place of business of the broker through whom he places mark orders. The address known as ——— was undoubtedly the estal lished place of business of B & Co. or of B, the individual, wit whom A had a number of active trading accounts. There is nothin to indicate that the address referred to had any other significance t A. It is also stated that practically all of the taxpayer's transac tions of sale were consummated through the selling organization o B & Co. or other brokers; through the various stock exchanges wher the securities are listed, with the exception of some large blocks o stock which were disposed of direct to individuals through the exer cise of options. At a conference held in this office in 1931 with C the accountant of both A and B, it was stated that most of A's trans actions were actual market orders; and that there may have beer times when he took a part of the " book " of B & Co., but it is hard to determine those instances.

There is nothing in the record to indicate any specific sale by A or in his behalf, direct to a known purchaser. It is frankly admitted that the principal source of his 1929 income was the usual syndicat and stock market operations respecting certain stocks; and that i transactions of sale occurred direct to known purchasers, they were rare and relatively unimportant. The reference to " the selling or ganization of B & Co." is confusing unless the primary facts are un derstood. This selling organization, if such it may be called, wa principally the customary brokers' arrangements and contacts be tween their clients and the floors of the various exchanges. B & Co does not sell securities owned by it, except in transactions respecting specialties on which it holds the " book." B & Co., from the very nature of its brokerage business, can have no " selling organization " in the sense of a merchant in securities.

B & Co. during 1929 employed a number of so-called " customer's men " whose duties were principally to service clients' accounts B & Co., like most large brokers, operated a statistical department which makes statistical studies of the various stocks. The " customer's men " seek to bring new clients to B & Co., and then act in an expert advisory capacity to the particular clients in whom they are interested. All brokerage houses are interested in having as many individual accounts as possible, margin or otherwise. The more clients and the more active their accounts, the more commissions and interest accrue to the broker. Although the customer's men must be discreet in advising the firm's clients, it is obvious that only by concerted action could these men have an influence on a particular stock and that such influence would be reflected only in the general process of artificially stimulating or depressing the market for a certain stock, or stocks, on the exchange. They do not represent themselves as selling A's stock to the clients of B & Co.; they can only, by their activities and advice, tend indirectly to influence the fluctuations in quotations of stocks on the stock exchanges. The foregoing facts set forth the nature of the so-called " selling organization " of B & Co. It is obviously not the selling organiza-

tion of a merchant in securities, nor is it a *selling organization* in common parlance or within the meaning of the regulations.

Considering the information submitted as to the manner in which the taxpayer conducts his business, it is evident that A's trading is done *primarily* for his own account through the medium of stock exchanges. In view of the foregoing it is held that A is not a merchant who buys for and sells to *customers*, and, consequently, does not qualify as a dealer in securities within the meaning of that term as used in article 105 of Regulations 74. He is, therefore, not entitled to inventory his securities for Federal income tax purposes.

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

ARTICLE 151: Taxes. XI-20-5479
I. T. 2625

REVENUE ACT OF 1928.

The fees paid by the M Corporation for filing articles of incorporation under section 176(1) of the Ohio General Code are deductible as taxes under section 23(c) of the Revenue Act of 1928.

A ruling is requested whether the fees paid by the M Corporation for filing articles of incorporation in Ohio are deductible as taxes under section 23(c) of the Revenue Act of 1928.

In I. T. 2570 (C. B. X-1, 115) it was held that the fees paid by a corporation under section 176 of the Ohio General Code, in connection with an amendment of its charter authorizing an increase in its capital stock, were deductible as taxes under the Revenue Act of 1928 and prior Revenue Acts. In connection with the present inquiry it is contended that as section 176 of the Ohio General Code covers fees for filing articles of incorporation as well as fees for increasing capital stock, and as all fees are credited to the general fund under section 270 of the Ohio General Code, the fees for filing articles of incorporation are also deductible as taxes under section 23(c) of the Revenue Act of 1928.

The section of the Ohio General Code referred to above reads in part as follows:

SEC. 176. *Fees to be collected by secretary of state.*—The secretary of state shall charge and collect the following fees for official services:

1. For filing articles of incorporation of a corporation whose capital stock is $10,000 or under, $10 * * *.

Section 270 of the Ohio General Code reads in part as follows:

SEC. 270. *Auditor shall collect illegal warrants.*—All money paid into the State treasury, the disposition of which is not otherwise provided for by law, shall be credited by the auditor of state to the general revenue fund. * * *

It is noted from the above-quoted provisions of law that it is not necessary for the law to specify the object for which the tax thus provided for is imposed. The fees paid by a corporation to the secretary of state for the State of Ohio, for the privilege of transacting business in that State, are paid into the general revenue fund. A tax may be paid for the double purpose of regulation and revenue. It may also be exacted for the privilege of exercising corporate franchise in the State and for general revenue. (*Ashley* v. *Ryan*, 49 Ohio St., 504, 31 N. E., 721.)

Accordingly, it is held that the fees paid by the M Corporation for filing articles of incorporation are deductible as taxes under section 23(c) of the Revenue Act of 1928.

ARTICLE 151: Taxes.

XI-26-5526
G. C. M. 10627

REVENUE ACT OF 1928.

The ruling contained in I. T. 2587 (C. B. X-2, 134), holding that the liquid fuels tax imposed by the State of Pennsylvania under the act approved May 21, 1931, is deductible in the income tax return of the distributor who pays it and to whom it is not refunded, is not affected by either act No. 136 or act No. 137 of the State legislature, approved June 1, 1931.

Reference is made to the ruling contained in I. T. 2587 relative to the deductibility, for Federal income tax purposes, of the liquid fuels tax imposed by the State of Pennsylvania under the act approved May 21, 1931, known as "the liquid fuels tax act."

It was held in that ruling that the tax is deductible in the income tax return of the distributor who pays it and to whom it is not refunded, but if such tax is added to or made a part of the business expenses of the distributor, it can not be deducted by him separately as a tax.

The act of May 21, 1931 (No. 105, Laws of Pennsylvania, 1931, page 149), upon which that ruling was predicated has been amended. Section 2 of that act, which defines "liquid fuel," was amended by an act approved June 1, 1931 (No. 136, Laws of Pennsylvania, 1931, page 298). Another act (No. 137, Laws of Pennsylvania, 1931, page 299), also approved June 1, 1931, requires that the tax rate be stated separately on the dealer's display signs, and that the price of liquid fuel and the tax rate shall appear on such signs in letters and figures not less than 2 inches in height and in such manner that purchasers may readily see the same.

It is contended that the ruling published as I. T. 2587 is inequitable and in conflict not only with the decisions of the Bureau with respect to the payment of a similar tax in other States, but in conflict with the State law itself. Attention has been invited to the second paragraph of section 5 of the act of May 21, 1931 (No. 105), which reads as follows:

Distributors may add the amount of the tax to the price of liquid fuels sold by them, and shall state the rate of the tax separately from the price of the liquid fuels on all price display signs, sales or delivery slips, bills, and statements which advertise or indicate the price of liquid fuels.

Attention has also been invited to the last sentence of section 1 act of June 1, 1931 (No. 137), which reads as follows:

The price of liquid fuel and the tax rate shall be stated in the same size on such signs in letters and figures not less than 2 inches in height and in such manner that purchasers may readily see the same.

It is further contended that it was the intention of the legislature of the State of Pennsylvania in enacting the liquid fuels tax act to impose the tax on the consumer and not on the distributor.

The Bureau has had occasion to consider both the act of May 1, 1929 (No. 405, Laws of Pennsylvania, 1929, page 1037), imposing a

tax on liquid fuels, and the liquid fuels tax act approved May 21, 1931. The title to the former act reads in part as follows:

AN ACT

Imposing a State tax on liquid fuels * * * sold by dealers in this Commonwealth, except for the purpose of resale, or used by consumers when no tax thereon has been collected by dealers * * *.

Section 9 of the said act reads in part as follows:

The tax imposed by this act shall be paid by the person, firm, copartnership, association, or corporation, purchasing liquid fuels from dealers for his own use and not for the purpose of resale, or by the person, firm, copartnership, association, or corporation, using liquid fuels, upon which no tax has been collected by a dealer; and every person, firm, copartnership, association, or corporation, required by this act to collect the tax herein specified, shall state the amount of such tax, separately from the price of the said liquid fuels, on all liquid fuel price display signs, sales or delivery slips, bills, statements, etc. * * * [Italics supplied.]

A study of the entire act of May 1, 1929, convinced the Bureau that the tax was intended to be imposed upon the consumer of liquid fuels and not upon the dealer. (See I. T. 2505, C. B. VIII-2, 104.)

The title to the liquid fuels tax act of May 21, 1931, which act repealed the preceding act, reads in part as follows:

AN ACT

Imposing a State tax, payable by those herein defined as distributors, on liquid fuels used or sold and delivered within the Commonwealth, which are ordinarily, practically, and commercially usable in internal combustion engines for the generation of power; providing for the collection and lien of the tax, and the distribution and use of the proceeds thereof * * *.

Section 5 of the act of May 21, 1931, is persuasive that the tax is imposed upon the distributor, as is evidenced by the following language:

SEC. 5. *By whom tax is payable.*—Every distributor using or delivering liquid fuels upon which a tax is imposed by this act shall pay the tax into the State treasury * * *.

See also section 4 of the act of May 21, 1931, which states in part as follows:

A State tax of 3 cents a gallon, or fractional part thereof, is hereby imposed and assessed upon all liquid fuels used or sold and delivered by distributors within this Commonwealth * * *.

Distributors shall be liable to the Commonwealth as taxpayers for the payment of the tax imposed by this act.

It seems quite clear to this office that the legislative intent behind the act of May 1, 1929, in respect of which I. T. 2505, supra, was issued holding that the tax was imposed upon the consumer, is entirely different from the intent behind the liquid fuels tax act of May 21, 1931, in respect of which I. T. 2587 was issued holding that the tax was imposed upon the distributor.

In view of the great difference between the two acts, it seems reasonable to conclude that the legislature indicated an intent in the latter act to impose an excise tax on distributors.

The second paragraph of section 5 of the act of May 21, 1931, quoted herein, which permits distributors to add the amount of the tax to the price of the liquid fuels sold by them, is not at all incon-

sistent with the conclusion that the tax is imposed upon the distributor. It is well recognized that excise taxes imposed upon manufacturers, dealers, or distributors are often passed on to the consumer, and the act of June 1, 1931 (No. 137), requiring the tax rate on liquid fuels to be displayed, evidently was passed as a matter of protection to consumers against excessive taxation.

Article 151 of Regulations 74, promulgated under the Revenue Act of 1928, provides in general that taxes are deductible only by the person upon whom they are imposed. In determining whether the tax is imposed upon the distributor or the consumer by somewhat similar tax laws of other States, the Bureau has been guided to some extent by the refund provisions of such laws. In general, where a tax improperly collected is refundable to the consumer, and not to the distributor or dealer who collected the tax and remitted it to the State, the Bureau has held such fact to be indicative of legislative intent to impose the tax upon the consumer.

Section 17 of the act of May 21, 1931, reads as follows:

SEC. 17. The board of finance and revenue may refund to distributors taxes, penalties, and interest paid by them on liquid fuels delivered to the United States Government, or paid as the result of an error of law or of fact or of both law and fact. Claims for refund shall be made under the procedure prescribed by the Fiscal Code.

Applying this test to the present Pennsylvania law, it would appear that the legislature has indicated an intent to impose a tax upon the distributor by providing for a refund to him of taxes, penalties, and interest paid by him on liquid fuels delivered to the United States Government, or paid as the result of an error of law or of fact, or of both law and fact.

In view of the foregoing, it is the opinion of this office that the burden of the tax is placed upon the distributor. The ruling contained in I. T. 2587, issued in respect of the act of May 21, 1931, apparently is not affected by either act No. 136 or act No. 137, both of which were approved June 1, 1931. This view is in accord with the position taken by the Bureau with respect to gasoline and liquid fuels taxes imposed by other States, and is believed to be a correct interpretation of law.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

ARTICLE 154: Federal estate and State inheritance taxes.

REVENUE ACT OF 1928.

Tax imposed by law of Mexico, effective August 1, 1931. (See I. T. 2620, page 44.)

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

ARTICLE 174: Shrinkage in value of stocks. XI–10–5405
I. T. 2617

REVENUE ACT OF 1928.

Where a bank failed in 1931 and was taken over by the State superintendent of banks, who made a call in that year upon the stockholders for payment of the additional liability imposed upon them by the State law, the call is a satisfactory showing of the determination of the worthlessness of the stock of the bank. Of the amount paid because of such additional liability, only the portion determined to be necessary to pay creditors may be deducted as a loss for the year in which such determination is made.

Inquiry is made with respect to the deductibility for Federal income tax purposes of a loss sustained by the stockholders of the M Bank because of its failure in 1931.

The stockholders contend that, after the bank was taken over by the State superintendent of banks, a determination was made that the bank was insolvent, and that as a consequence they have lost their original investment. Under the State law the stockholders of the bank are liable to its creditors and depositors to the extent of the amount of their stock therein, at the par value thereof, in addition to the amount invested in such shares. In accordance with the State law, the superintendent of banks has made a call upon the stockholders for payment of the additional liability and the majority of the stockholders have paid accordingly.

The question presented is whether the cost or other basis of the stock may be deducted as a loss in the returns of the stockholders for 1931, and whether the deduction for a loss because of the payment of the additional liability imposed by the State law should be postponed until the bank is completely liquidated.

If stock of a corporation becomes worthless, its cost or other basis may be deducted by the owner for the taxable year in which the stock became worthless, provided a satisfactory showing of its worthlessness is made, as in the case of bad debts. (Article 174, Regulations 74.) A showing that an insolvent bank is in process of liquidation and, by reason of the assets of the bank being insufficient to pay the creditors, the additional liability provided by the State banking law has been assessed against the stockholders, is a satisfactory showing of the worthlessness of the stock of the bank for allowance of a deduction by the stockholders of the cost or other basis of such stock. The amount paid by the stockholders because of their additional liability, to the extent of any portion thereof determined to be necessary to pay creditors, may also be deducted as a loss by the stockholders for the year in which such determination is made. This determination may or may not be made before a bank is completely liquidated, depending upon the circumstances of the particular case.

Therefore, if the M Bank was insolvent and in the process of liquidation in 1931, and the additional liability assessments referred to were made against the stockholders in 1931 because the assets of the bank were insufficient to pay the creditors, the stockholders may deduct the cost or other basis of their stock as a loss in their returns for

that year. Of the amount paid by the stockholders because of their additional liability, only the portion determined to be necessary to pay creditors may be deducted as a loss for the year in which such determination is made.

SECTION 23(j).—DEDUCTIONS FROM GROSS INCOME: BAD DEBTS.

ARTICLE 191: Bad debts. XI-3-5359
I. T. 2612

REVENUE ACT OF 1928.

Where national bank examiners require national banks to charge off notes, mortgages, or bonds in whole or in part, and the basis of the examiner's order is the worthlessness or partial recoverability of the item, such debts will, for income tax purposes, be considered prima facie worthless or recoverable only in part, and the banks may deduct the amount charged off in their income tax returns. But where the charge-off is due to market fluctuations, or where bonds or similar obligations in default are charged off in full, no attempt being made to determine to what extent recovery may be made, no deduction for income tax purposes of the amount so charged off can be permitted.

A ruling is requested relative to the right of a national bank to take a deduction in its income tax return for bad debts as provided in section 23(j) of the Revenue Act of 1928, in the case of bonds, notes, and mortgages which are charged off in accordance with orders issued by national bank authorities. In this connection reference is made to article 191 of Income Tax Regulations 74, promulgated under the Revenue Act of 1928.

It is stated that the objection is frequently made by national banks that they are not allowed to take a deduction in income tax returns for the reduction in the value of bonds until sale thereof has been made. It is further stated that because of the depressed condition of the bond market and the greatly reduced value shown in many issues the policy of instructing national banks to charge off such reduced values on bonds at the time of each examination has been adopted.

Where national bank examiners, in accordance with the policy adopted, require national banks to charge off notes, mortgages, or bonds in whole or in part, and the basis of the examiner's order is the worthlessness or partial recoverability of the item, such debts will, for income tax purposes, be considered prima facie worthless or recoverable only in part, and the banks may deduct the amount charged off in their income tax returns. But where the charge-off is due to market fluctuations, or where bonds or similar obligations in default are charged off in full, no attempt being made to determine to what extent recovery may be made, no deduction for income tax purposes of the amount so charged off can be permitted.

SECTION 23(m).—DEDUCTIONS FROM GROSS INCOME: BASIS FOR DEPRECIATION AND DEPLETION.

ARTICLE 243: Charges to capital and to expense in the case of oil and gas wells. XI-15-5440 T. D. 4333

INCOME TAX.

Charges to capital and to expense in the case of oil and gas wells—Restatement of article 223, Regulations 45; article 223, Regulations 45 (1920 edition); article 223, Regulations 62; article 225, Regulations 65; article 223, Regulations 69; and article 243, Regulations 74.

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

To Collectors of Internal Revenue and Others Concerned:

Article 223 of Regulations 45, article 223 of Regulations 45 (1920 edition), article 223 of Regulations 62, article 225 of Regulations 65, article 223 of Regulations 69, and article 243 of Regulations 74 are hereby restated so as to incorporate therein certain details of administrative application and practice of long standing. No change in administrative policy or in the practice under the regulations is made, or intended to be made, by this restatement; nor is any new option or election as to the treatment of the expenditures involved granted or intended to be granted. The new matter appearing in the restatement represents the practice of the Bureau of Internal Revenue under the regulations since prior to the promulgation of Regulations 45, on April 16, 1919. That portion of article 223, Regulations 45; article 223, Regulations 45 (1920 edition); article 223, Regulations 62; and article 225, Regulations 65, dealing with casing-head gas contracts and the use of inventories, is not restated. The restatement follows:

Charges to capital and to expense in the case of oil and gas wells.—(a) Items chargeable to capital or to expense at taxpayer's option. (1) Option with respect to intangible drilling and development costs in general: All expenditures for wages, fuel, repairs, hauling, supplies, etc., incident to and necessary for the drilling of wells and the preparation of wells for the production of oil or gas, may, at the option of the taxpayer, be deducted from gross income as an expense or charged to capital account. Such expenditures have for convenience been termed intangible drilling and development costs. Examples of items to which this option applies are, all amounts paid for labor, fuel, repairs, hauling, and supplies, or any of them, which are used (A) in the drilling, shooting, and cleaning of wells; (B) in such clearing of ground, draining, road-making, surveying, and geological work as are necessary in preparation for the drilling of wells; and (C) in the construction of such derricks, tanks, pipe lines, and other physical structures as are necessary for the drilling of wells and the preparation of wells for the production of oil or gas. In general, this option applies only to expenditures for those drilling and development items which in themselves do not have a salvage value. For the purpose of this option labor, fuel, repairs, hauling, supplies, etc., are not considered as having a salvage value, even though used in connection with the installation of physical property which has a salvage value. Drilling and development costs shall not be excepted from the option merely because they are incurred under a contract providing for the drilling of a well to an agreed depth, or depths, at an agreed price per foot or other unit of measurement.

(2) Option with respect to cost of nonproductive wells: In addition to the foregoing option the cost of drilling nonproductive wells may at the option of the taxpayer be deducted from gross income as an expense or charged to cap-

ital account returnable through depletion and depreciation as in the case of productive wells.

(3) Elections once made under these options will control the taxpayer's returns for all subsequent years. Where deductions for depreciation or depletion have either on the books of the taxpayer or in his returns of net income been included in the past in expense or other accounts, rather than specifically as depreciation or depletion, or where capital expenditures have been charged to expense in lieu of depreciation or depletion, a statement indicating the extent to which this practice has been carried should accompany the return.

(b) Recovery of optional items, if capitalized. (1) Items returnable through depletion: If in exercising these options, or either of them, the taxpayer charges such expenditures as fall within the options to capital account, the amounts so capitalized, in so far as they are not represented by physical property, are returnable through depletion. For the purposes of this article the expenditures for clearing ground, draining, road-making, surveying, geological work, excavation, grading, and the drilling, shooting and cleaning of wells, are considered not to be represented by physical property, and when charged to capital account are returnable through depletion.

(2) Items returnable through depreciation: If in exercising these options, the taxpayer charges such expenditures as fall within the options to capital account, the amounts so capitalized, in so far as they are represented by physical property, are returnable through depreciation. Such expenditures are, amounts paid for wages, fuel, repairs, hauling, supplies, etc., used in the installation of casing and equipment and in the construction on the property of derricks and other physical structures.

(3) In the case of capitalized intangible drilling and development costs incurred under a contract, such costs shall be subject to the foregoing segregation for the purposes of determining the depletion and depreciation allowances.

(c) Nonoptional items distinguished. (1) Capital items: The option with respect to intangible drilling and development costs in general does not apply to expenditures by which the taxpayer acquires tangible property ordinarily considered as having a salvage value. Examples of such items are the costs of the *actual materials* in those structures which are constructed in the wells and on the property, and the cost of drilling tools, pipe, casing, tubing, tanks, engines, boilers, machines, etc. The options do not apply to any expenditure for wages, fuel, repairs, hauling, supplies, etc., in connection with equipment, facilities, or structures, not incident to or necessary for the drilling of wells, such as structures for storing or treating oil or gas. These are capital items and are returnable through depreciation.

(2) Expense items: Expenditures which must be charged off as expense, regardless of the options provided by this article, are those for labor, fuel, repairs, hauling, supplies, etc., in connection with the operation of the wells and of other facilities on the property for the production of oil or gas. General overhead expense, taxes, and depreciation of drilling equipment, are not considered as capital items, even when incurred during the development of the property.

DAVID BURNET,
Commissioner of Internal Revenue.

Approved March 30, 1932.

A. A. BALLANTINE,
Acting Secretary of the Treasury.

SECTION 23(n).—DEDUCTIONS FROM GROSS INCOME: CHARITABLE AND OTHER CONTRIBUTIONS.

ARTICLE 261: Contributions or gifts by individuals. XI-7-5386
Mim. 3931

Basis for computing 15 per cent limitation on deductions for contributions by individuals having a "capital net gain" or a "capital net loss."

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C., January 27, 1932.

Collectors of Internal Revenue, Internal Revenue Agents in Charge, and Others Concerned:

Reference is made to the decision of the United States Board of Tax Appeals, promulgated November 3, 1931, in the case of *Hallie D. Elkins* v. *Commissioner* (24 B. T. A., 572), in which the Board held that a "capital net loss" should be excluded in computing net income for the purpose of determining the 15 per cent limitation on deductions for charitable, etc., contributions.

While the decision of the Board in the Elkins case was rendered with respect to a taxable year governed by the Revenue Act of 1924, the decision is equally applicable to years governed by the Revenue Acts of 1926 and 1928. The Board's decision is contrary to the position which the Bureau has consistently followed as announced in I. T. 2104 (C. B. III-2, 152). The decision will be appealed, and in the audit of returns involving capital net losses, the Bureau will continue to follow I. T. 2104.

In view, however, of the decision of the Board in the Elkins case, and pending the final decision of the courts on the question, it will also be necessary, in order to protect fully the interests of the Government in cases where a taxpayer has a "capital net gain," to compute the 15 per cent limitation on the deduction for contributions upon the basis of the net income excluding the "capital net gain."

In view of the foregoing, the audit of returns for 1929 and subsequent taxable years in which the question arises as to the basis for computing the 15 per cent limitation on deductions for contributions, in cases in which the taxpayer has a "capital net gain," will be governed by the following rules:

(1) In all such cases the 15 per cent limitation on the deduction for contributions will be computed upon the basis of the taxpayer's net income excluding "capital net gain."

(2) Where issues other than the basis upon which to compute the 15 per cent limitation on contributions are also involved, the usual procedure (except as hereinafter stated) will be followed with respect to the other issues with a view to their settlement. In such cases letters notifying the taxpayer of proposed changes in tax liability will include a paragraph stating specifically that consideration of the issue with respect to the basis for computing the 15 per cent limitation on the deduction for contributions is to be postponed pending the final court decision on the question, unless prior to such decision it becomes necessary to mail a formal notice of deficiency

(60-day letter) because of the running of the statute of limitations on assessment, or because of the taxpayer's nonacquiescence in the proposed adjustment of the other issues.

(3) If the adjustment of all the other issues results in no change in tax liability, or a change in tax liability to which the taxpayer agrees, the administrative file in the case, after the usual review, will be appropriately labeled, and, pending the final court decision, will be held in the office of the internal revenue agent in charge (or in the Income Tax Unit in Washington in the case of returns which have already been forwarded to the unit in Washington for review).

(4) If the taxpayer does not acquiesce in the proposed adjustment of all the other issues and such adjustment results in an overassessment, the administrative file will be labeled and held as in paragraph (3) above, and the taxpayer will be advised to protect his interests with respect to any overpayment by filing a timely claim for refund.

(5) If the taxpayer does not acquiesce in the proposed adjustment of all the other issues and such adjustment results in a deficiency, the case will be forwarded to the Income Tax Unit in Washington for the mailing of a 60-day deficiency letter and the proposed deficiency stated in such letter will include the portion of the deficiency attributable to the rule stated in paragraph (1) above, with respect to the basis for computing the 15 per cent limitation on deductions for contributions.

(6) A closing agreement on Form 866 will not be entered into for 1929 or any subsequent year in any case contrary to the rule stated in paragraph (1) above prior to the final court decision.

(7) Claims for refund based on a computation of the limitation on deductions for contributions will be held in the claims control section of the Income Tax Unit and no such refund will hereafter be allowed contrary to the rule stated in paragraph (1) above.

(8) If, in any case, it appears that the statutory period for assessment is about to expire prior to the final court decision, the taxpayer will be advised that if, under the circumstances, he so desires he may submit a waiver of the statute of limitations on assessment. If the taxpayer does not submit a waiver, the case will be forwarded to the Income Tax Unit in Washington in sufficient time for the mailing of a 60-day deficiency letter upon the basis of the rule stated in paragraph (1) above prior to the expiration of the statutory period of limitation.

Correspondence and inquiries regarding this mimeograph should refer to the number and the symbols IT:E:JCW.

DAVID BURNET, *Commissioner.*

SECTION 24.—ITEMS NOT DEDUCTIBLE.

ARTICLE 281: Personal and family expenses. XI-22-5493
I. T. 2628

REVENUE ACTS OF 1918, 1921, 1924, 1926, AND 1928.

Under the terms of a trust the husband conveyed and delivered to the trustee certain securities for the purpose of providing for specified payments to be made to his divorced wife and as consideration therefor she released all claims against him for alimony, dower, maintenance, and support. Any excess income was to be

paid to the husband, any deficit in the income was to be met by the deposit of additional securities, and the remainder or reversionary interest was retained by him.

The amounts so received by the wife do not constitute taxable income to her. Such amounts are deductible by the trust and taxable to the husband as the true beneficiary. Office Decision 1092 (C. B. 5, 190) is revoked and Office Decision 399 (C. B. 2, 156) is reinstated.

A ruling is requested relative to the liability for the payment of income tax on the income from certain property held in trust by the M Trust Co. as trustee under an indenture executed in 1919 by A, his divorced wife, and the above-named company in its capacity as trustee.

The above-named individuals were formerly husband and wife, the marriage having been dissolved by a decree of absolute divorce in 1919. By the terms of the indenture the husband conveyed and delivered to the trustee certain securities, designated in a schedule attached thereto, for the purpose of providing for specified payments to be made to the wife, and as consideration therefor the wife released all claims against the husband for alimony, dower, maintenance, and support. Stated briefly, the wife was to receive during her lifetime $2x$ dollars a year, or in case of her remarriage x dollars a year, payable out of the income from the property placed in trust. Any income in excess thereof after payment of the necessary expenses was to be paid to the husband. If necessary in order to produce the required amount of income, the husband was to convey and deliver to the trustee such additional securities as might be required to make up any deficit in that respect. The remainder or reversionary interest in such property was retained by the husband.

In accordance with the decision rendered by the United States Supreme Court in the case of *Gould* v. *Gould* (245 U. S., 151), it is provided in article 83 of Regulations 74 that neither alimony nor an allowance based on a separation agreement is taxable income to the recipient, and it is provided in article 281 of Regulations 74 that such payments are not deductible from gross income of the payor. The same provisions were likewise contained in the prior regulations. (See articles 73 and 291 of Regulations 45, 62, 65, and 69.)

The first question is whether the amounts so received by the wife are to be considered as having the status of alimony, or whether such amounts are to be considered as being received by her as beneficiary of the trust, unaffected by the fact that the payments are in satisfaction of her claim against the husband for alimony, dower, maintenance, and support.

In this connection attention is invited to the decision rendered by the United States Board of Tax Appeals in the case of *Mary R. Spencer* v. *Commissioner* (20 B. T. A., 58), which has been acquiesced in by the Commissioner. (C. B. IX–2, 56.) In that case a divorce action was pending when the parties entered into an agreement for the formation of a trust to provide for certain payments out of income to be made to the wife in consideration of the release of her claim against the husband for support and the release of her right of dower in his property. It was contended in behalf of the respondent that the payments were received by the wife as beneficiary of the trust and that the purpose for which the trust was created should not be considered. This theory was rejected in

the decision, it being held that the agreement entered into between the parties was an incident of the divorce action and that such payments were received by the wife in lieu of alimony, or in lieu of alimony and dower rights combined. The payments were accordingly held not to constitute taxable income to the wife. The theory that such amounts were received by the wife as beneficiary of the trust unaffected by the fact that the amounts in question were to be received by her in satisfaction of her claim for support and her right of dower, is, therefore, to be considered as having been abandoned by the Commissioner through his acquiescence in the decision rendered in that case.

Accordingly, it is held that the amounts so received by the wife in the instant case do not constitute taxable income to her. The question remains whether such income is taxable to the trust or to the husband. The trust instrument specifically provided that the trust income was not to be retained by the trustee, but was to be distributed to a designated beneficiary or beneficiaries. The amounts so distributed constitute allowable deductions to the trust under section 162 of the Revenue Act of 1928 and the corresponding provisions of the prior Acts.

In the instant case the payments made to the wife were made in satisfaction of the husband's personal obligation and in this respect the facts are identical with those considered by the United States Board of Tax Appeals in the case of Mary R. Spencer, supra. In accordance with the foregoing, it is held that the amounts so payable to the wife from the income of the trust in question are taxable to the husband as the true beneficiary of the trust. Office Decision 1092 (C. B. 5, 190) to the contrary is therefore revoked and Office Decision 399 (C. B. 2, 156) is reinstated.

SECTION 25.—CREDITS OF INDIVIDUAL AGAINST NET INCOME.

ARTICLE 292: Personal exemption of head of family. XI-2-5348
I. T. 2611

REVENUE ACTS OF 1918, 1921, 1924, 1926, AND 1928.

A taxpayer is not entitled to credit as the head of a family by virtue of support and maintenance of a child adopted without legal proceedings, but is entitled to the credit allowed on account of the support of a dependent.

A ruling is requested with respect to the status of a taxpayer as the head of a family for the years 1920 to 1930, inclusive.

In 1916 the taxpayer adopted a child, not through any legal proceedings but merely as a self-imposed obligation; and since that date the taxpayer has fulfilled every qualification of a parent and the child is at present a student in high school. Final action upon completion of the delinquent returns for the years in question is dependent upon the taxpayer's classification for those years. The taxpayer's representatives have called attention to the difference between the status of guardians and of persons standing in loco parentis in an effort to distinguish Income Tax ruling 1619 (C. B. II-1,

124) from the case of the instant taxpayer. In Income Tax ruling 1619 a legal guardian was denied classification as the head of a family for the reason that there did not exist any blood relationship or relationship by marriage or by adoption between the guardian and her wards.

Article 292 of Regulations 74 defines a head of a family as an individual who actually supports and maintains in one household one or more individuals who are closely connected with him by blood relationship, relationship by marriage, or by adoption, and whose right to exercise family control and provide for these dependent individuals is based upon some moral or legal obligation. Under this article, unless there exists a relationship by reason of blood or marriage or legal adoption, the person furnishing the support of the dependent would not be entitled to classification as the head of a family, irrespective of the fact that the dependent may be maintained in the taxpayer's home or that the taxpayer may furnish the chief support of the dependent. The same rule is applicable under the various Revenue Acts covering the taxable years here in question.

It is clear that the taxpayer does not meet the requirements of the regulations above referred to and, as a consequence, she is not entitled by reason of the support furnished this dependent to classification as the head of a family. Inasmuch, however, as the taxpayer has, during the years 1920 to 1930, inclusive, actually supported and maintained the dependent, she is entitled to the credit allowed by the Revenue Acts applicable to those years on account of the support furnished a dependent.

ARTICLE 292: Personal exemption of head of family. XI–16–5449 G. C. M. 10431

REVENUE ACT OF 1928.

The taxpayer owns the home in which he and his sister live. She does the housework but is entirely dependent on the taxpayer for her support.

Held, the taxpayer is entitled to classification as the head of a family as defined by the regulations.

An opinion is requested whether the taxpayer is entitled to classification as the head of a family under article 292 of Regulations 74.

The taxpayer owns a home in which he and his sister live. Their parents are dead. All other members of the family are married and maintain separate homes. The sister does the housework but she is unable to work outside the home and is not strong enough to earn an independent livelihood. The taxpayer states that 100 per cent of the amount required for her maintenance is paid by him.

It is contended that he should be denied classification as a head of a family in view of the decision of the Board of Tax Appeals in *Massey* v. *Commissioner* (14 B. T. A., 407), which was sustained in *Massey* v. *Commissioner* (51 Fed. (2d), 76). The view taken by the Board in that case was that the maintenance of a home by the brother which was superintended by the sister was little more than "an arrangement of convenience." The Circuit Court of Appeals in sustaining the Board referred to the sister as an "employee."

Article 292 of Regulations 74 provides that a head of a family is an individual who actually supports and maintains in one household

one or more individuals who are closely connected with him by blood relationship, relationship by marriage, or by adoption, and whose right to exercise family control and provide for these dependent individuals is based upon some moral or legal obligation.

This office is of the opinion that the instant case may be distinguished from *Massey* v. *Commissioner* for the reason that the facts indicate that the sister is incapable of self-support, although she is able to do the housework, and it appears that the entire cost of her maintenance is borne by the taxpayer. The Bureau has held that in order to meet the test of actual support and maintenance a person claiming the benefit of the head of a family classification must furnish an amount in excess of one-half of the support. (O. D. 775, C. B. 4, 214; O. D. 422, C. B. 2, 159; O. D. 474, C. B. 2, 159; I. T. 1618, C. B. II–1, 123.)

In view of the foregoing, this office is of the opinion that the taxpayer should be classified as the head of a family as defined by the regulations.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

ARTICLE 295: Date determining exemption. XI–1–5340
G. C. M. 10129

REVENUE ACTS OF 1924, 1926, AND 1928.

Computation of personal exemption where there is a change in the status of the taxpayer during the taxable year. Modification of Mimeograph 3288 (C. B. IV–1, 40) and Mimeograph 3800 (C. B. IX–1, 119) recommended.

The opinion of this office is requested whether, in the case where two individuals marry during the taxable year and each was the head of a family, the joint personal exemption may exceed $3,500.

Section 25(c) of the Revenue Act of 1928 reads as follows:

(c) *Personal exemption.*—In the case of a single person, a personal exemption of $1,500; or in the case of the head of a family or a married person living with husband or wife, a personal exemption of $3,500. A husband and wife living together shall receive but one personal exemption. The amount of such personal exemption shall be $3,500. If such husband and wife make separate returns, the personal exemption may be taken by either or divided between them.

The personal exemption thereby granted depends in reality not upon whether the taxpayer is a married or a single person, but whether he occupies such a family status as is ordinarily met by his maintaining a household or home. (See articles 292 and 293, Regulations 74.) Such interpretation has been generally sustained. (See *Appeal of Paul Polichroniades*, 2 B. T. A., 1263, C. B. V–1, 4; *Hannah D. Stratton* v. *Commissioner*, 5 B. T. A., 1025; *Chester F. Morrow* v. *Commissioner*, 9 B. T. A., 448; *Louise Kingsley* v. *Commissioner*, 11 B. T. A., 296, C. B. VII–2, 22; *W. E. Massey* v. *Commissioner*, 14 B. T. A., 407; and *Louise C. Ball* v. *Commissioner*, 16 B. T. A., 785.) The true test becomes clear when it is noted that the first phrase of the provisions quoted above could be changed to read: "In the case of a single person (who is not the head of a family)," without changing the sense of the whole. The requirement that hus-

band and wife must be living together to entitle them to the larger exemption is of the same import.

Further, it should be noted that the statute apparently recognizes that both husband and wife may be contributing to the support of the home or household. At any rate it expresses no concern as to whether either can qualify as the head of a family, as that term is generally understood, but limits them to a single deduction that may be divided between them. As neither spouse is favored and their combined exemption is but $3,500, it seems to follow that neither can claim more than half that sum as a matter of right in the absence of their mutual agreement. The above-quoted provision and accompanying discussion control only where the status of the taxpayer remains unchanged throughout the taxable year.

With respect to a change of status during the taxable year, section 216(f) of the Revenue Act of 1921 made no provision for varying the allowable exemption by reason of such change, but made the status on the last day of the taxable year govern. In support of the present provision (quoted below), which was proposed by the Senate when the Revenue Act of 1924 was under consideration, the Committee on Finance (Sixty-eighth Congress, first session, Report No. 398, page 25) said in part:

> * * * The subdivision has been amended to provide that if the status of the taxpayer changes during the taxable year, the credits provided in subdivision (c) shall be prorated according to the months during which the taxpayer occupied each status. This is obviously a more equitable rule than that provided in the existing law whereby the amount of these credits is determined by the status of the taxpayer on a single day rather than during the entire taxable period.

The resulting provision, which in substance has been retained in all subsequent Revenue Acts, appears in the Revenue Act of 1928 as section 25(e)2, and reads as follows:

> (e) *Change of status.*—
> (2) The personal exemption allowed by subsection (c) of this section shall, in case the status of the taxpayer changes during his taxable year, be the sum of an amount which bears the same ratio to $1,500 as the number of months during which the taxpayer was single bears to 12 months, plus an amount which bears the same ratio to $3,500 as the number of months during which the taxpayer was a married person living with husband or wife or was the head of a family bears to 12 months. For the purposes of this paragraph a fractional part of a month shall be disregarded unless it amounts to more than half a month, in which case it shall be considered as a month.

Manifestly this provision was not intended to vary the allowance for any status as fixed in section 25(c) of the Revenue Act of 1928. It was expressly designed to equitably vary the total exemption by taking into account any changes in status that occurred during the taxable year, by allowing a due proportion of the exemption attributable to each status. The phrase "in case the status of the taxpayer changes during his taxable year" is all-inclusive and not susceptible to limitation to any particular type of change (excepting, of course, changes due to death which are separately treated under section 25(e)3, which is not here material) other than the express disregarding of a fractional part of a month, unless it amounts to more than half a month. If the equitable proportioning intended is to be made effective, the amount allowable for any one status occupied for a portion of the taxable year must be computed without regard to the status for the remainder of that year and irrespective

of the order in which the status changes occur. That is, section 25(c) governs only as to the amount allowable for each status. The words used therein should not be interpreted as limiting the full recognition granted in section 25(e) to changes of status. For example, section 25(c) limits a husband and wife living together to but one exemption of $3,500, but when read with section 25(e), the latter section measures the exemption allowable to them for the time they were living together, whether or not that status continued to the end of the taxable period. It does not limit those married and living together at the end of the year to $3,500 if they are entitled to a greater amount under section 25(e) by virtue of their both having been heads of families for a portion of the taxable year prior to their marriage, as the statute recognizes that out of their combined incomes they maintained two homes for a time. The same is, of course, true if the situation is reversed, i. e., where two individuals married during the first part of the year, and during the latter part separated, both maintaining homes as the heads of families.

Under the stated principles, the prorating becomes a simple mathematical computation. Section 25(c) provides for three different allowances, i. e., $3,500 for the head of a family (whether taxpayer is single or married and separated); $3,500 combined exemption for husband and wife living together (if separated before the end of the period each may take half of the fraction thereof allocable under section 25(e) to the time they were living together, unless they agree upon a different division of any combined allowance for that period); and $1,500 for all others. Suppose all three allowances were applicable to each spouse in equal parts in the order named. The exemption of each would then be ⅓ of $3,500, or $1,166.67, plus ½ of ⅓ of $3,500, or $583.33 (unless varied by agreement), plus ⅓ of $1,500, or $500—a total of $2,250. Again, suppose both were heads of families for the first six months and married and living together during the remainder of the year. The combined exemption allowable to both for the first six months would be $3,500 (twice the $1,750 allowable to each), and the combined exemption allowed them for the last six months would be $1,750, making a total exemption of $5,250. That is true whether they file joint or separate returns, as the provisions governing returns have no special relation to the question of exemption. If they had separated on December 16 (the remainder of that month being disregarded) the sum of the allowable exemptions would be the same (though they would not then have the option of filing joint returns under section 51, Act of 1928, as the status on the last day of the taxable period controls under that section). That is, the exemption allowable to each would be half of $5,250, or $2,625, unless they agreed to a different division of the joint amount allowable during the time they were living together.

As section 216(f) of the Revenue Acts of 1924 and 1926 is the same as section 25(e)2 of the Revenue Act of 1928, except as to amounts, the foregoing principles are likewise applicable to cases arising under those Acts.

It is recommended that Mimeograph 3288 (C. B. IV–1, 40) and Mimeograph 3800 (C. B. IX–1, 119) be modified to conform to the opinion herein expressed.

C. M. Charest,
General Counsel, Bureau of Internal Revenue.

ARTICLE 295: Date determining exemption. XI-1-5341
I. T. 2610

REVENUE ACTS OF 1924 AND 1928.

Mimeograph 3288 (C. B. IV-1, 40) and Mimeograph 3800 (C. B. IX-1, 119), which relate to the method of computing the personal exemption where the status of the taxpayer changes during the taxable year, are modified to conform with General Counsel's Memorandum 10129. (See page 38.)

PART III.—CREDITS AGAINST TAX.

SECTION 31.—EARNED INCOME CREDIT.

ARTICLE 311: Earned income credit. XI-15-5441
G. C. M. 10416

REVENUE ACT OF 1928.

Computation of earned net income where individual filed his return on the calendar-year basis for 1930, received income from a partnership which filed its return on a fiscal-year basis ended during that year, and his actual earned net income was less than $5,000.

An opinion is requested relative to the computation of earned net income in a case where an individual filed his return on the calendar-year basis for 1930, received income from a partnership which filed its return on a fiscal-year basis ended during that year, and his actual earned income was less than $5,000.

The question under consideration involves the interpretation of Mimeograph 3819 (C. B. IX-2, 116), which laid down the rule to be applied in cases where the earned net income was in excess of $30,000, the maximum amount allowable under the statute.

Section 31(a)3 of the Revenue Act of 1928, pertaining to earned net income, reads as follows:

(3) "Earned net income" means the excess of the amount of the earned income over the sum of the earned income deductions. If the taxpayer's net income is not more than $5,000, his entire net income shall be considered to be earned net income, and if his net income is more than $5,000, his earned net income *shall not be considered to be less than $5,000.* In no case shall the earned net income be considered to be more than $30,000. (Italics supplied.)

Section 182(a) of the Revenue Act of 1928 provides that there shall be included in the net income of each partner his distributive share of the partnership income, whether distributed or not, and that if his taxable year is different from that of the partnership the amount so included shall be based upon the income of the partnership for any taxable year of the partnership ending within his taxable year. Section 182(b) provides that if the fiscal year of a partnership begins in one calendar year and ends in another calendar year, and the "law applicable to the second calendar year is different from the law applicable to the first calendar year," then (1) the rates for the calendar year during which such fiscal year begins shall apply to an amount of each partner's share of such partnership net income (determined under the law applicable to such calendar year) equal to the proportion which the part of such fiscal year

falling within such calendar year bears to the full fiscal year, and (2) the rates for the calendar year during which such fiscal year ends shall apply to an amount of each partner's share of such partnership net income (determined under the law applicable to such calendar year) equal to the proportion which the part of such fiscal year falling within such calendar year bears to the full fiscal year. As the normal tax rates for 1929 were ½ of 1 per cent, 2 per cent, and 4 per cent, as compared with the rates for 1930 of 1½ per cent, 3 per cent, and 5 per cent, the law applicable to the second calendar year is different from the law applicable to the first taxable year, and it is necessary to apply the provisions of section 182(b) above. (See Public Resolution No. 23, Seventy-first Congress, approved December 16, 1929, 46 Stat., 47, reducing rates for the calendar year 1929.)

In Mimeograph 3819 there was used as an illustration the case where an individual entitled to a personal exemption of $3,500 made a return for the calendar year 1929 and reported $4,000 as commissions earned in his individual capacity, $36,000 as his share of the profits from a law partnership which made its return for the fiscal year ended August 31, 1929, and $14,000 as an individual loss.

The computation, showing a tax of $960, was as follows:

Income taxable at 1928 rates.		*Income taxable at 1929 rates.*	
Partnership income	$12,000	Commissions	$4,000
Personal exemption	None	Partnership income	24,000
Balance taxable at 5 per cent	12,000	Total	28,000
		Losses	14,000
Normal tax on $12,000	600	Net income	14,000
Surtax on $26,000, less surtax on $14,000	540	Personal exemption	3,500
		Balance	10,500
Tax at 1928 rates	1,140		
Tax at 1929 rates	240	Normal tax on $10,500	200
		Surtax on $14,000	40
Total	1,380		
Credit for earned income	420	Tax at 1929 rates	240
Balance of tax	960		

The credit of $420 for earned net income was determined as follows:

Portion of $30,000 allocable to 1928	$9,000	Credit allowed, limited to 25 per cent of $1,680	$420
Personal exemption	None	Portion of $30,000 allocable to 1929	21,000
Balance taxable at 5 per cent	9,000	Personal exemption	3,500
		Balance	17,500
Normal tax on $9,000	450		
Surtax on $30,000, less surtax on $21,000	610	Normal tax on $17,500	480
		Surtax on $21,000	270
Tax at 1928 rates	1,060		
Tax at 1929 rates	750	Total tax at 1929 rates	750
Total	1,810		

In explanation of the rule of apportionment set forth in Mimeograph 3819, it may be stated that in computing the earned income credit there were three possible methods of apportioning the $30,000 maximum earned net income. In the illustration given in that mimeograph there was $36,000 distributive income from a partnership which had a fiscal year ending August 31, 1929. Under the provisions of section 182(b) of the Revenue Act of 1928, 4/12, or $12,000, was taxable at 1928 rates, and 8/12, or $24,000, was taxable at 1929 rates. Commissions amounting to $4,000 were also received in 1929, making a total of $40,000 actual earned net income, $12,000 of which was taxable at 1928 rates and $28,000 of which was taxable at 1929 rates. But only $30,000 could be treated as earned net income under section 31(a)3 of the Revenue Act of 1928. One method of apportioning the $30,000 considered was to treat $12,000 as allocable to 1928 and the balance, $18,000, as allocable to 1929. Another method was to treat $18,000 as allocable to 1928 and the balance, $12,000, as allocable to 1929. The third method, and the one adopted, was to apportion the statutory earned net income of $30,000 on the basis of the actual earned net income of $40,000 ($12,000 of which was attributable to 1928 and $28,000 of which was attributable to 1929). Consequently, $12000/40000 \times 30{,}000$, or $9,000, was allocated to 1928, and $28000/40000 \times 30{,}000$, or $21,000, was allocated to 1929. This method seemed to be the most equitable both from the standpoint of the taxpayer and of the Government.

Although the illustration given in Mimeograph 3819 relates to a case where the total earned net income was in excess of $30,000, the maximum amount allowable under the statute, the general theory outlined therein to the effect that the statutory earned net income shall first be allocated to the two tax years on the basis of actual earned net income attributable to each, is also applicable in a case where the earned net income is less than $5,000, the minimum amount allowable under the statute. For example, assume the case of a taxpayer who for 1930 filed his return on a calendar-year basis, received earned income from a law partnership having a fiscal year ended September 30, 1930, and whose total income was as follows:

Actual earned income (commissions) received in 1930	$500
Partnership income, $4,000:	
Attributable to 1929 ($\frac{3}{12}$ of $4,000)	1,000
Attributable to 1930 ($\frac{9}{12}$ of $4,000)	3,000
Interest on bonds received in 1930	2,000
Total income	6,500

As stated in Mimeograph 3819 "In determining the credit for earned income on such returns, the earned net income allowed an individual shall first be allocated to 1928 [1929] and 1929 [1930] on the basis of the actual earned net income attributable to each of the years." In the instant case the taxpayer's actual earned net income attributable to 1929 from the partnership which has a fiscal year ended September 30, 1930, is 3/12 of $4,000, or $1,000, and the actual earned net income attributable to 1930 is 9/12 of $4,000, or $3,000. This is in accordance with the rule laid down in section 182(b) of the Revenue Act of 1928, which provides for the prorating of the partnership income in a case where the individual's taxable year is different from that of the partnership. In addition to the

partnership earned income attributable to 1930, namely, $3,000, the taxpayer actually earned $500 commissions in 1930, making a total of $3,500 earned net income for that year. Adding to that amount $1,000 earned net income for 1929, the aggregate actual earned net income is $4,500. As the taxpayer is allowed a minimum earned net income of $5,000 it should be apportioned on the basis of actual earned net income as follows: 1000/4500×5,000=$1,111.11, which is the earned net income allocable to 1929, and 3500/4500×5,000=$3,888.89, which is the earned net income allocable to 1930. The effect of the foregoing is to treat part of the bond interest as earned income, but this is caused by the mandatory provisions of section 31(a) which state that if a taxpayer's net income is more than $5,000 his earned net income "shall not be considered to be less than $5,000." Although for the purpose of computing *the earned net income credit* it is necessary to apportion $1,111.11 income to 1929 and $3,888.89 income to 1930, in making the computation of the *tax against which the credit is applied* the actual income attributable to those years should be used, i. e., $1,000 earned net income is taxable at 1929 rates, $3,500 earned net income is taxable at 1930 rates, and $2,000 bond interest is taxable at 1930 rates.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

SECTION 32.—TAXES OF FOREIGN COUNTRIES AND POSSESSIONS OF UNITED STATES.

(Also Section 23(c), Article 154; Section 131, Article 691.) XI-14-5431 I. T. 2620

REVENUE ACT OF 1928.

The tax imposed by certain sections of the Mexican law effective August 1, 1931, is an income tax which may be credited against United States income tax under sections 32 and 131 of the Revenue Act of 1928. The tax imposed by certain other sections of the Mexican law may not be credited against the United States income tax, but may be deducted from gross income under section 23 of the Revenue Act of 1928.

Advice has been requested whether the tax levied by the Republic of Mexico on "receipts" originating from various sources is an income tax which may be claimed as a credit against United States income tax under sections 32 and 131 of the Revenue Act of 1928. The law referred to is entitled "Law covering an extraordinary assessment on receipts," approved July 31, 1931, and effective August 1, 1931. The Bureau has considered the question of the credit for taxes paid under that law, and has reached the conclusions hereinafter set out.

Section 23 of the Revenue Act of 1928 provides in part as follows:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * * * *

(c) *Taxes generally.*—Taxes paid or accrued within the taxable year, except—

(1) income, war-profits, and excess-profits taxes imposed by the authority of the United States;

(2) so much of the income, war-profits, and excess-profits taxes imposed by the authority of any foreign country or possession of the United States as is allowed as a credit against the tax under section 131.

Section 32 of the Revenue Act of 1928 reads as follows:

SEC. 32. TAXES OF FOREIGN COUNTRIES AND POSSESSIONS OF UNITED STATES.

The amount of income, war-profits, and excess-profits taxes imposed by foreign countries or possessions of the United States shall be allowed as a credit against the tax, to the extent provided in section 131.

Section 131 of the Revenue Act of 1928 provides in part as follows:

SEC. 131. TAXES OF FOREIGN COUNTRIES AND POSSESSIONS OF UNITED STATES.

(a) *Allowance of credit.*—The tax imposed by this title shall be credited with:

(1) *Citizen and domestic corporation.*—In the case of a citizen of the United States and of a domestic corporation, the amount of any income, war-profits, and excess-profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States; and

* * * * * * *

(3) *Alien resident of United States.*—In the case of an alien resident of the United States, the amount of any such taxes paid or accrued during the taxable year to any foreign country, if the foreign country of which such alien resident is a citizen or subject, in imposing such taxes, allows a similar credit to citizens of the United States residing in such country; and

* * * * * * *

(b) *Limit on credit.*—In no case shall the amount of credit taken under this section exceed the same proportion of the tax (computed on the basis of the taxpayer's net income without the deduction of any income, war-profits, or excess-profits tax any part of which may be allowed to him as a credit by this section), against which such credit is taken, which the taxpayer's net income (computed without the deduction of any such income, war-profits, or excess-profits tax) from sources without the United States bears to his entire net income (computed without such deduction) for the same taxable year.

In construing the foregoing sections dealing with deductions and credits for taxes paid to foreign countries, the Bureau has held that in order for the tax paid to the foreign country to be allowed as a credit under section 131, it must be shown that the tax imposed by the foreign law is a tax on income, according to the United States concept, as distinguished from a tax on gross receipts. (I. T. 2596, C. B. X–2, 184.) If, upon examination of the foreign income tax law, it is concluded that the tax imposed by such law is on gross receipts as distinguished from the United States concept of income, such tax is allowed as a deduction from gross income under the above-quoted parts of section 23 instead of a credit against tax.

Articles 1 and 2 of the Mexican law referred to, which became effective on August 1, 1931, read as follows:

ARTICLE 1ST.—There is established an extraordinary Federal tax on receipts originating as follows:

I.—From the exercise of commerce, industry and agriculture.

II.—From the transactions or investments of capital covered by article 20 of the income tax law in effect.

III.—From the exploitation of the subsoil, or of concessions granted by the Federal Government, the States or the municipalities, when such receipts have the nature of participations, either under the name of rents or royalties, or with any other denomination.

There is excepted from the above, the case in which the taxpayer obtains such receipts as a participation in the profits of the operating company.

IV.—From the total or partial sale or transfer of ownership of concessions granted by the Federal Government, by the States or the municipalities, as well as of the rights derived from them or of the rights for exploitation of the subsoil.

V.—From labor:

(a).—For wages, salaries and other similar compensations taxed by article 28 of the income tax law in effect;

(b).—For fees and other compensations received from the exercise of professions, arts or trades.

(c).—For remunerations that may be received from permanent enterprises for acting in sports, shows or other occupations of similar nature.

ARTICLE 2D.—For the effects of this law, there shall be considered as taxable receipts:

I.—In the cases of commerce and industry, those declared for income tax purposes covering the sale of merchandise, manufactured articles and effects, or from other sources.

II.—In the case of agriculture, the amount of the final inventory of stocks made up for presenting the declarations for the payment of income tax, and the receipts originating from the sale of products or proceeds from the exploitation, or from other sources, deducting from this sum the amount of the inventory of stocks executed at the beginning of the period that may cover the declarations.

III.—In the cases referred to in Fractions II, III, IV and V of the preceding article, those subject to income tax.

From the receipts originating from the business of commerce, industry and agriculture or from the sources referred to in subdivision (b) of Fraction V of the preceding article, there shall be excepted those mentioned in the second paragraph of Fraction I of the following article 3d.

An examination of the above-quoted provisions of the Mexican law of August 1, 1931, in conjunction with the provisions of the present Mexican income tax law, discloses that the tax imposed by the Mexican law of August 1, 1931, is imposed in part on gross receipts and in part on net income. The tax on receipts derived from the sources mentioned in Section IV of article 1 appears to be a tax on the net amount of capital gain.

The Supreme Court of the United States, in *Eisner* v. *Macomber* (252 U. S., 189, T. D. 3010, C. B. 3, 25), defined income as follows:

> Income may be defined as the gain derived from capital, from labor, or from both combined, provided it be understood to include profit gained through a sale or conversion of capital assets * * *.

It is the tax on income in its fundamental sense as meaning gain or profit that is subject to be credited under sections 32 and 131 of the Revenue Act of 1928. This does not preclude, however, a tax which is based on statutory net income from being an income tax, where such statutory net income is determined by starting with gross income in its constitutional sense, less the customary deductions usually to be found in an income tax law.

Applying the foregoing principles to the tax imposed by the Mexican law of August 1, 1931, it clearly appears that the tax imposed by article 1, Section I, on gross receipts derived from the exercise of commerce, industry, and agriculture is not an income tax according to the United States concept. It is, therefore, the opinion of this office that any tax paid under the Mexican law of August 1, 1931, on account of gross receipts received from the sources set forth in Section I of article 1 may not be credited against United States income tax under sections 32 and 131 of the Revenue Act of 1928, but such tax is deductible from gross income under section 23 of that Act.

With respect to Section II of article 1, it appears that this is a tax on receipts derived in the form of interest or rents, and on receipts generally, which tax is required to be deducted and withheld at the source under article 20 of the Mexican income tax law of

1925, as amended. Tax on receipts in the form of interest or rents comes within the United States concept of an income tax and may be credited against the United States income tax under sections 32 and 131 of the 1928 Act. It is entirely possible, however, that the tax on receipts from other activities, which is required to be withheld, may not come within the United States concept of an income tax and, therefore, may not be credited against the United States income tax. With respect to such other receipts, it will be necessary to determine whether the tax is a tax on income within the concept of that term as used and recognized in the United States income tax law.

With respect to the tax imposed on receipts described in Section III of article 1, the question whether the tax is on income, according to the United States concept, must be determined in the light of all the facts, in accordance with the principles hereinabove set out.

With respect to the tax imposed on receipts described in Sections IV and V(a) of article 1, this tax is clearly a tax on income, according to the United States concept, and therefore may be credited against the United States income tax under sections 32 and 131 of the Revenue Act of 1928. The nature of the tax imposed under Section V (b) and (c) of article 1 must be determined in the light of all the facts, in accordance with the foregoing principles.

PART IV.—ACCOUNTING PERIODS AND METHODS OF ACCOUNTING.

SECTION 41.—GENERAL RULE.

ARTICLE 321: Computation of net income. XI–5–5373
I. T. 2613

REVENUE ACT OF 1928.

The following rates of exchange are accepted by the Bureau of Internal Revenue as the current or market rates of exchange prevailing as of December 31, 1931:

Country or city.	Monetary unit.	Value in terms of United States money.	Country or city.	Monetary unit.	Value in terms of United States money.
Austria	Schilling	$0.139581	Switzerland	Franc	$0.194960
Belgium	Belga	.138928	Yugoslavia	Dinar	.017787
Bulgaria	Lev	.007150	Hongkong	Dollar	.248392
Czechoslovakia	Crown	.029626	China	Shanghai tael	.330892
Denmark	Krone	.1·6970	China	Mexican dollar	.238125
England	Pound	3.389404	China	Yuan dollar	.239166
Finland	Markka	.015687	India	Rupee	.256041
France	Franc	.039225	Japan	Yen	.346071
Germany	Reichsmark	.237436	Singapore	Dollar	.392500
Greece	Drachma	.012878	Canada	Dollar	.839705
Hungary	Pengö	.174633	Cuba	Peso	.999300
Italy	Lira	.050700	Mexico	Peso	.396100
Netherlands	Guilder	.400850	Argentina	Peso (gold)	.585190
Norway	Krone	.185470	Argentina	Peso (paper)	.257483
Poland	Zloty	.111921	Brazil	Milreis	.061807
Portugal	Escudo	.031250	Chile	Peso	.120500
Rumania	Leu	.005950	Colombia	Peso	.965700
Spain	Peseta	.084517	Uruguay	Peso	.445166
Sweden	Krona	.188941	Philippine Islands	Peso	.4965

ARTICLE 322: Bases of computation. XI-6-5379
I. T. 2614

REVENUE ACT OF 1928.

A taxpayer desiring to change its accounting method from the cash receipts and disbursements basis to the crop basis must obtain the consent of the Commissioner in accordance with article 322 of Regulations 74. As a condition precedent to the granting of permission to make the change for the calendar year 1931, the taxpayer must agree that any expense of planting, cultivating, and otherwise producing the crop, which was incurred prior to January 1, 1931, and previously claimed as a deduction under the cash basis, may not again be deducted either in 1931 or any subsequent year.

Office Decision 841 (C. B. 4, 53) and Mimeograph 3180 (C. B. III-1, 64) are revoked in so far as inconsistent herewith.

Advice is requested pertaining to a taxpayer's application for permission to change its accounting method from the cash receipts and disbursements basis to the crop basis.

Article 322 of Regulations 74 sets out in general terms the conditions which must be met by a taxpayer seeking the Commissioner's permission to change from one recognized method of reporting income to a different recognized method. The discretionary control over accounting methods granted by section 41 of the Revenue Act of 1928, and the essential accompanying power of granting or denying requests for permission to change accounting bases as prescribed by administrative regulations of long standing, were lodged in the Commissioner not only for the purpose of insuring the accurate reflection of income for a particular accounting period but also to prevent the revenue from being ultimately defeated by the elimination of items of gross income and the duplication of deductions by means of theoretical accounting changes. The cash basis, the accrual basis, the long-term contract basis, the crop basis, and the various methods of valuing inventories are all recognized under the regulations, but a change from one to the other must be accomplished with the consent of the Commissioner in order to comply with the intent of the law and regulations. The taxpayer states that the Bureau fails to distinguish between "double deductions" and "substitution of deductions." The same theoretical argument has been advanced by other taxpayers seeking the permanent elimination of items of gross income by means of accounting changes. Whatever the effect may be from the standpoint of a single accounting period, it is a fact that in the long run a recognition of the taxpayer's contention would grant the taxpayer a double tax benefit from the same identical expenditures. The Bureau has consistently denied the contention whether presented from the angle of gross income or of deductions. The so-called "requirements of the Bureau" represent the conditions precedent to the granting of permission to change from the cash basis to the crop basis, and to which the taxpayer must voluntarily agree prior to the issuance of such permission.

The Bureau is not unmindful that the United States Board of Tax Appeals has uniformly held that there must be consistency of treatment with respect to items of income and deduction within the taxable period under the method of accounting employed. Where the practical application of this rule works to the detriment of the taxpayer with respect to previously taxed income, the Board has not been uniformly sustained. (See *National Bank of South Carolina* v.

Lucas, 36 Fed. (2d), 1013, and *Jacob Bros. Co.* v. *Commissioner*, 50 Fed. (2d), 394.) Prior to the promulgation of this rule by the Board, the Bureau had for many years granted applications for accounting changes, in the absence of some exceptional distortion of income, on the basis of picking up in the year of change all previously nontax-paid items of gross income and the allowance of all previous nondeducted items of deduction. Since the promulgation of the Board decisions the Bureau has denied such applications unless the taxpayer and the Commissioner mutually agree as to the adjustments to be made in connection with the change. The taxpayer is not being forced by the Bureau to change its accounting method. The Bureau is willing to meet the taxpayer's accounting convenience, but is constrained to hold that permission to change will not be granted on a basis which ultimately defeats the revenue by means of permitting double deductions. A taxpayer desiring to change its method of accounting from the cash receipts and disbursements basis to the crop basis will be required to incorporate in its application, as an inseparable term and condition thereof, an agreement to eliminate previously deducted items of expenditure.

In the instant case, therefore, as a condition precedent to the granting of permission to make the change for the calendar year 1931, the taxpayer must agree that any expense of planting, cultivating, and otherwise producing the crop, which was incurred prior to January 1, 1931, and previously claimed as a deduction on the cash basis, may not again be deducted in 1931 or any subsequent year. Otherwise, the taxpayer must continue to report income for Federal income tax purposes on the basis presently employed by it.

Office Decision 841 and Mimeograph 3180, to the extent that same are inconsistent herewith, are revoked.

SECTION 43.—PERIOD FOR WHICH DEDUCTIONS AND CREDITS TAKEN.

ARTICLE 341: " Paid or incurred " and " paid or accrued." XI–15–5442 G. C. M. 10384

REVENUE ACTS OF 1926 AND 1928.

The provisions of a bond relative to the payment of interest for the period from April 1, 1926, to April 1, 1930, indicate that payment of the interest in those years was within the discretion of the board of directors. The bonds provide that interest will be paid at a specified rate per annum and if not paid annually will be paid upon redemption or maturity of the bonds.

Held, that if the taxpayer's books are kept on the accrual basis, the amount of interest eventually to be paid may be deducted annually, even though it may not be paid for a number of years beyond the date on which the liability comes into existence.

An opinion is requested as to the legality of a deduction from gross income of accrued interest on certain bonds.

The material facts are as follows:

The taxpayer corporation authorized the issue of first mortgage bonds of the face value of x dollars dated April —, 1925, and due January 1, 1965. These bonds were sold in the open market.

The portions of the bond here material read as follows:

M Corporation, a State of R corporation (hereinafter called the company), for value received, hereby promises to pay to the bearer, or, if registered, to the registered holder, of this bond, on the 1st day of January, 1965, at the office or agency of the company in the city of S, State of R, one thousand dollars in gold coin of the United States of America, of or equal to the standard of weight and fineness as it existed on January 1, 1925, and to pay interest on said principal amount, at said office or agency, in like gold coin, from January 1, 1925, at the rate of six per centum (6%) per annum, until payment in full of said principal amount, but only as and to the extent provided in the indenture hereinafter mentioned. Interest on said principal amount shall be paid on April 1, 1926, and on each succeeding April 1 to and including April 1, 1930, only if and to the extent that the board of directors of the company shall in its absolute discretion determine to make such payment, and shall declare the same to be then due and payable * * *.

Interest on this bond shall be cumulative from and after January 1, 1925, as provided in said indenture, and all accumulated and unpaid interest on this bond, which shall not have theretofore been declared due and payable and paid, shall be paid whenever the principal of this bond shall become due, whether by declaration, call for redemption or at maturity, or otherwise, but such accumulated and unpaid interest shall not bear interest, except as in said indenture provided. The board of directors shall have the right from time to time at its option to declare any accumulated and unpaid interest on the income bonds, or any part thereof, to be due and payable on such date as the board of directors may determine.

The interest coupons provide for the payment of interest "if and when such interest shall be ascertained and determined to be payable in accordance with the terms of said bond and of the indenture of trust mentioned therein."

Article — of the indenture provides in part as follows:

SEC. —. * * * The term "accumulated and unpaid interest" as used herein with respect to any of the income bonds shall mean interest on such income bonds at the rate of six per cent (6%) per annum from January 1, 1925, whether earned or not, to the extent that such interest shall not have been declared due and payable as herein provided and paid. Accumulated and unpaid interest shall not bear interest unless and until the company shall have made default in paying the same on any date on which the same shall have become due and payable as herein provided, and in that event interest on the amount so in default shall be paid from the date of such default at the rate of six per cent (6%) per annum.

* * * * * * *

SEC. —. On or before March 15, 1926, and thereafter annually on or before March 15 of each year to and including March 15, 1930, the board of directors of the company shall declare such sum, if any, to be due and payable as interest on the income bonds on the next succeeding April 1, as in its absolute discretion * * * it may determine, not exceeding, however, the accumulated and unpaid interest on the income bonds to the date of such payment.

* * * * * * *

SEC. —. * * * the board of directors of the company shall have the right at its option at any time to declare any accumulated and unpaid interest on the income bonds, or any part thereof, to be due and payable on such date as the board of directors may determine, although such payment of interest shall not be compulsory under the provisions of this article.

SEC. —. Whenever interest on the income bonds shall have been declared by the board of directors of the company to be due and payable as herein provided on any April 1, or on any other date, such interest shall become due and payable on such date.

The taxpayer's books are kept on the accrual basis.

The Income Tax Unit has questioned the right of the taxpayer corporation to accrue as a deduction interest during the years 1926, 1927, and 1928 upon the ground that no payment of interest was

authorized during those years by the board of directors and no interest was paid. In this connection it is pointed out that the taxpayer corporation operated at a loss during each of the years under consideration and as a consequence there is no assurance that the interest will be paid on redemption or maturity of the bonds.

The taxpayer contends that the deduction should be allowed as taken on the returns even though no part of the interest was in fact paid, and that the interest on indebtedness accrued and became an actual liability to the extent set forth in its returns because the interest accruing on and after January 1, 1925, must be paid sooner or later, and in any event upon maturity of the bonds in 1965.

The provisions of the bonds and indenture with reference to the payment of interest for the period subsequent to April 1, 1930, differ from the provisions for payment on and prior to that date, and, since only the years prior to 1930 are at issue here, the provisions applicable to the payment of interest subsequent to 1930 are not considered.

A reading of the provisions of the bond relative to the payment of interest for the period from April 1, 1926, to and including April 1, 1930, indicates that payment of the interest during that period was within the discretion of the board of directors. The bonds provide that interest *will be paid* at the rate of 6 per cent per annum and if not paid annually *will be paid* upon redemption or maturity of the bonds. Therefore, the question presented is whether the amount of the interest eventually to be paid may be accrued and deducted annually, even though payment in the particular year was not authorized by the board of directors. This in turn embraces the further question whether an item is accruable in a given year, even though it may not be paid for a number of years beyond the date upon which the liability comes into existence.

Section 23(b) of the Revenue Act of 1928 permits as a deduction from gross income "all interest paid or accrued within the taxable year on indebtedness," with certain exceptions not here material. Section 43 of the Revenue Act of 1928 and section 200(d) of the Revenue Act of 1926 provide that the deductions and credits allowed by the statute shall be taken for the taxable year in which "paid or accrued," dependent upon the method of accounting. Article 341 of Regulations 74 provides in part as follows:

> The terms "paid or incurred" and "paid or accrued" will be construed according to the method of accounting upon the basis of which the net income is computed by the taxpayer. (See section 48(c).) The deductions and credits * * * must be taken for the taxable year in which "paid or accrued" or "paid or incurred," unless in order clearly to reflect the income such deductions or credits should be taken as of a different period * * *.

Article 342 of Regulations 74 and article 112 of Regulations 69 provide in part as follows:

> * * * A taxpayer has the right to deduct all authorized allowances, and it follows that if he does not within any year deduct certain of his expenses, losses, interest, taxes, or other charges, he can not deduct them from the income of the next or any succeeding year. * * *

The general rule is that a taxpayer keeping books of account on the accrual basis must take interest deductions in the periods within which the liability to pay interest accrues, regardless of when payment is actually made. (*Appeal of John W. Butler, Inc.*, 1 B. T. A., 1105, C. B. X-1, 10; *Appeal of McIntosh & Seymour Corporation*,

2 B. T. A., 953; *Appeal of H. Harwood & Sons, Inc.*, 2 B. T. A., 1293; *Appeal of North Wayne Tool Co.*, 2 B. T. A., 366.)

In the oft-cited case of *United States* v. *Anderson* (269 U. S., 422, T. D. 3839, C. B. V–1, 179) the question arose as to the proper time of accrual of munitions taxes. The court said in part:

> Only a word need be said with reference to the contention that the tax upon munitions manufactured and sold in 1916 did not accrue until 1917. In a technical legal sense it may be argued that a tax does not accrue until it has been assessed and becomes due; but it is also true that in advance of the assessment of a tax, all the events may occur which fix the amount of the tax and determine the liability of the taxpayer to pay it. In this respect, for purposes of accounting and of ascertaining true income for a given accounting period, the munitions tax here in question did not stand on any different footing than other accrued expenses appearing on appellee's books. In the economic and bookkeeping sense with which the statute and Treasury decision were concerned, the taxes had accrued. It should be noted that section 13(d) makes no use of the words "accrue" or "accrual" but merely provides for a return upon the basis upon which the taxpayer's accounts are kept, if it reflects income—which is precisely the return insisted upon by the Government. * * *

Another case supporting the principle set forth in the foregoing decision is that of *American National Co.* v. *United States* (274 U. S., 99, T. D. 4099, C. B. VI–2, 193). In that case it was held that under the Revenue Act of 1917 the liability under an agreement to pay a purchaser of a mortgage note a bonus of 1 per cent per annum during the life of the note in addition to the interest carried by the note may be accrued as an ordinary and necessary expense of doing business by a taxpayer keeping his books on an accrual basis, although the total amount of the bonus is uncertain because the maker of the note may pay it in full before maturity.

The court cited the Anderson case in support of its decision and said in part:

> So, in the present case, we think that the amount of the bonus contracts was "an expense incurred and properly attributable" to the company's process of earning income during the year 1917. These contracts were not analogous to obligations to pay interest on money borrowed, but were expenses incurred in selling the loan notes in as real a sense as if under its original system of doing business the company had paid these amounts to brokers as fees for selling the loans or given them notes for such fees. *The company's net income for the year could not have been rightly determined without deducting from the gross income represented by the commission notes, the obligations which it incurred under the bonus contracts*, and would not have been accurately shown by keeping its books or making its return on the basis of actual receipts and disbursements. The method which it adopted clearly reflected the true income. And, just as the aggregate amount of the commission note was properly included in its gross income for the year—although not due and payable until the expiration of two years—so, under the doctrine of the Anderson case, the total amount of the bonus contracts was deductible as an expense incurred within the year, although it did not "accrue" in that year, in the sense of becoming then due and payable. (Italics supplied.)

To the same effect: *Lucas* v. *American Code Co., Inc.* (280 U. S., 445, Ct. D. 168, C. B. IX–1, 314). (See also *Fawcus Machine Co.* v. *U. S.*, 282 U. S., 375, Ct. D. 278, C. B. X–1, 424.)

The *Appeal of Cumberland Glass Manufacturing Co.* (2 B. T. A., 1122) appears to be an analogous case. In that case the company issued its bonds providing among other things:

> * * * and the company is to have the right at its option to defer the payment of any and all interest accruing upon the bonds of series B until the date of the maturity of said bonds, and shall not be liable to pay interest upon said interest payments so deferred * * *.

The Board said in part:

* * * By force of the provisions of the indenture, the bonds and the coupons, interest became due on November 10 and May 10 of each year. The taxpayer had the option of deferring payment until the maturity date of the bonds. That right did not give the directors power to make interest due at such time as they saw fit.

Interest is an accrued expense, ratably over an elapsed period of time. (*Appeal of Chatham & Phenix National Bank*, 1 B. T. A., 460.) The taxpayer recognized that in at least two ways; the vote of the directors of June 9, 1917, referred to "Amount *due* Nov. 10. 1906," etc. The indenture and the bonds themselves contained the provision that, if interest payments were deferred, no interest *upon* the interest would accrue. Clearly, the taxpayer understood and intended to have all interest due and owing as of the respective coupon dates. The payment only was deferred. (*Appeal of Tel-Electric Co.*, 1 B. T. A., 434; *Appeal of North Wayne Tool Co.*, 2 B. T. A., 366; *Appeal of McIntosh & Seymour Corporation*, 2 B T. A., 953.)

Accordingly, it follows, that the Commissioner's computation of the taxpayer's income and invested capital was correct, and the determination of deficiency is approved.

Subsequently the taxpayer raised the same question in the Court of Claims. That court reached the same conclusion November 3, 1930, as was reached by the Board. (See 44 Fed. (2d), 455.)

In *Miller & Vidor Lumber Co.* v. *Commissioner* (15 B. T. A., 948) the Board had for consideration the case of a corporation which had issued several sets of notes, a part of which provided that interest was payable upon maturity of the notes. The date of maturity was April 1, 1919. The notes were liquidated April 1, 1920, by a new series of notes. The taxpayer was on the accrual basis and sought to take a deduction in 1920 for the interest paid by it in that year. The Board held that the taxpayer could not deduct from its gross income for any one year, several years' interest upon indebtedness, even though the interest was not payable until the maturity of the indebtedness. This decision was affirmed (39 Fed. (2d), 890) by the Circuit Court of Appeals for the Fifth Circuit and certiorari was denied by the United States Supreme Court (282 U. S., 864). The Circuit Court of Appeals in its opinion used the following significant language:

In this case the petitioner kept its books and made its returns on the accrual basis, which reflected true income. The interest on the notes was a fixed liability of a definite amount, ascertainable at the end of each year. While the interest was not paid annually, and was not due annually, it was earned annually. Each year's interest was ratably earned by the use of the principal sum in the business of the taxpayer during the year of its use. It was an expense of creating the income for each separate year, and the net income of the business for a particular year could be ascertained only by deducting from gross income the item of annual interest. The year of the payment of the interest and the year when the interest matured have no importance, where the accounting is on the accrual basis. * * *

In view of the foregoing, it is the opinion of this office that the general rule that interest accrues ratably over the period of an obligation is applicable to the instant case. Consequently, the amount of interest eventually to be paid may be deducted annually, even though it may not be paid for a number of years beyond the date on which the liability comes into existence.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

PART V.—RETURNS AND PAYMENT OF TAX.

SECTION 51.—INDIVIDUAL RETURNS.

ARTICLE 381: Individual returns. XI–23–5501 I. T. 2630

REVENUE ACT OF 1928.

The taxpayer was married and living with his wife until on August 1, 1930, a separation occurred and thereafter they lived apart, although there was no divorce.

Held, under the laws of California they were husband and wife for the entire taxable year, and the salary of the husband for the entire year was divisible between the husband and wife for income tax purposes.

Advice is requested relative to the divisibility of the salary of a husband as earned income where husband and wife, resident in California, were separated but not divorced in the middle of the year.

During the first seven months of the year 1930 the taxpayer was married and living with his wife. On August 1, 1930, a separation occurred and the taxpayer and his wife lived apart during the remainder of the year, although there was no divorce. In making their income tax returns for 1930 the wife reported on a separate return as her income only one-half of the salary of the husband to the date of the separation, and the husband reported one-half of such income as his own and all salary earned from August 1, 1930, to the end of the year.

The California courts are unanimous in holding that during the pendency of an interlocutory decree of divorce the parties are still husband and wife, and if one of them dies, the survivor has the same rights as if no decree had been entered. (See *In re Seiler's Estate*, 164 Cal., 181, 128 Pac., 334; *Olson* v. *Superior Court*, 175 Cal., 250, 165 Pac., 706.)

In *Brown* v. *Brown* (170 Cal., 1, 147 Pac., 1168) it was said:

* * * As we have seen, the marriage status remains until the final decree. Such property acquired after the interlocutory decree and before final decree is acquired "after marriage" and before its termination, and is therefore community property. * * *

To the same effect see *In re Dargie's Estate* (162 Cal., 51, 121 Pac., 320); *Grannis* v. *Superior Court* (146 Cal., 245, 79 Pac., 891).

It is evident from the above-cited cases that the parties here involved were husband and wife for the entire taxable year 1930. The salary of the husband for the entire year 1930 was divisible between husband and wife for the purposes of Federal income tax. The husband and wife may file amended returns for 1930, each reporting one-half of the salary of the husband for that year.

SECTION 52.—CORPORATION RETURNS.

ARTICLE 392: Returns by receivers. XI-21-5485
I. T. 2626

REVENUE ACT OF 1928.

Where the receiver in the cases of closed State banks, who is a special deputy representing the secretary of banking, requires persons obligated to these banks to keep up all interest and other payments, the special deputy, as a receiver in control of the business and property of such banks, rather than the officers, should file income tax returns for the banks, subject to the provisions of I. T. 2264 (C. B. V-1, 100), where any bank is entitled to the benefit of section 22 of the Act of March 1, 1879. Such returns should include the income for the entire taxable year, regardless of whether such income was received by the bank prior to the date it closed or by the special deputy while he was in charge of the bank. I. T. 2092 (C. B. III-2, 253) and I. T. 2193 (C. B. IV-2, 85) and all other rulings in so far as they may be inconsistent with this conclusion are revoked.

Inquiry is made whether in the cases of closed State banks the action of the receiver in requiring persons obligated to the banks to keep up all interest and other payments constitutes "operation" by the receiver; whether the receiver or the officers of the banks should be required to file income tax returns for the banks; and whether the returns should cover the period from the beginning of the taxable year to the date the respective banks closed or the entire taxable year, including the period during which the special deputy was in charge of the banks.

During 1931 a large number of State banks were taken over by the secretary of banking of the State of X, such banks being closed and liquidation of assets started. The receiver in the cases of the closed banks, who is a special deputy representing the secretary of banking, requires persons obligated to these banks to keep up all interest and other payments. The books are in the possession of the receiver.

Under the Bureau's ruling in I. T. 2193, supra, if a special bank examiner is engaged in operating the business or property of an insolvent bank he is required to file returns for the bank. If the receiver is merely engaged in marshaling, selling, and distributing the bank's assets for the purpose of winding up its affairs, the principal officers of the bank are required to file its returns. In I. T. 2264, supra, it was held that where a bank is entitled to the benefit of section 22 of the Act of March 1, 1879 (20 Stat., 351), an affidavit to that effect, executed by the receiver and securely attached to each return filed, may be accepted in lieu of the data and information called for in the return.

In General Counsel's Memorandum 3876 (C. B. VII-1, 127) it was held that the superintendent of insurance for the State of New York is required to make income tax returns for insurance companies in process of liquidation, under the provisions of section 63 of the New York insurance law. In that memorandum it was observed that the method of liquidating insurance companies, as provided in the New York statute, seems to differ in no essential from the method prescribed by the statutes of many of the States for the liquidation of insolvent banks through the State officer who has general super-

vision over State banks. The point of the memorandum was that the superintendent of insurance for the State of New York when acting in the liquidation of an insurance company is considered by the Bureau to be a receiver within the meaning of section 239 of the Revenue Act of 1926, and the corresponding provisions of prior Revenue Acts, and as such is required to file income tax returns for insurance companies in process of liquidation under section 63 of the New York insurance law.

The conclusion stated in General Counsel's Memorandum 3876 is predicated upon that portion of section 239 of the Revenue Act of 1926 which provides that "In cases where receivers, trustees in bankruptcy, or assignees are operating the property or business of corporations, such receivers, trustees, or assignees shall make returns for such corporations in the same manner and form as corporations are required to make returns. * * *" The same language is contained in section 52(a) of the Revenue Act of 1928. In General Counsel's Memorandum 3876, supra, the phrase "operating the property or business," as it is used in the statutes, was not taken as a basis for relieving receivers who were merely engaged in marshaling, selling, and distributing assets, from filing returns. On the contrary, the memorandum was specifically directed to those cases in which the State superintendent of insurance is engaged in performing his duty, under the New York statutes, of marshaling the assets of an insolvent insurance company, receiving and passing upon claims, and making distribution. The phrase "operating the property or business" was construed in its broader meaning of having influence or control over the business or property of insolvent insurance companies, and not merely in the sense of carrying on the business for which such companies were organized.

In view of the conclusions stated in General Counsel's Memorandum 3876, which apply also to receivers of insolvent State banks and receivers in general, the question whether a receiver is engaged only in marshaling, selling, and distributing assets, as distinguished from carrying on the business of the insolvent taxpayer, is of no importance in determining his liability for making income tax returns for the taxpayer whose business or property he controls or has in custody. Where a receiver has full custody of and control over the business or property of a corporation, he is deemed to be "operating" such business or property within the meaning of section 52(a) of the Revenue Act of 1928, and the corresponding provisions of prior Acts, whether he is engaged in carrying on the business for which the corporation was organized or only in marshaling, selling, and disposing of its assets for purposes of liquidation. (See article 392 of Regulations 74.)

Accordingly, in the cases of the insolvent State banks here under consideration, the special deputy, as a receiver in control of the business and property of such banks, rather than the officers, should file income tax returns for the banks, subject to the provisions of I. T. 2264, where any bank is entitled to the benefit of section 22 of the Act of March 1, 1879. The return filed by the special deputy in each case should be for the entire taxable year, and should include the income received during the portion of the taxable year that he was in charge of the bank and also the income received by the bank for

the period from the beginning of the taxable year to the date the bank closed. See O. D. 884 (C. B. 4, 309).

I. T. 2092 and I. T. 2193 and all other rulings in so far as they may be inconsistent with the views expressed herein are revoked.

SECTION 55.—PUBLICITY OF RETURNS.

ARTICLE 421: Inspection of returns. XI–14–5438
T. D. 4332

INCOME TAX.

Amending Treasury Decision 3856, as amended, to permit inspection of returns by State officers for State intangible property tax purposes.

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

To Collectors of Internal Revenue and Others Concerned:

Treasury Decision 3856 (C. B. V–1, 106) as amended by Treasury Decisions 4187 (C. B. VII–2, 161), 4264 (C. B. VIII–1, 93), 4291 (C. B. IX–1, 127), and 4317 (C. B. X–1, 146) (being regulations prescribed by the Secretary of the Treasury and approved by the President, applicable to the inspection of returns under the Revenue Act of 1928 and prior Revenue Acts), is further amended by changing paragraphs 5, 6, 7, 8, and 9 thereof to read as follows:

5. The return of an individual shall be open to inspection (a) by the person who made the return, or by his duly constituted attorney in fact; (b) if the maker of the return has died, by the administrator, executor, or trustee of his estate, or by the duly constituted attorney in fact of such administrator, executor, or trustee; (c) in the discretion of the Commissioner of Internal Revenue, by any heir at law, next of kin, or beneficiary under the will, of such deceased person, upon a showing that such heir at law, next of kin, or beneficiary has a material interest which will be affected by information contained in the return, or by the duly constituted attorney in fact of such heir at law, next of kin, or beneficiary; and (d) in the discretion of the Commissioner of Internal Revenue, and at such time and in such manner as the Commissioner may prescribe for the inspection, by an officer of any State having a law imposing an income tax upon the individual, or a tax upon intangible property owned by the individual, measured by the income derived therefrom, upon written application signed by the governor of such State under the seal of the State, designating the officer to make the inspection and showing that the inspection is solely for such State income and/or intangible property tax purposes.

6. A joint return of a husband and wife shall be open to inspection (a) by either spouse for whom the return was made, upon satisfactory evidence of such relationship being furnished, or by his or her duly constituted attorney in fact; (b) if either spouse has died, by the administrator, executor, or trustee of his or her estate, or by the duly constituted attorney in fact of such administrator, executor, or trustee; (c) in the discretion of the Commissioner of Internal Revenue, by any heir at law, next of kin, or beneficiary under the will, of such deceased spouse, upon a showing that such heir at law, next of kin, or beneficiary has a material interest which will be affected by information contained in the return, or by the duly constituted attorney in fact of such heir at law, next of kin, or beneficiary; and (d) in the discretion of the Commissioner of Internal Revenue, and at such time and in such manner as the Commissioner may prescribe for the inspection by an officer of any State having a law imposing an income tax upon either spouse or a tax upon intangible property owned by either spouse, measured by the income derived therefrom, upon written application signed by the governor of such State under the seal of the State, designating the

officer to make the inspection and showing that the inspection is solely for such State income and/or intangible property tax purposes.

7. The return of a partnership shall be open to inspection (a) by any individual who was a member of such partnership during any part of the time covered by the return upon satisfactory evidence of such fact being furnished, or by his duly constituted attorney in fact; (b) if a member of such partnership during any part of the time covered by the return has died, by the administrator, executor, or trustee of his estate, or by the duly constituted attorney in fact of such administrator, executor, or trustee; (c) in the discretion of the Commissioner of Internal Revenue, by any heir at law, next of kin, or beneficiary under the will, of such deceased person, upon a showing that such heir at law, next of kin, or beneficiary has a material interest which will be affected by information contained in the return, or by the duly constituted attorney in fact of such heir at law, next of kin, or beneficiary; and (d) in the discretion of the Commissioner of Internal Revenue, and at such time and in such manner as the Commissioner may prescribe for the inspection by an officer of any State having a law imposing an income tax upon the partnership or upon any member thereof in respect of income therefrom or a tax upon intangible property owned by the partnership, measured by the income derived therefrom, upon written application signed by the governor of such State under the seal of the State, designating the officer to make the inspection and showing that the inspection is solely for such State income and/or intangible property tax purposes.

8. The return of an estate shall be open to inspection (a) by the administrator, executor, or trustee of such estate, or by his duly constituted attorney in fact; (b) in the discretion of the Commissioner of Internal Revenue, by any heir at law, next of kin, or beneficiary under the will, of the deceased person for whose estate the return is made, upon a showing of material interest which will be affected by information contained in the return, or by the duly constituted attorney in fact of such heir at law, next of kin, or beneficiary; and (c) in the discretion of the Commissioner of Internal Revenue, and at such time and in such manner as the Commissioner may prescribe for the inspection, by an officer of any State having a law imposing an income tax upon the estate or upon any beneficiary of the estate in respect of income therefrom, or a tax upon intangible property owned by the estate, measured by the income derived therefrom, upon written application signed by the governor of such State under the seal of the State, designating the officer to make the inspection and showing that the inspection is solely for such State income and/or intangible property tax purposes.

9. The return of a trust shall be open to inspection (a) by the trustee or trustees, jointly or severally, or the duly constituted attorney in fact of such trustee or trustees; (b) by any individual who was a beneficiary of such trust during any part of the time covered by the return, upon satisfactory evidence of such fact being furnished, or by his duly constituted attorney in fact; (c) if any individual who was a beneficiary of such trust during any part of the time covered by the return has died, by the administrator, executor, or trustee of his estate, or by the duly constituted attorney in fact of such administrator, executor, or trustee; (d) in the discretion of the Commissioner of Internal Revenue, by any heir at law, next of kin, or beneficiary under the will, of such deceased person, upon a showing that such heir at law, next of kin, or beneficiary has a material interest which will be affected by information contained in the return, or by the duly constituted attorney in fact of such heir at law, next of kin, or beneficiary; and (e) in the discretion of the Commissioner of Internal Revenue, and at such time and in such manner as the Commissioner may prescribe for the inspection, by an officer of any State having a law imposing an income tax upon the trust or upon any beneficiary of the trust in respect of income therefrom, or a tax upon intangible property owned by the trust, measured by the income derived therefrom, upon written application signed by the governor of such State under the seal of the State, designating the officer to make the inspection and showing that the inspection is solely for such State income and/or intangible property tax purposes.

OGDEN L. MILLS,
Secretary of the Treasury.

Approved March 22, 1932.

HERBERT HOOVER,
The White House.

EXECUTIVE ORDER—INSPECTION OF INCOME TAX RETURNS.

Pursuant to the provisions of section 257(a) of the Revenue Act of 1926 and section 55 of the Revenue Act of 1928, it is hereby ordered that returns may be open to inspection by State officers for State intangible property tax purposes, in accordance and upon compliance with the amendment, bearing even date herewith, to the rules and regulations prescribed by the Secretary of the Treasury and approved by the President, bearing date of April 13, 1926, as amended.

HERBERT HOOVER.

THE WHITE HOUSE, *March 22, 1932.*

ARTICLE 421: Inspection of returns. XI-17-5459
G. C. M. 10401

REVENUE ACT OF 1928.

There is no provision of law which authorizes the disclosure to a bondholders' protective committee of information shown on withholding returns. Likewise, there is no authority in the law which authorizes a stockholder owning 1 per cent or more of the outstanding stock of a corporation to inspect withholding returns.

An opinion is requested whether a bondholders' protective committee may be furnished with copies of withholding returns, Form 1012, for the purpose of securing the names and addresses of persons owning bonds issued by the corporation. An opinion is also requested whether a shareholder of a corporation may, under authority granted to inspect the corporation income tax return, Form 1120, also inspect or obtain copies of the withholding returns filed by the same corporation.

Section 3167 of the Revised Statutes, as amended, makes it unlawful to disclose information concerning the source or amount of income, profits, losses, or expenditures, shown in any income return, except as expressly provided by law. Withholding returns (Form 1012) show the names and addresses of the bondholders, the amount of interest paid to the bondholders, and amount of tax withheld. These withholding returns show a source of income of the taxpayers listed thereon.

There is no provision of law which authorizes the disclosure to a bondholders' protective committee of the information shown on withholding returns. Likewise, there is no provision of law which authorizes a stockholder owning 1 per cent or more of the outstanding stock of the corporation to inspect withholding returns. While it is true that the law authorizes inspection of the corporation's income tax return, Form 1120, by a stockholder owning 1 per cent or more of the outstanding capital stock, this return is a return of income of the corporation. Withholding returns serve a different purpose. They report tax withheld from income of the bondholders of the corporation.

This office has held that ownership certificates made by persons owning securities, showing income of the makers, which pursuant to law and regulations are filed with the Department, are income returns, and as they are required to be filed as the result of income

tax laws for the purpose of being a complement to income tax returns of the makers, they should be treated the same as income tax returns are treated under the regulations governing the furnishing of copies of such tax returns. (L. O. 879, C. B. 1, 262, and S. M. 1301, C. B. 2, 259.) Withholding returns, Form 1012, disclose the same information in tabulated form as is shown on ownership certificates, and being required under authority of law are income returns and subject to the same limitations with respect to inspection as other income returns. The regulations prescribed by the Secretary and approved by the President under authority of section 257(a) of the Revenue Act of 1926 make no provision for inspection of withholding returns by bondholders or by a committee of bondholders, nor is provision made for a shareholder owning 1 per cent or more of the outstanding stock of a corporation to inspect withholding returns. Such inspection is, therefore, prohibited by law.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

ARTICLE 421: Inspection of returns. XI-25-5517
I. T. 2631

REVENUE ACT OF 1928.

There is no provision of law or regulations which authorizes inspection of Federal income tax returns by State officers in connection with the administration of State laws imposing a tax upon intangible property based upon its value.

Reference is made to Treasury Decision 4332 (see on page 57), which authorizes the Commissioner of Internal Revenue, in his discretion, to permit inspection of income tax returns of individuals, partnerships, estates, etc., by an officer of any State having a law imposing a tax upon intangible property owned by individuals, partnerships, estates, etc., measured by the income derived therefrom, upon written application signed by the governor of such State, designating the officer to make the inspection, and advice is requested concerning the procedure necessary for the county assessor of taxes, or his designated deputy, to inspect returns under the foregoing Treasury decision.

The constitution of the State of California (Article XIII, section 16) authorizes a tax on intangible property based upon *actual value.*

The regulations referred to authorize inspection of Federal income tax returns of individuals, partnerships, estates, etc., by State officers in connection with the administration of a State law imposing a tax upon income, or a tax upon intangible property *measured by the income therefrom.* There is no provision of law or regulations, however, which authorizes the inspection of such returns by State officers in connection with the administration of State laws imposing a tax upon intangible property based upon the value of such property.

The privilege of inspecting Federal income tax returns is extended to State officers, as provided in existing regulations, for the reason that the information shown in such returns affords a reasonably accurate check in the enforcement of State income tax laws, and

State laws imposing a tax on intangible property which is measured by the income therefrom.

While it is possible that inspection of Federal income tax returns might be of some assistance to State officers in the enforcement of State laws which impose a tax on intangible property based upon value, it has been considered necessary to limit the privilege of inspection to those States where, in the enforcement of the State taxing laws, the information shown in Federal income returns has a reasonably direct relationship.

SECTION 57.—EXAMINATION OF RETURN AND DETERMINATION OF TAX.

ARTICLE 451: Examination of return and determination of tax by the Commissioner. XI–9–5399 Mim. 3937

Examination of income tax returns and determination of tax liability.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C., February 15, 1932.

Collectors of Internal Revenue, Internal Revenue Agents in Charge, and Others Concerned:

Article 451 of Regulations 74, as amended by Treasury Decision 4327 approved October 5, 1931 [C. B. X–2, 157], provides that as soon as practicable after returns are filed, they will be examined and the correct amount of the tax determined under such procedure as may be prescribed from time to time by the Commissioner. Pursuant thereto the following procedure is prescribed covering the examination of income tax returns:

CLASSES OF RETURNS TO BE EXAMINED BY COLLECTORS AND INTERNAL REVENUE AGENTS IN CHARGE.

Returns on Form 1040A will be retained and examined by collectors. Returns on Forms 1120, 1041, and 1065 will be examined by internal revenue agents in charge.

Returns on Form 1040 will be examined by collectors or by internal revenue agents in charge, ordinarily on the basis of the following general classification:

(1) Those reporting gross income of $25,000 or less, by collectors;
(2) Those reporting gross income of more than $25,000, by internal revenue agents in charge.

PROCEDURE FOR THE HANDLING OF RETURNS ON FORMS 1041 AND 1065.

At the earliest practicable date after the filing of returns on Forms 1041 and 1065, a segregation of those returns will be made by internal revenue agents in charge upon the following basis:

(a) Those returns which internal revenue agents in charge desire to examine;

(b) Those returns which internal revenue agents in charge recommend be accepted as filed.

Returns which internal revenue agents in charge recommend for acceptance as filed will be retained in the collectors' offices.

Collectors will then prepare a "Notice of acceptance" on Form 918 (revised April, 1931) for each member of a partnership and each beneficiary of an estate or trust whose taxable income therefrom amounted to $3,500 or more during the taxable year. This form will be attached to the related individual return if such return is in the collector's office. If the return is not in the collector's office, the form will be forwarded to the Income Tax Unit in Washington, or to the appropriate collector if the member of the partnership or beneficiary of the estate or trust filed his return in a different district. Internal revenue agents in charge will place the word "Field" in the center of the top of each of the returns segregated for examination. Such returns will be retained in the office of the internal revenue agent in charge. Internal revenue agents in charge will at early convenient dates assign the segregated returns on Forms 1041 and 1065 for investigation.

When individual returns of partners or beneficiaries are not available, and it is deemed advisable to obtain such individual returns before beginning an examination of a partnership or fiduciary return, appropriate requisition will be made. Examinations may be based on retained copies in possession of the taxpayer when original returns are not readily obtainable.

The reports of examining officers covering an entire group of related returns should, wherever practicable, be handled as a unit.

Where all taxpayers in a group of related taxpayers whose returns were filed in the same collection district have agreed to the deficiencies determined in cases in which no overassessment is involved (and in the case of consolidated returns where no change in affiliation is disclosed), the returns will be forwarded to the Income Tax Unit in Washington through the collector. In all other cases where the tax liability of a group of related taxpayers is determined (except in cases in which a report is not made of the examination where no change in tax liability is determined), the returns of the group will be kept intact and forwarded to the Income Tax Unit in Washington direct.

PRELIMINARY EXAMINATION OR MATHEMATICAL VERIFICATION BY COLLECTORS OF RETURNS ON FORMS 1040 AND 1120.

The mathematical accuracy of returns will be checked and verified by collectors. Where errors have been indicated, the correct amount of tax should be written on the return immediately to the left of the incorrect amount and the taxpayer immediately notified of the changes.

CLASSIFICATION OF RETURNS ON FORM 1040 FOR EXAMINATION BY COLLECTORS.

Returns on Form 1040 showing gross income of $25,000 or less will be classified by collectors as follows:

(a) Those returns which collectors wish returned for examination;

(b) Those returns which collectors recommend be accepted as filed.

Collectors will place the letter "E" in the center of the top of each return to be returned to them for examination. No such mark or stamp will be placed upon returns which are to be accepted as filed.

FIELD DETERMINATION OF TAX LIABILITY.

NOTIFICATION TO TAXPAYERS—AGREEMENTS—PROTESTS.

Upon the completion of a field examination of an income tax return which results in a change in the tax liability shown thereon, the taxpayer will be notified of the result of such examination. If the taxpayer agrees with the tax liability as determined by the examining officer, he may execute the form provided for use in indicating such agreements. If the taxpayer does not agree with the determination of his tax liability, the internal revenue agent in charge or the collector, as the case may be, will cause any protest submitted by the taxpayer to be carefully considered. If requested, a hearing will be granted.

Any protest and any supplemental statement which the taxpayer may desire to submit in connection with a protest should be submitted to the internal revenue agent in charge or the collector, as the case may be, and protests filed with the Income Tax Unit in Washington will be referred to the appropriate field office.

If no agreement or protest is received from the taxpayer in the time specified in the letter of notification, the internal revenue agent in charge or the collector, as the case may be, will forward the return and complete file pertaining thereto to the Income Tax Unit in Washington for review.

PROCEDURE IN COLLECTORS' NONAGREEMENT CASES.

As to those returns which are examined by collectors, if the collector and the taxpayer are unable to agree respecting the determination of the tax liability, the return and complete file pertaining thereto will be forwarded by the collector to the internal revenue agent in charge for consideration.

The taxpayer will be advised by letter of the result of such consideration and may within the period stated in the letter request a hearing before the internal revenue agent in charge. Procedure thereafter will be similar to the procedure in cases of returns examined by internal revenue agents in the first instance.

ITEMS WHICH A PROTEST MUST COVER.

A protest must cover all items which the taxpayer questions and should be accompanied by a statement of all additional facts upon which the taxpayer intends to rely and by a brief if the taxpayer desires to file one. The protest shall be filed in triplicate and shall contain the following information:

(a) The name and address of the taxpayer (in the case of an individual, the residence and in the case of a corporation, the principal office or place of business);

(b) In the case of a corporation, the State in which incorporated;

(c) The designation by date and symbol of the letter advising of the determination with respect to which the protest is made;

(d) The designation of the year or years covered and a statement of the amount of tax liability in dispute for each year;

(e) An itemized schedule of the findings to which the taxpayer takes exception;

(f) A statement of the grounds upon which the taxpayer relies in connection with each exception; and

(g) In case the taxpayer desires a hearing, a statement to that effect.

Letters of protest and accompanying statements of fact, if any, must be executed by the taxpayer under oath.

In case the protest is prepared by an attorney or agent, it should be accompanied by a statement signed by such attorney or agent, showing that he prepared the protest and whether or not he knows of his own knowledge that the facts stated in the protest are true.

REVIEW IN WASHINGTON OF FIELD EXAMINATIONS.

All income tax returns examined in the field, together with internal revenue agent's or deputy collector's reports and related papers, including copies of conference reports, will be forwarded to the Income Tax Unit in Washington for review and final action, except—

(a) Returns on Form 1040A, and

(b) Returns on Forms 1041 and 1065, in cases in which no changes are recommended.

If after review in the Income Tax Unit in Washington of any case where a change in tax liability is recommended by the internal revenue agent in charge the change is approved, and a protest is filed, the taxpayer will be afforded an opportunity for a hearing in the Income Tax Unit in Washington. If after further consideration of the taxpayer's protest in the Income Tax Unit in Washington the recommendations of the internal revenue agent in charge, notwithstanding the taxpayer's protest, are approved, and a deficiency results to which the taxpayer does not agree, the taxpayer will be notified by registered mail, in accordance with the provisions of section 272 of the Revenue Act of 1928.

Any changes in the recommendations of the internal revenue agent in charge determined upon by the Income Tax Unit in Washington, *after careful consideration of comments to be invited from the internal revenue agent in charge*, will be explained to the taxpayer by letter, and the taxpayer will be afforded an opportunity to file a protest. If requested in the protest, a hearing will be granted. If the taxpayer agrees to the tax liability determined by the Income Tax Unit in Washington, he may execute the form provided for use in indicating such agreement. If the changes proposed by the Income Tax Unit in Washington result in a deficiency to which the taxpayer does not agree, he will be notified by registered mail, in accordance with the provisions of section 272 of the Revenue Act of 1928.

PROCEDURE WHERE THE GOVERNMENT'S INTERESTS MAY BE JEOPARDIZED BY DELAY.

An immediate assessment without prior notice to the taxpayer will be made under the provisions of section 273(a) of the Revenue Act of 1928, if it appears in any case that collection of a deficiency may be jeopardized by delay.

EXAMINATIONS IN SPECIAL CASES.

Where for any reason it is considered desirable to do so, the Commissioner may direct that a field examination of a return be made by such revenue agents, special agents, or other officers as he may designate.

PROCEDURE WHERE WILLFUL ATTEMPT IS MADE TO EVADE TAX.

If, in the course of any field examination, it appears that a willful attempt has been made to evade tax, the report of the examining agent will be forwarded to the Income Tax Unit in Washington without the taxpayer being notified of the proposed deficiency. Thereafter, the procedure, in so far as practicable, will be the same as prescribed in the case of other returns received in the Income Tax Unit in Washington for review. If in any such case a deficiency is determined in respect of which the taxpayer does not file a protest or execute an agreement, the taxpayer will be notified of the deficiency by registered mail, in accordance with the provisions of section 272 of the Revenue Act of 1928.

EXCEPTIONS.

The procedure outlined in this mimeograph will be followed in all cases except where it is impracticable, as, for example, in cases in which the period of limitation for assessment is about to expire. Where it is necessary to protect the interests of the Government against the running of the period of limitation on assessment, the taxpayer may be notified by registered mail of a deficiency, in accordance with the provisions of section 272 of the Revenue Act of 1928, even though he has not been afforded an opportunity for filing a protest.

All mimeographs and other instructions are hereby modified in so far as they are inconsistent with the procedure herein provided.

Correspondence from collectors in regard to the procedure outlined herein should refer to the number of this mimeograph and to the symbols A&C: Col. Correspondence from internal revenue agents in charge regarding this procedure should refer to the number of this mimeograph and to the symbols IT: E: JCW.

DAVID BURNET, *Commissioner.*

SUBTITLE C.—SUPPLEMENTAL PROVISIONS.

SUPPLEMENT A.—RATES OF TAX.

SECTION 103.—EXEMPTIONS FROM TAX ON CORPORATIONS.

ARTICLE 530: Social clubs. XI-17-5460
I. T. 2622

REVENUE ACT OF 1928.

An organization otherwise entitled to exemption as a social club under section 103(9) of the Revenue Act of 1928, is not entitled to exemption for the fiscal year ended March 31, 1929, since it sold

its property at a profit in that year, nor is it entitled to exemption in any subsequent fiscal year or taxable period in which that profit may be returnable on the installment basis.

A ruling is requested whether the M organization is entitled to exemption from Federal income taxation for the fiscal year ended March 31, 1929, inasmuch as it received income from the sale of property during that taxable year.

The taxpayer was incorporated without capital stock under the laws of the State of R. Its purposes are to cultivate and encourage gymnastic and athletic exercise, to promote social intercourse and elevate morals, to cultivate the ——— language and ——— customs, to encourage art and literature by lectures and debates and a hearty support of everything pertaining thereto, to contribute or assist any charitable purpose, and to appropriate funds for such purposes.

The facts presented show that the activities of the organization consist of bowling, dancing, entertainments for members and their families, banquets, pool, and tennis; that its income is derived from membership dues and fees, tennis courts, lockers, bowling alleys, and interest; and that such income is used to defray the expenses of the organization.

It appears that the club acquired a site many years ago in the residential section of the city of S; that the growth of the city made it necessary for the club to remove to a more practical location; that in April, 1928, when the opportunity to do so presented itself, the club sold its property for $16x$ dollars, $6x$ dollars in cash and $10x$ dollars in notes; that a substantial profit resulted from the sale; that part of the cash received was used to erect the present club building; that it would be impossible to operate the club without the interest received on the outstanding notes of $10x$ dollars, as the cost of operating the club is about three times the receipts from dues and fees; and that the income of the club from dues would be far from sufficient to pay its running expenses.

Article 530 of Regulations 74 provides that "If a club, by reason of the comprehensive powers granted in its charter, engages in traffic, in agriculture or horticulture, or in the sale of real estate, timber, etc., for profit, such club is not organized and operated exclusively for pleasure, recreation, or social purposes, and any profit realized from such activities is subject to tax."

It is clearly shown in the instant case that the organization sold property in April, 1928, from which it derived a substantial profit. It is not, therefore, entitled to exemption from Federal income taxation for the fiscal year ended March 31, 1929, or for any subsequent fiscal year, or taxable period, in which the profit from that sale is returnable under the installment method of reporting income.

SECTION 111.—DETERMINATION OF AMOUNT OF GAIN OR LOSS.

ARTICLE 561: Determination of the amount of gain or loss.

REVENUE ACT OF 1928.

Adjustment of basis of property acquired prior to March 1, 1913, for computation of gain or loss from sale. (See G. C. M. 10093, page 72.)

ARTICLE 561: Determination of the amount of gain or loss. XI-16-5450 I. T. 2621

REVENUE ACT OF 1928.

The taxpayer in 1931 sold to the M Company an easement across 160 acres of land for the construction, maintenance, operation, and repair of power transmission lines. The contract for the sale gave the buyer the right of egress and ingress at all times for construction and repair work and the seller the right of farming any part not actually occupied by the lines or equipment.

Held, the amount received for the sale of this easement should be applied against the cost of the 160 acres in determining gain or loss from the subsequent sale or other disposition of the property. If the consideration for the easement exceeded the basis of the 160 acres, then the excess would be taxable income for 1931.

A ruling is requested whether taxable income was realized from the granting of an easement under the following circumstances:

The taxpayer, A, is the owner of approximately 160 acres of land in Indiana which he purchased in 1928. In 1931 the M Company purchased an easement across the land for the construction, maintenance, operation, and repair of one or more power transmission lines. The right of way covered by the easement is 200 feet wide and about 2,800 feet long, comprises approximately 13 acres, and crosses the farm from the northern boundary to the southern boundary.

The contract for the sale of the easement provides that the M Company has the right of egress and ingress at all times for construction and repair work, and that A may farm any part of the land covered by the easement not actually occupied by the transmission lines or their equipment, but may not be reimbursed for any damage to crops planted within the 200-foot strip. The company also reserved the right to remove trees where they interfered in the construction and repair of the power lines.

The question is raised whether the decision of the Board of Tax Appeals in *H. L. Scales* v. *Commissioner* (10 B. T. A., 1024, C. B. X-1, 58) should apply in the instant case.

In the Scales case the Board found that by the terms of the written instrument the petitioner surrendered "perpetual and complete control" of the land granted to the levee improvement district, and that it was useless for purposes of cultivation or grazing because almost always overflowed by water. In the cases relied upon by the Board grants had been made of the exclusive use of the lands, and the grantors were the holders of the naked legal title, reserving to

themselves no beneficial interest in such lands. The Board concluded that the conveyance to the levee improvement district was tantamount to a sale and that the petitioner had no beneficial interest therein.

Whether an instrument is a grant of an easement in particular land, or a transfer of the ownership of such land, with a specification of the user which is expected to be made of the land, is obviously a question of the construction of the language used. (Tiffany on Real Property, volume 2, section 361.)

In the instant case it is evident from the language used in the contract that although the owner of the fee granted the M Company a right of way for the purpose of construction, maintenance, operation, and repair of one or more power transmission lines, the owner reserved to himself the right to use the land covered by the grant for cultivation purposes. The question whether a deed granting a right of way vests an estate in fee to the land described in it was decided by the Indiana court in *Cincinnati, I., St. L. & C. Ry. Co.* v. *Geisel* (119 Ind., 77, 21 N. E., 470). In that case, which was cited with approval by the Indiana courts in *Vandalia R. Co.* v. *Topping et al.* (62 Ind. App., 657, 113 N. E., 421) and *Meyer et al.* v. *Pittsburgh, C., C. & St. L. Ry. Co.* (63 Ind. App., 156, 113 N. E., 443), the court said:

* * * The grant of a right of way is the grant of an easement, and implies that the fee remains in the grantor. A person who has a right of way has nothing more than a right of passage, and can not be the owner of the *corpus* of the land. It is a settled rule that, where the owner of the fee becomes the owner of the easement, the lesser estate is merged in the greater, but where one person owns only the right of way the fee is in the owner of the servient estate.

In view of the facts in the instant case and the legal definition of an easement as recognized by the courts in the above-cited decisions, the contract of sale between A and the M Company is held to be a grant of an easement in land and not a transfer of the ownership thereof. As it appears that A holds more than a naked legal title to the strip of land, and can make use of it for cultivation purposes, the decision in the Scales case is not applicable.

The amount received by A during the year 1931 from the M Company from the sale of this easement should be applied against the cost of the 160 acres in determining gain or loss from the subsequent sale or other disposition of the property. If the consideration for the grant of the easement exceeded the basis for determining gain or loss on the 160 acres affected by the grant, then and in that event the difference between such consideration and the basis for determining gain or loss would be taxable income for the year 1931.

SECTION 112.—RECOGNITION OF GAIN OR LOSS.

ARTICLE 571: Recognition of gain or loss. XI-8-5393
G. C. M. 10235

REVENUE ACT OF 1928.

No gain or loss results, for Federal income tax purposes, through the conversion of certificates of beneficial interest issued by a trust into the underlying stocks constituting the corpus of the trust, in accordance with an option provided for in the trust instrument.

An opinion is requested whether a gain or loss results, for Federal income tax purposes, through the conversion of certificates of bene-

ficial interest issued by the M Trust, an investment trust, into the underlying stocks constituting the corpus of the trust, in accordance with the option provided for in the trust instrument.

The M Trust was created under a trust agreement executed on January —, 1929, and is taxable as a trust and not an association.

By the trust agreement the N Company, a State of R corporation (referred to in the agreement as depositor), deposited with the trustee common stocks of different corporations, which stocks the depositor had acquired with its own funds. It divided these stocks into units of 4 shares of stock of each of y specified corporations. Each unit, together with a certain amount of cash, was deposited in trust with the trustee by the depositor, against which the trustee issued to the depositor bearer certificates representing a total of 4,000z M Trust shares, each trust share thus constituting an undivided $\frac{1}{4000}$ of the beneficial interest in the respective deposited unit. These certificates were countersigned by the depositor, and were ultimately sold to the public at a price based on the market price of the fixed underlying stocks. The trust agreement contains the form of the certificate so issued, indicating that the bearer is the owner of M Trust shares, each share representing $\frac{1}{4000}$ interest in (1) a stock unit consisting of 4 shares of stock of each of the specified companies and (2) the proportion of the reserve fund and other property which may be held by the trustee from time to time.

This certificate provides further as follows:

> The bearer of any such certificate or certificates representing an aggregate of 1,000z M Trust shares or any multiple thereof at his option, and upon the expiration of such time as the trustee shall with reasonable diligence require for the transfer of the shares of stock involved, upon reimbursing the trustee for its actual expenses in connection with the transfer and upon such surrender to the trustee of such certificates with all unmatured coupons, shall be entitled to receive such part of the deposited property held by the trustee on the date of surrender (not then distributable with respect to matured coupons) as shall bear the same proportion to all such deposited property (not then distributable with respect to matured coupons) as the number of M Trust shares represented by such certificate or certificates shall bear to the total number of M Trust shares then outstanding. Any fractional interest in securities or other property is to be adjusted in cash as provided in the agreement; provided, however, that if the number of M Trust shares represented by such certificate or certificates shall not be evenly divisible by 1,000 the depositor shall have the option to purchase the certificate or certificates representing such part of the stock unit and any cash and other property deliverable therewith by paying to such bearer a sum equal to such cash and the market value of such part of the stock unit and other property (as in the agreement defined) on the day next succeeding the date of surrender (excluding any day on which the O Stock Exchange is closed).

The certificate elsewhere provides that "This certificate represents the right to receive securities in certain events as provided in the agreement."

The foregoing provisions contained in the certificate are, in effect, a summary of certain provisions contained in the trust agreement, whereby the holder of certificates may terminate the trust relationship in so far as he is concerned and receive his interest in cash, or, if he holds certificates representing an aggregate of 1,000z trust shares or any multiple thereof, may, at his option, receive his proportionate share of the underlying securities.

It appears that certain holders of the trust certificates are now exercising their rights under the trust agreement and under the

conditions set forth in their certificates, and are claiming and receiving their proportionate share of the underlying securities constituting the particular stock unit represented by their certificates. It appears that such certificate holders are the owners of certificates representing 1,000*z* trust shares (that is, one-fourth of a stock unit) or a multiple thereof.

It is clear that when an investor purchases the certificate he not only purchases an equitable interest in the underlying securities constituting a stock unit, but also acquires a fixed right to terminate the trust relationship, as far as he is concerned, together with the right to demand and to receive, under certain conditions, his proportionate share of the securities constituting the particular stock unit. When he exercises that right and claims the securities he does not transfer anything to the trustee (other than the proper transfer fees called for by the trust agreement). On the contrary, he terminates the trust relationship and demands and receives the legal title to securities to which he had theretofore only an equitable title. He sells nothing to the trust. He disposes of nothing. He simply terminates the trust relationship, whereupon the trustee transfers to him the legal title to the securities to which he already had a right by the terms of the agreement. It is true that the certificate holder surrenders to the trustee the certificate evidencing his equitable title, but such surrender is evidential only of the termination of the trust relationship. The surrender does not convey to the trustee the holder's equitable title in the securities. He retains such equitable title and receives in addition the legal title from the trustee, thus merging in one title the legal and equitable interest in the securities. Such surrender of the certificate (or certificates) and the receipt of the securities do not constitute a sale or an exchange or other disposition of property so as to make the transaction a taxable transaction involving gain or loss for Federal income tax purposes.

This case is clearly distinguishable from that of *Allen* v. *Commissioner* (49 Fed. (2d), 716, Ct. D. 417, C. B. X–2, 315, certiorari denied 52 S. C., 34). In that case the Knickerbocker Trust Co. of New York merged with another bank and the two became a third. The Knickerbocker Trust Co.'s assets were divided into three parts, "Schedules A, B, and C." The new bank took "Schedules A and B" outright. "Schedule C" was placed in trust to secure the bank against any unknown debts of the Knickerbocker Trust Co. and against any shrinkage in the assets represented by "Schedule B" below their appraised value. The trust was to continue for two years, after which the trustee was to liquidate the assets and distribute the residue among the holders of "beneficial certificates" which were issued to the Knickerbocker Trust Co. shareholders, and were transferable at will. The plaintiff, a shareholder in the Knickerbocker Trust Co., received some of these certificates, and bought others. Meanwhile the trustee had made a series of cash distributions, leaving among the undistributed assets some shares of stock in another company, and a large mortgage. The trustee, on liquidating the trust, believed that the remaining assets were not salable at their proper value, and during 1922 distributed the stock ratably among the holders of "beneficial certificates" and also distributed likewise "mortgage participation certificates" in the mortgage. The

plaintiff did not sell the stock and mortgage certificates in the year received, 1922, and therefore did not enter any profit on them in his return for that year. The Commissioner treated them as gain in that year at the value the plaintiff had entered them in his books, because the earlier distributions by the trustee had redeemed the cost or other basis of the "beneficial certificates."

The United States Board of Tax Appeals upheld the position taken by the Commissioner. (See *Benjamin L. Allen* v. *Commissioner*, 19 B. T. A., 1005.) On appeal, the Circuit Court of Appeals affirmed the Board's decision on the ground that the receipt by the plaintiff of the securities in kind effected a substantial change in the beneficiary's interest, gave him a new command over the securities, and thus rendered the transaction one involving gain or loss for Federal income tax purposes. It is quite apparent, however, that the plaintiff, in receiving the "beneficial certificates" as a stockholder of the Knickerbocker Trust Co., or in purchasing additional ones, did not acquire a right to receive anything in kind, on demand, as in the instant case. This right, clearly set forth in the terms of the certificates in the present case, presents a very different situation and distinguishes the instant case from the case above referred to.

Nor is the surrender of the certificates in the instant case and the receipt of the underlying securities analogous to the redemption of stock by a corporation in complete or partial liquidation, which is usually treated as a sale by the stockholder of his shares to the corporation. When a stockholder acquires stock, he does not acquire the right to terminate individually his relationship as stockholder by presenting his certificates for redemption, as the beneficiary does in the instant case. Nor does the stockholder, in acquiring a certificate of stock, acquire the right to any specific assets of the corporation, as does the beneficiary of the instant trust. The beneficiary in this case, in acquiring the certificate of beneficial interest, acquires not only the equitable title to an undivided interest in the trust corpus, but also acquires the right to demand and receive a portion of the securities forming part of the corpus of the trust. After exercising that right to demand and receive the specific securities, the beneficiary is no richer nor poorer than he was before. He has simply reduced to possession that to which he was entitled under the terms of the trust agreement and under the conditions of his certificate. The transaction is, therefore, not one resulting in gain or loss for Federal income tax purposes.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

ARTICLE 579: Involuntary conversion of property. XI–18–5467
I. T. 2623

REVENUE ACT OF 1928.

In the case of an involuntary conversion of property the net amount of the award was $4.72x$ dollars, the March 1, 1913, value $1.92x$ dollars, the tentative gain $2.80x$ dollars, and the replacement expenditures $2.52x$ dollars.

Held, that under section 112(f) of the Revenue Act of 1928 the gain recognized "in an amount not in excess of the money which is not so expended" is $2.20x$ dollars.

A ruling is requested whether the method of computing the profit derived from a transaction falling within section 112(f) of the

Revenue Act of 1928 is the same as under the corresponding provision of the Revenue Act of 1921.

It is contended that under the Revenue Act of 1928 a profit from an involuntary conversion of property, where the taxpayer has expended only a part of the proceeds in purchasing similar property, is determined in accordance with the same procedure as was followed under the Revenue Act of 1921.

According to the figures submitted, the sum of $4.72x$ dollars represented the net amount of the award. The March 1, 1913, value of the property was $1.92x$ dollars, with the result that the sum of $2.80x$ dollars was the tentative gain. The replacement expenditures amount to $2.52x$ dollars, leaving a balance of $2.20x$ dollars unexpended.

Section 112(f) of the Revenue Act of 1928 provides in part:

* * * If any part of the money is not so expended, the gain, if any, shall be recognized, but in an amount not in excess of the money which is not so expended.

Section 203(b)5 of the Revenue Acts of 1924 and 1926 contains the same provision.

It will be noted from the language used in section 112(f), supra, that if the entire proceeds from the compulsory or involuntary conversion of property are not expended in replacement, the gain, if any, is recognized from the transaction but "in an amount not in excess of the money which is not so expended." The Revenue Act of 1921 was different in this respect. Under section 214(a)12 and section 234(a)14 of the Revenue Act of 1921 the taxable gain from an involuntary conversion consists of only a part of the actual gain where the entire proceeds are not expended in replacement. In other words, the gain from the transaction is included in gross income, but there is allowed as a deduction "such portion of the gain derived" as the portion of the proceeds expended in replacement bears to the entire proceeds.

Under the Revenue Acts of 1924, 1926, and 1928 taxable gain can not exceed the amount of the unexpended balance. As the instant case arose under the Revenue Act of 1928 and the actual gain was $2.80x$ dollars, the taxable gain is limited to $2.20x$ dollars, which is the unexpended balance of the proceeds of the sale. (See article 601 of Regulations 74.)

SECTION 113.—BASIS FOR DETERMINING GAIN OR LOSS.

ARTICLE 591: Basis for determining gain or loss from sale. XI–3–5360 G. C. M. 10093

(Also Section 111, Article 561.)

REVENUE ACT OF 1928.

In determining the basis for computing gain or loss from the sale of property acquired prior to March 1, 1913, before cost is compared with the March 1, 1913, value under section 111(b) of the Revenue Act of 1928, the original cost is to be (a) adjusted by all expenditures, receipts, losses, or other items properly chargeable to capital account, in respect of any period prior to March 1, 1913, and (b) diminished in the amount of exhaustion, wear and tear, obsolescence, and depletion actually sustained before March 1, 1913.

The opinion of this office is requested relative to the "basis" to be used under the Revenue Act of 1928 in computing gain or loss from the sale of a building acquired prior to March 1, 1913, the original cost of which is greater than the fair market value as of March 1, 1913, but the cost of which, reduced by depreciation actually sustained before March 1, 1913, is less than the fair market value as of March 1, 1913.

The relevant provisions of the Revenue Act of 1928 are:

SEC. 111. DETERMINATION OF AMOUNT OF GAIN OR LOSS.

(a) *Computation of gain or loss.*—Except as hereinafter provided in this section, the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the basis provided in section 113, and the loss shall be the excess of such basis over the amount realized.

(b) *Adjustment of basis.*—In computing the amount of gain or loss under subsection (a)—

(1) Proper adjustment shall be made for any expenditure, receipt, loss, or other item, properly chargeable to capital account, and

(2) The basis shall be diminished by the amount of the deductions for exhaustion, wear and tear, obsolescence, amortization, and depletion which have since the acquisition of the property been allowable in respect of such property under this Act or prior income tax laws; but in no case shall the amount of the diminution in respect of depletion exceed a depletion deduction computed without reference to discovery value under section 114(b)2 or to percentage depletion under section 114(b)3. In addition, if the property was acquired before March 1, 1913, the basis (if other than the fair market value as of March 1, 1913) shall be diminished in the amount of exhaustion, wear and tear, obsolescence, and depletion actually sustained before such date, and * * *.

SEC. 113. BASIS FOR DETERMINING GAIN OR LOSS.

* * * * * * *

(b) *Property acquired before March 1, 1913.*—The basis for determining the gain or loss from the sale or other disposition of property acquired before March 1, 1913, shall be:

(1) the cost of such property (or, in the case of such property as is described in subsection (a) (1), (4), (5), or (12) of this section, the basis as therein provided), or

(2) the fair market value of such property as of March 1, 1913, whichever is greater. * * *

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

(a) *Basis for depreciation.*—The basis upon which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the same as is provided in section 113 for the purpose of determining the gain or loss upon the sale or other disposition of such property.

(b) *Basis for depletion.*—

(1) *General rule.*—The basis upon which depletion is to be allowed in respect of any property shall be the same as is provided in section 113 for the purpose of determining the gain or loss upon the sale or other disposition of such property, except as provided in paragraphs (2) and (3) of this subsection. * * *

The issue presented comes down to this: When is the comparison, prescribed by section 113(b), between cost and fair market value as of March 1, 1913 (to determine which is the greater), to be made? The Income Tax Unit suggests three alternatives, under each of which a computation is made showing the results. Under the first, designated herein as method 1, the comparison is made initially, that is, original cost (without any adjustment whatever for depreciation) is compared with the fair market value as of March 1, 1913, to determine which is the greater. The greater is then adjusted for depreciation conformably to section 111(b)2, and the result is compared with the amount realized from the sale or other disposition of the property, in order to determine the gain or loss under section 111(a).

The second, designated herein as method 2, diminishes original cost by depreciation sustained prior to March 1, 1913, and by depreciation allowable thereafter (net cost); diminishes the fair market value as of March 1, 1913, by depreciation allowable thereafter (net value as of March 1, 1913), and compares the remainders (net original cost and net value as of March 1, 1913) with each other to determine which is greater. The greater is then compared with the amount realized, in order to determine the gain or loss under section 111(a).

The third, designated herein as method 3, diminishes original cost by depreciation sustained prior to March 1, 1913, and then compares the remainder (cost adjusted to March 1, 1913) with the fair market value as of March 1, 1913; to determine which is the greater. The greater is then compared with the amount realized, in order to determine the gain or loss under section 111(a).

If the statute is read with close literalness, method 1 is that prescribed by it. "Section 111. * * * (a) * * * the gain from the sale * * * of property shall be the excess of the amount realized therefrom over the basis provided in section 113 * * *." "Section 113. * * * (b) * * * The basis * * * shall be: (1) the cost of such property * * *, or (2) the fair market value of such property as of March 1, 1913, whichever is greater. * * *" "Section 111. * * * (b) * * * In computing the amount of gain or loss under subsection (a) [of section 111]— * * * (2) * * * the basis (if other than the fair market value as of March 1, 1913) shall be diminished in the amount of exhaustion, wear and tear, obsolescence, and depletion actually sustained before such date * * *."

The statute thus literally says in section 111(a) that it is "the basis provided in section 113" which is to be compared with the amount realized in order to determine gain or loss; in section 113 that "the basis * * * shall be * * * (1) the cost * * *, or (2) the fair market value of such property as of March 1, 1913, whichever is greater"; and in section 111(b) that, in the computation under section 111(a), the basis provided in section 113 "shall be diminished in the amount of exhaustion, wear and tear, obsolescence, and depletion actually sustained before" March 1, 1913.

That portion of section 111(b)2 here relevant (the last sentence thereof) is identical with the last sentence of section 202(b)2 of the Revenue Act of 1926, and appeared in the latter Act for the first time. The legislative history of the bill which became the Revenue Act of 1926 throws little light on the present question. There was no discussion of the provision in the debates in either House, although the report of the committee in each House in charge of the bill contains the following explanations:

Section 202(b): When property was acquired prior to March 1, 1913, the present law provides that in the case of a sale of such property the basis for determining gain or loss shall be cost or March 1, 1913, value, whichever is higher; and also provides that in making adjustments for depreciation, etc., proper adjustment shall be made for depreciation, etc., "previously allowed." Owing to the fact that there was no income tax prior to March 1, 1913, in cases where property was acquired prior to that date no depreciation has been "allowed," and the taxpayer may receive too large a basis for determining gain or loss. The amendment proposed provides that the deductions for depreciation, etc., to be made in such cases shall be such deductions as were actually

sustained with respect to such property, which would include such depreciation as had occurred prior to that date. (Sixty-ninth Congress, first session, Senate Report No. 52, page 15, submitted by Mr. Smoot, Committee on Finance, January 16, 1926; House Report No. 1, page 5, submitted by Mr. Green, Committee on Ways and Means, December 7, 1925.)

It may be noted that this language of the committee reports not only is not inconsistent with, but also contradicts in no particular, the literal language of the statute.

Method 2, which would adjust cost for all depreciation sustained prior to March 1, 1913, and for all depreciation allowable thereafter, and would adjust the March 1, 1913, value for all depreciation allowable thereafter, and then compare the two net amounts resulting, finds no support in the language or purpose of the statute. The development, both in the Revenue Acts and in the judicial decisions construing them, of March 1, 1913, as a basic date seems wholly inconsistent with method 2.

Method 2 makes unworkable section 23(k), prescribing a reasonable allowance for depreciation, and section 114(a) of the Revenue Act of 1928, prescribing that the basis for depreciation is the same as the basis for determining gain or loss. These provisions require currently in each year an allowance for depreciation, but if method 2 is valid, the basis for such an allowance must remain unknown until the property is sold or disposed of. The intention to create such a cul-de-sac in the law can not be imputed to Congress.

The use of method 2 creates another anomaly. Since section 111(b)2 requires adjustment of the basis for depreciation allowable, and the depreciation allowable is itself dependent upon the basis, even where the property has been sold, the determination of the basis becomes either an elaborate algebraic equation or a double set of complex computations.

Method 2, being wholly wanting in either plausibility or rationality, would merit little consideration were it not for the circumstance that seemingly it was used and approved by the Board of Tax Appeals in its computations and decisions in *Noaker Ice Cream Co.* v. *Commissioner* (9 B. T. A., 1100) and *Title Insurance & Trust Co.* v. *Commissioner* (11 B. T. A., 288, C. B. VII–2, 39). In the former case, the Board said, inter alia: "In view of the foregoing, we are of the opinion that only by taking into consideration depreciation sustained both prior and subsequent to March 1, 1913, on *cost*, can we obtain a true depreciated cost which we can compare with the depreciated March 1, 1913, value for the purpose of determining a deductible loss in 1918 of assets acquired prior to March 1, 1913." And in *Title Insurance & Trust Co.*, the Board said, inter alia: " * * * in computing the amount of the loss sustained, the building should be depreciated from date of acquisition to date of disposition."

It is to be noted *first*, that in both decisions the Board was dealing with the application of the Revenue Act of 1918, under which the depreciation allowable was in the same amount, and, hence, the adjustment of cost or March 1, 1913, value was in the same amount, whether cost or March 1, 1913, value was to be taken as the basis for gain or loss (the Board's computation would, therefore, be correct upon the facts presented even though method 2 was used); and, *second*, the Board was applying the rule of *United States* v. *Flannery*

(268 U. S., 98, T. D. 3703, C. B. IV–1, 106), wherein it was stated that "the provision in reference to the market value on March 1, 1913, was applicable only where there was such an actual gain or loss, that is, that this provision was merely a limitation upon the amount of the actual gain or loss that would otherwise have been taxable or deductible," and not the rule of section 113(b), that the basis is cost or 1913 value, "whichever is greater." It is believed that the question here raised was wholly irrelevant in the two Board cases, and that the language of the Board can not properly be construed as passing upon it. The Board's true thought, it is believed, appears in its quotation in *Noaker Ice Cream Co.* (cited supra), from its decision in *Appeal of Even Realty Co.* (1 B. T. A., 355) as follows: "The same considerations that lead us to the conclusion that adjustment for recoveries of capital by allowance for exhaustion, wear and tear, and obsolescence must be made in computing gain upon the sale of property, compel us to the belief that similar *adjustments should be made to cost before comparing it with value on March 1, 1913*, for the purpose of deciding which of them should be the *basis* for that computation." [Italics supplied.]

This office has found nowhere, either in the legislative history or in any board or court decisions construing any of the Revenue Acts, anything to suggest that the intent of the Revenue Act of 1928 was to tax the least gain and allow the greatest loss. Finding nowhere any support for the use of method 2, this office is of the opinion that it is not in accord with the above-quoted provisions of the Revenue Act of 1928.

Method 3 proceeds upon the premise "that adjustment for recoveries of capital by allowance for exhaustion, wear and tear, and obsolescence must be made * * * to cost before comparing it with value on March 1, 1913, for the purpose of deciding which of them should be the *basis* for that computation." (*Even Realty Co.*, cited supra.) While the provisions of section 204(b) of the Revenue Act of 1924, section 204(b) of the Revenue Act of 1926, and section 113(b) of the Revenue Act of 1928 have abrogated the rule of *United States* v. *Flannery*, supra, and *McCaughn* v. *Ludington* (286 U. S., 106; T. D. 3705, C. B. IV–1, 110), there is not the faintest indication or suggestion, either in the statute or the circumstances attending its passage, that these provisions or section 202(b)2 of the Revenue Act of 1926 or section 113(b) of the Revenue Act of 1928 were intended to abrogate the rule that gain received by a taxpayer "attributable to and accrued during the period before the effective date of the sixteenth amendment (February 25, 1913), and of the first law taxing the income of individuals (March 1, 1913), * * *, for income tax purposes, must be deemed an accretion to capital not taxable by the income tax Acts enacted under the sixteenth amendment." (See *Lucas* v. *Alexander*, 279 U. S., 573, Ct. D. 76, C. B. VIII–2, 273; citing *Southern Pacific Co.* v. *Lowe*, 247 U. S., 330; *Doyle* v. *Mitchell Bros. Co.*, 247 U. S., 179, and *Lynch* v. *Turrish*, 247 U. S., 221.)

The legislative history of the provision which is now section 111(b)2 of the Revenue Act of 1928 clearly shows that the intention of this provision was to prevent taxpayers being given a double allowance for return of capital through failure to bring into the compu-

tation the depreciation sustained prior to March 1, 1913 (a constructive return of capital by virtue of use and enjoyment). (Cf. *United States* v. *Ludey*, 274 U. S., 295. T. D. 4046, C. B. VI–2, 157.) Nothing could have been further from the congressional intent than to have these provisions, when construed with the provisions of section 113(b), operate so as to tax, either in whole or in part (even though the part be a small one), gains attributable to and accrued before March 1, 1913.

Method 1, by comparing original cost (without any adjustment for depreciation sustained prior to March 1, 1913) with March 1, 1913, value, results in particular cases in the taxation as income of gain which is attributable to and accrued prior to March 1, 1913. It is true, so far as the particular facts here under consideration are concerned, that method 1 operates only where the appreciation in market value between the date of acquisition and March 1, 1913, does not exceed the depreciation sustained during that period, but the Supreme Court has made it clear that violation of March 1, 1913, values is not to be permitted, even though such violations are casual and incidental. In *Lucas* v. *Alexander* (cited supra) the court said:

> But of this total gain received by the insured, a part is attributable to and accrued during the period before the effective date of the sixteenth amendment (February 25, 1913), and of the first law taxing the income of individuals (March 1, 1913), and hence, for income tax purposes, must be deemed an accretion to capital not taxable by the income tax Acts enacted under the sixteenth amendment. (See *Southern Pacific Co.* v. *Lowe*, 247 U. S., 330, 334; cf. *Doyle* v. *Mitchell Bros. Co.*, 247 U. S., 179; *Lynch* v. *Turrish*, 247 U. S., 221.) Whether or not such accretions may be constitutionally subjected to tax, we have no occasion to decide. The present Act, at least, does not attempt it. But the question presented necessarily involves a determination of what part of the total gain received by the taxpayer accrued to him after March 1, 1913. In answering it, provisions of the taxing statute enacted as aids in arriving at the answer must be construed with an eye to possible constitutional limitations so as to avoid doubts as to its validity. (*United States* v. *Delaware & Hudson Co.*, 213 U. S., 366, 407, 408; *United States* v. *Standard Brewery*, 251 U. S., 210, 220; *Texas* v. *Eastern Texas R. R. Co.*, 258 U. S., 204, 217; *Bratton* v. *Chandler*, 260 U. S., 110, 114; *Panama R. R. Co.* v. *Johnson*, 264 U. S., 375, 390.)

Method 3 alone fails to violate the principles thus laid down by the Supreme Court. Method 2 is untenable in any event, and hence, method 1 alone requires consideration. The violation of March 1, 1913, values by method 1 is not, however, casual and incidental. Method 1, as has been noted supra, rests upon the premise that sections 111 (a) and (b) and 113(b) require the comparison of original cost with March 1, 1913, value, the selection of the greater as "the basis," and the diminution of "the basis," if cost, by depreciation sustained prior to March 1, 1913. If this be true, it is equally plain that sections 111 (a) and (b) and 113(b) require the comparison of original cost with March 1, 1913, value, the selection of the greater as "the basis," and the increase or diminution, as the case may be, of "the basis" by not only depreciation sustained prior to March 1, 1913, but also by "any expenditure, receipt, loss, or other item properly chargeable to capital account" in respect of any period prior to March 1, 1913.

While it is possible under this view to regard the cost of additions to the property as a part of cost and, therefore, to be added to cost before comparing it with March 1, 1913, value, it seems impossible to

add to cost any other charge to capital account (prior to making the comparison with March 1, 1913, value). It would also seem quite impossible to diminish cost by any receipts prior to March 1, 1913, by way of partial recovery (prior to making the comparison with March 1, 1913, value). In other words, the same premise, which alone can sustain method 1, requires that the same interpretation be given the whole of section 111(b) and, under it, no account can be taken either of depreciation, depletion, or capital account items in respect of the period prior to March 1, 1913. Under this interpretation, prime original cost, unadjusted in any respect, must literally be compared with March 1, 1913, value. This interpretation would, in particular cases, violate both the rule declared in *Lucas* v. *Alexander* (cited supra) and the cases therein cited, and also the more fundamental rule of *Goodrich* v. *Edwards* (255 U. S., 527, T. D. 3174, C. B. 4, 40) and *Walsh* v. *Brewster* (255 U. S., 536, T. D. 3176, C. B. 4, 41), that gains, and gains alone, were intended to be taxed by the Federal income tax laws.

However facile such an interpretation might be, it is impossible to suppose that Congress intended such an absurd result. Rather, the intention was that the comparison was to be made between two comparables, not two incomparables. The development through the various Revenue Acts, and through Board of Tax Appeals and court decisions, of the provisions of section 111 of the Revenue Act of 1928, does not support the conclusion that the term "basis" means a specific amount or sum. Neither does it support the conclusion that Congress was attempting to lay down either arithmetical processes or their order. Rather, the intention was to use the term "basis" to mean the datum or starting point, and to make it clear, beyond peradventure of doubt, by section 111 that, consistently with the full recognition, both of March 1, 1913, values and the taxation of real gains, the constituent elements of any sound or scientific computation must be brought into account. The statute is concerned with principles, and not with arithmetical details, and the language therein is not to be construed as prescribing the details or the order of the mathematics to be used in its application. To override principles as old as the Federal income tax itself, particularly when to do so raises constitutional doubts, requires language unmistakable in meaning; and an intention to violate such basic principles can not be derived from mere cross references and the mere order of words in the statute.

This office is of the opinion that before cost is to be compared with March 1, 1913, value, under section 111(b), cost (prime original) is to be (a) adjusted by all expenditures, receipts, losses, or other items properly chargeable to capital account, in respect of any period prior to March 1, 1913, and (b) diminished in the amount of exhaustion, wear and tear, obsolescence, and depletion actually sustained before March 1, 1913. Method 3 alone does this, and, for that reason, this office believes it alone is consistent with law.

The computation in this case should, therefore, be made in accordance with method 3.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

ARTICLE 591: Basis for determining gain or loss from sale.

REVENUE ACT OF 1928.

Stock fire and marine insurance corporation's gain during taxable year from the sale or other disposition of property acquired before January 1, 1928. (See Ct. D. 496, page 124.)

ARTICLE 596: Property transmitted at death. XI–13–5424
G. C. M. 10260

REVENUE ACT OF 1928.

Basis for determining gain or loss from the sale of personal property acquired by will.

An opinion is requested relative to the basis for determining gain or loss from the sale of personal property which came to the children of A under the wills of B, C, and A, respectively.

I.

B died in 1880. Her will reads in part as follows:

Item 2. To my son, D, I give, devise, and bequeath the property in this item set forth, in trust however for the uses and purposes also hereinafter expressed.

First. [A certain described tract of land.]

Second. All my shares of the capital stock of the M Company, being 1.32y shares, more or less.

Third. The sum of 9.01x dollars in cash.

Fourth. The one-fourth part of any sum that may be received by the executors of my will in payment of the whole or any part of the debt due to me from my sister, E, and her husband, F.

The property in this item above mentioned is devised and bequeathed to my said son * * * in trust * * * for the following uses and purposes, viz: to rent said real estate * * *, or to sell and convey the same * * * as to him shall seem fit; to collect the income from said stock, or to sell the same * * * in his discretion * * *; to invest * * * the said moneys, and the moneys arising from the sale of said real estate or stock, should he see fit to sell * * *; to collect the rents, income, or interest * * *, and the same to apply as follows, viz, to pay the same over in quarterly payments * * * to my daughter, A, * * * during her natural life * * *; and in trust, further, should my said daughter die leaving lawful issue living, to pay said income * * * to said issue, share and share alike, * * * counting as one such the lawful issue of any deceased child of hers, until the youngest person of those entitled to a portion of said income * * * reaches the age of 21 years, whereupon said trustee is directed to convey, assign, transfer, or deliver absolutely to said issue then living, share and share alike, counting as one the lawful issue of any deceased child of my said daughter, all of the real estate, securities, or moneys or stocks then in his hands under the trust.

But if my said daughter should die leaving no lawful issue living, or if her said lawful issue living at her death should all die before the youngest reaches the age of 21 years, then all the property * * * shall go to and form part of my residuary estate * * *.

It appears that A died on June —, 1926, leaving seven children living, all of whom had then attained the age of 21 years. The corpus of this trust was delivered to them "as soon as possible" thereafter, and such delivery was completed by May —, 1927.

As there is no evidence that those beneficiaries sold any of such property prior to 1928, it is only necessary to consider the method of

ascertaining the basis for determining gain or loss under the Revenue Act of 1928. Section 113 of that Act provides in part as follows:

(a) *Property acquired after February 28, 1913.*—The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; except that—

* * * * * * *

(5) PROPERTY TRANSMITTED AT DEATH.—If personal property was acquired by specific bequest, or if real property was acquired by general or specific devise or by intestacy, the basis shall be the fair market value of the property at the time of the death of the decedent. If the property was acquired by the decedent's estate from the decedent, the basis in the hands of the estate shall be the fair market value of the property at the time of the death of the decedent. In all other cases if the property was acquired either by will or by intestacy, the basis shall be the fair market value of the property at the time of the distribution to the taxpayer. * * *

* * * * * * *

(b) *Property acquired before March 1, 1913.*—The basis for determining the gain or loss from the sale or other disposition of property acquired before March 1, 1913, shall be:

(1) the cost of such property (or, in the case of such property as is described in subsection (a) (1), (4), (5), or (12) of this section, the basis as therein provided), or

(2) the fair market value of such property as of March 1, 1913, whichever is greater. * * *

The first question is whether the children of A (the grandchildren of the testatrix) "acquired" the property before March 1, 1913. It is concluded that the answer is in the negative, and for two reasons: First, there is no evidence that all of the grandchildren were in being prior to that date, and any person not yet in being obviously could not acquire property; in the second place, their interests were wholly contingent under the law of Pennsylvania until the death of their mother in 1926 (*In re Adams' Estate*, 208 Pa., 500, 57 Atl., 979; *In re Alburger's Estate*, 274 Pa., 15, 117 Atl., 452); and the position of this office has been that one who has a mere contingent interest does not "acquire" the property in question until his interest becomes vested. (O. D. 727, C. B. 3, 53; S. M. 4640, C. B. V–1, 60.) (See also I. T. 1622, C. B. II–1, 135; S. O. 35, C. B. 3, 50.)

Since the children did not acquire their property until after February 28, 1913, and the property was sold during 1928, the basis for determining gain or loss from the sale of such property is governed by section 113(a)5 of the Revenue Act of 1928.

The next question is whether the basis is to be computed under the first or under the third sentence of section 113(a)5, or partly under one sentence and partly under the other. Although a portion of the corpus of the trust consisted of realty, the only question in the instant case is with respect to the basis of the personalty. Nevertheless, as the first sentence of section 113(a)5 appears on its face to deal with specific bequests, the further question arises whether any part of the personalty in question was the subject of a specific bequest. Clearly, the bequest of "the sum of $9.01x$ dollars in cash," without designating any particular $9.01x$ dollars, is a general legacy. (Schouler on Wills, Executors, etc., 5th ed., 1461.) On the other hand, the bequest of "all my shares of the capital stock of the M Company, being $1.32y$ shares, more or less," appears to be a specific legacy because the intention is evidently to bequeath the identical shares of stock in that corporation which the decedent would own at her death. (Schouler, ibid.) Likewise, the bequest of "one-

fourth part of any sum that may be received by the executors * * * in payment of * * * the debt due to me from my sister, E, and her husband, F," seems to be a specific bequest, because it is a bequest of a portion of a specific fund. (Schouler, ibid.)

The fact that the testamentary trustee had power to sell all of the trust corpus and reinvest the proceeds, so that the beneficiaries might ultimately get possession only of the proceeds of the particular thing bequeathed, rather than possession of the thing itself, is of course immaterial in this connection. (See *Moffatt* v. *Heon*, 242 Mass., 201, 136 N. E., 123; *In re Martin*, 25 R. I., 1, 54 At., 589; *Connecticut Trust & Safe Deposit Co.* v. *Hollister*, 74 Conn., 228, 50 At., 750; *Pennsylvania Co.* v. *Riley*, 89 N. J. Eq., 253, 104 At., 225.) Indeed, it is customary for most purposes to regard the testamentary trustee, rather than the cestui que trust, as technically constituting the "legatee" (see *Logan's Estate*, 131 N. Y., 456, 30 N. E., 485; *Crawford* v. *Mound Grove Cemetery Assn.*, 218 Ill., 399, 75 N. E., 998; *Lockman* v. *Reilly*, 95 N. Y., 64); and under that view it becomes doubly immaterial whether the cestui que trust secures the identical property bequeathed. In any event, the trustee certainly represents the cestui for the purpose of deciding whether a bequest is general or specific.

There is no evidence whatever whether anything was recovered by the executors of B on the debt due from the decedent's sister and her husband. If anything was recovered, presumably the trustee invested the one-fourth part of it in suitable property for the trust. Furthermore, there is no evidence whether the trustee, during the 46 years of the trust's existence, sold any of the land or any of the shares of M Company stock and reinvested the proceeds in other property, or simply retained the original corpus until 1926. However, under the position that will be taken in this memorandum it is immaterial what happened in these respects, and this fact will be shown at a later point herein.

For the present, it will be assumed, merely for the sake of argument, that the shares of M Company stock were delivered to the beneficiaries in kind on the termination of the trust in 1926. Under this assumption, it would appear at first glance that the basis of such shares, when sold by the beneficiaries in 1928, would be the fair market value of such shares at the time of the decedent's death in 1880. It has already been pointed out that they were not "acquired" by the beneficiaries prior to March 1, 1913, and that consequently the basis must be governed by section 113(a)5, rather than by section 113(b). The first sentence of section 113(a)5 states that if personal property was acquired by specific bequest, the basis shall be the fair market value of the property at the time of the death of the decedent, which event occurred, in the instant case, in 1880. Nevertheless, it is entirely clear that Congress can not have intended such cases as the instant case to be governed by the first sentence of section 113(a)5, because both the Senate Finance Committee report and the conference committee report specifically state that the first sentence of the subsection was intended to apply to those cases where the beneficiary secures *substantial ownership at the decedent's death.*

Referring to the cases covered by the first sentence of section 113(a)5, the conference committee report states (p. 14):

* * * In these cases it may be said, as a matter of *substance*, that the property for all practical purposes vests in the beneficiary *immediately upon the decedent's death*, and *therefore* the value at the date of death is a proper basis for the determination of gain or loss to the beneficiary. * * * [Italics supplied.]

The Senate Finance Committee report is identical in this respect (p. 26).

In the instant case it is evident that the property did not, "as a matter of substance," vest in the grandchildren "immediately upon the decedent's death." In the first place, it may be that none of the grandchildren was in being in 1880, and if not in being the property could not have vested in them. But even if they were in being at that time, their interests were most insubstantial because they were entirely contingent upon their continuing to be alive at the death of their mother, which did not occur until 46 years later. The committee reports therefore afford the strongest kind of evidence that the first sentence of section 113(a)5 was not intended to cover cases like the instant case.

However, it is not necessary to rely solely on the committee reports. The very spirit and purpose of section 113(a)5, as revealed not only by the committee reports but also by its own language and legislative history, are to fix the basic date at, and not before, the time substantial ownership is acquired by the particular taxpayer in question. When Congress enacted the Revenue Act of 1928, the Supreme Court had not yet decided in *Brewster* v. *Gage* (280 U. S., 327, Ct. D. 148, C. B. IX–1, 274) that a residuary legatee in fee simple "acquires" his property at the date of the decedent's death. On the contrary, the Board of Tax Appeals and Court of Claims in the Matthiessen case (2 B. T. A., 921, C. B. VII–1, 39; 65 Ct. Cls., 484) and the District Court for the Western District of New York in the Brewster case (25 Fed. (2d), 915), had decided that a residuary legatee does not "acquire" his property until the time of the "distribution" of the residue to such legatee. The principal ground of these decisions was that prior to "distribution" the claim of a residuary legatee is too insubstantial to constitute an acquisition of property by him; that, on the decedent's death he acquires no *specific* property, but only a general right to whatever may remain after all the debts and expenses and other legacies are paid. The third sentence of section 113(a)5 is a recognition of these decisions in statutory form, and it applies the principle not only to residuary legatees but also to all general legatees, to all distributees of the personal property of an intestate, and to any property purchased by the executor and distributed to the beneficiaries. (See committee reports referred to above.) But with respect to the ordinary devisee or heir of land and the specific legatee of personalty, Congress refused to apply the principle that "distribution" is essential to acquisition, because "in these cases [state the committees] it may be said, as a matter of substance, that the property for all practical purposes vests in the beneficiary *immediately* upon the decedent's *death*, and *therefore* the value at date of death is a proper basis * * *." [Italics supplied.]

The heir, devisee, and specific legatee are, of course, also subject to the possibility of receiving nothing if the decedent's debts equal or exceed his total estate. But their ownership at the decedent's death is usually, nevertheless, more *substantial* than is the ownership, at that time, of distributees (i. e., of those designated by statute to take the personal property of one dying intestate) or of general legatees, because realty and specific legacies are not used to pay the decedent's debts until the general personalty has been exhausted. Moreover, heirs, devisees, and specific legatees can usually point to specific property which will be theirs if it escapes the decedent's creditors, whereas the property of a distributee or general legatee is usually not identified until "distribution" of the estate. Consequently, Congress provided in the first sentence of section 113(a)5 that the basic date for ordinary heirs, devisees, and specific legatees should be the time of the decedent's death, and then stated in the third sentence that in all other cases the basic date should be the "time of the distribution to the taxpayer." In other words, Congress was endeavoring to fix the basic date at the time when the taxpayer in question acquires substantial ownership, and if that does not occur at the decedent's death, to postpone the basic date until it does occur.

The third sentence specifically shows that Congress regarded the ownership of an ordinary distributee or general legatee to be too insubstantial at the decedent's death to warrant fixing his basic date as of that time. If this is so in the case of an ordinary legatee or distributee where the only contingency involved is the possibility that the decedent's estate may be consumed in paying debts, or in satisfying other prior legacies, it is much more true in the case of a taxpayer who is not even in existence at the decedent's death, or in the case of a taxpayer who, although then in existence, has, at that time, only a contingent remainder. The interests of such persons are not only subject to the possibility that the decedent's estate may be consumed by debts, but they are also subject to the additional contingency that the taxpayers in question may never be born, or if already in existence at the decedent's death, to the contingency that they may never outlive the life tenant. To fix the basic date of the property in the hands of such persons at the time of the decedent's death, while postponing the basic date of the property in the hands of ordinary legatees and distributees until the date of distribution, would be inconsistent and unreasonable, and directly opposed to the spirit and purpose of section 113(a)5. It would achieve the very opposite of what Congress intended.

Furthermore, such an interpretation would, in another way, cause absurd, illogical, and inconsistent results. Suppose that A had died in 1912, instead of in 1926, leaving children living. In that event, the children would have "acquired" the property before March 1, 1913, and section 113(b) of the Revenue Act of 1928 would apply. Under this subdivision the basis of the property in the hands of the children is the value under section 113(a)5 or the value on March 1, 1913, whichever is *greater*. Assuming that the section 113(a)5 value is computed under the first sentence thereof, the basis prescribed by section 113(b) is then the value at the decedent's death in 1880 or the value on March 1, 1913, whichever is greater. But where, as in the instant case, the life tenant does not die until after March 1, 1913, then, because of their contingent remainders,

the grandchildren have no recourse to section 113(b), and their basis, if computed under the first sentence of section 113(a)5, is the value in 1880, irrespective of what the March 1, 1913, value may be. It is incomprehensible that Congress should allow contingent remaindermen whose interests vest *before* March 1, 1913, to take as a basis either the value in 1880 or on March 1, 1913, whichever is greater, while forcing contingent remaindermen whose interests do not vest until after March 1, 1913, to take the 1880 value, irrespective of what the March 1, 1913, value may be. The natural supposition is that the later the date on which one acquires property, the later his basic date should be, whereas the effect of putting contingent remainder cases under the first sentence of section 113(a)5 (assuming that the decedent dies before March 1, 1913, and that the property has been gradually increasing in value) is to force an earlier basic date on contingent remaindermen who acquire their property *after* March 1, 1913, than is required of contingent remaindermen who acquire their property *before* March 1, 1913.

In other words, the inconsistency just pointed out arises between contingent remaindermen themselves, depending on when their remainders vest. The inconsistency noted in the preceding paragraph is between contingent remaindermen and ordinary distributees or legatees whose interests are vested at the decedent's death. In each case the effect of applying the first sentence of section 113(a)5 to contingent interests is to cause results directly contrary to the plain intent of Congress.

Furthermore, it is well known that the gravest doubt exists as to the constitutionality of any Federal law attempting to levy an income tax on sums realized by reason of an increase in value of property occurring before the effective date of the income tax amendment. (See for example *Lucas* v. *Alexander*, 279 U. S., 573, Ct. D. 76, C. B. VIII–2, 273.) Yet this would frequently result if the basic date for contingent remaindermen of specific bequests or of realty is ascertained under the first sentence of section 113(a)5.

The situation, then, is this: It is evident on the face of the statute, by comparing the first sentence of section 113(a)5 with the third sentence and by comparing the first sentence with section 113(b), that Congress could never have intended the first sentence of section 113(a)5 to apply to persons whose interests, at the decedent's death, were not substantial, and of course not to persons who were not even in existence at that time. An examination of the committee reports and of the legislative history further establishes this beyond all shadow of doubt, and if any reinforcement were necessary it is present in the fact that such an interpretation would raise the gravest doubts as to the constitutionality of the statute. This being so, does the mere fact that the literal language of the first sentence applies to all persons acquiring specific bequests and to all those acquiring realty by devise or intestacy, require that such sentence be held applicable to contingent interests in such properties? In the opinion of this office there is no such requirement. It is only necessary to infer four words in two different places in the first sentence of section 113(a)5 in order to make the sentence carry out the plain intent of Congress. The sentence would then read:

If personal property was *substantially* acquired *at decedent's death* by specific bequest, or if real property was *substantially* acquired *at decedent's death*

by general or specific devise or by intestacy, the basis shall be the fair market value of the property at the time of the death of the decedent.

In other words, the phrase "at decedent's death" and the word "substantially" are inferred in two places in the sentence, and since it is perfectly obvious that this inference corresponds with the intent of Congress, and that any other construction brings about the most illogical, absurd, unjust, and probably unconstitutional results, the insertion of the words is abundantly justified as a matter of statutory construction. In 2 Lewis' Sutherland, Statutory Construction, 2d edition, it is said:

382. *Words deemed inserted to carry out intent.*—"The intention of the legislature being ascertained with reasonable certainty, words may be supplied in the statute so as to give it effect and avoid any repugnancy or inconsistency with such intention." * * * Where the omission is not plainly indicated and the statute as written is not incongruous or unintelligible and leads to no absurd results, the court is not justified in making an interpolation.

It is of course obvious from the foregoing that the first sentence of section 113(a)5 is incongruous and leads to the most absurd results if it includes interests which are not substantially acquired by the taxpayer at the decedent's death. This result would be inconsistent with the third sentence of the same subdivision, with section 113(b), and with the fundamental purpose of the subsection—that purpose being to fix the basic date at the time substantial ownership is acquired by the taxpayer in question, and to require that the ownership be *more* substantial than the Bureau had required under prior Revenue Acts for fixing the basic date, whereas the literal language of the first sentence would fix the basic date at a time when the beneficiary frequently has no ownership whatever, and at a time which, in many cases, would raise the gravest doubts as to the constitutionality of the statute.

Numerous court decisions uphold the principle of interpretation just stated. In *Hawaii* v. *Mankichi* (190 U. S., 197) the resolution annexing Hawaii provided that:

The municipal legislation of the Hawaiian Islands * * * not inconsistent with this joint resolution nor contrary to the Constitution of the United States nor to any existing treaty of the United States, shall remain in force until the Congress of the United States shall otherwise determine.

It was held that the subsequent trial and conviction of one tried on information and convicted by a jury not unanimous, in accordance with the legislation of Hawaii, was legal, notwithstanding it was not in compliance with the fifth and sixth amendments of the United States Constitution. The court in effect inserted the words "fundamental provisions of the," making the phrase read "nor contrary to the *fundamental provisions* of the Constitution of the United States," instead of merely "nor contrary to the Constitution of the United States," stating that the two constitutional rights violated were not "fundamental," but were merely procedural. The court further stated:

If the words * * * be literally applied, the petitioner is entitled to his discharge * * *. But there is another question underlying this and all other rules for the interpretation of statutes, and that is, what was the intention of the legislative body? * * * "A thing which is within the intention of the makers of a statute is as much within the statute as if it were within the letter; and a thing which is within the letter of the statute, is not within the statute, unless it be within the intention of the makers."

As a matter of fact, the court in that case had nothing like t amount of evidence existing in the instant case to show what t intent of Congress really was, and yet the court refused to apply t literal wording of the statute, and refused, moreover, in a crimin case, where the defendant was presumably entitled to a strict co struction in his favor.

In *Holy Trinity Church* v. *United States* (143 U. S., 457) the cou said:

> * * * It is a familiar rule, that a thing may be within the letter of t statute and yet not within the statute, because not within its spirit, nor with the intention of its makers. * * * This is not the substitution of the will the judge for that of the legislator, for frequently words * * * are us * * * words broad enough to include an act in question, and yet a consider tion of the whole legislation, or of the circumstances surrounding its enactmer or of the absurd results which follow * * * makes it unreasonable believe that the legislator intended to include the particular act. * * *

In that case, an Act of Congress made it "unlawful for any perso company, partnership, or corporation * * * to prepay the tran portation, or in any way assist or encourage the importation * * of any alien or aliens, any foreigner or foreigners, into the Unite States * * * under contract or agreement * * * to perfor labor or service of any kind in the United States * * *." Tl fifth section of the Act expressly excepted professional actors, le turers, singers, and domestic servants, but not ministers, rectors, pastors. The court nevertheless in effect added the words "ministe rectors, and pastors" to the exceptions named in the Act. In *Mill* v. *Standard Nut Margarine Co. of Florida* (52 S. Ct., 260) the S preme Court in effect added to a statute providing that "no suit f the purpose of restraining the assessment or collection of any ta shall be maintained in any court" a qualifying phrase as follow "unless in addition to the illegality of an exaction in the guise of tax there exist special and extraordinary circumstances sufficient bring the case within some acknowledged head of equity jurispr dence." See also *U. S.* v. *Burr* (159 U. S., 78), where the court, to statute providing "that on and after the 1st day of August, 189 * * * [a certain tax] shall be levied, collected and paid * * * inserted an entire qualifying phrase by construction, making the sta ute read, "that on and after the 1st day of August, 1894, * * *or as soon thereafter as this Act shall become a law, * * * the shall be levied, collected and paid * * *." In *Baltzell* v. *Mitche* (3 Fed. (2d), 428, T. D. 3668, C. B. IV–1, 191, cert. denied, 268 U. S 690) the court, in order to arrive at the true intent of Congres omitted a word from section 219(d) of the Revenue Act of 1918.

This section stated that the beneficiary of a trust is taxable upo "his distributive share, whether distributed or not, of the *net incom* of the estate or trust for the taxable year." The court held that th statute should be interpreted as though it said that the beneficiary taxable upon "his distributive share, whether distributed or not, the *income* of the estate or trust for the taxable year." In *Barrett* *Van Pelt* (268 U. S., 85) the court omitted a comma and changed th word "damaged" to "damage," thereby fundamentally changin the literal language of the statute. In *Baker* v. *Jacobs* (64 Vt., 19 23 Atl., 588), to a statute providing that if a party obtaining a verdi in his favor should give to any of the jurors in the cause "any vi tuals or drink" by way of treat, the verdict should be set aside, th

court in effect added the word "cigars" to the phrase "victuals or drink." In *Singer Manufacturing Co.* v. *Wright* (97 Ga., 114, 25 S. E., 249) an act, which in terms applied to companies was held to include individuals engaged in the same business, the court thereby inserting the word "individuals" in the statute. In *Ott* v. *Lowrey* (78 Miss., 487, 29 So., 520) the statute provided that at the "first regular meeting succeeding the annual election," the board of aldermen should appoint certain municipal officers. The court in effect inserted a qualifying phrase as follows, "except that, if such meeting is of the old board of aldermen, the appointments shall be made at the first meeting of the new board."

In *State Board of Education* v. *Mobile & O. R. Co.* (72 Miss., 236, 16 So., 489), to a statute requiring every railroad company to erect signs at highway crossings reading "Look out for the locomotive," the court in effect inserted the phrase "or any other inscription giving sufficient warning." In *State* v. *Ross* (20 Nev., 61, 14 Pac., 827) the statute provided that "all officers and members of the volunteer militia of this State, on becoming members or performing duty, must take and subscribe the following oath." The court held that the statute applied to those who were already members as well as to those afterwards becoming members, thereby in effect adding the phrase, "or if already members." In *Tsoi Sim* v. *United States* (116 Fed., 920) the court held that an Act of Congress, requiring all Chinese laborers then lawfully in the United States to procure certificates of residence within six months under penalty of deportation, did not apply to a Chinese woman, who, although not securing the certificate of residence prior to the expiration of the six months, had, after that period expired, become the wife of an American citizen. Thus the court in effect added to the Act a qualifying exception reading, "but the Act shall not apply to a Chinese woman who, after the six months has expired, becomes the wife of an American citizen." In *Rogers* v. *Jacob* (88 Ky., 502, 11 S. W., 513) a statute required each voter to retire separately to a compartment and there mark his ballot unaided. The court held that the statute did not apply to an illiterate person, thereby in effect adding to the word "voter" the qualifying phrase, "unless such voter be illiterate."

The books are full of similar illustrations, and of course the rule that statutes are to be construed, if possible, so as to avoid doubts of their constitutionality (*U. S.* v. *La Franca*, 282 U. S., 568, and cases cited) affords an additional reason why the purpose and spirit of section 113 (a) 5 should be followed, rather than its literal language.

The rule that ambiguous tax statutes are to be construed in favor of taxpayers has no direct application to the instant question because it can not be known in advance which interpretation would benefit the majority. (*Brewster* v. *Gage*, supra.) However, it may be said that the interpretation contended for here would probably favor taxpayers in most cases, since it would eliminate all attempted taxation of increases in value occurring before March 1, 1913, and in general the values of property have tended to rise rather than fall. Consequently, if this canon of construction has any application at all, it is an additional argument in favor of following the spirit of the statute rather than the letter.

In view of the foregoing, it is the opinion of this office that the first sentence of section 113(a)5 is not applicable to personal property acquired by specific bequest, or to real property acquired by general or specific devise, or by intestacy, except in those cases where the taxpayer in question has acquired substantial ownership of the property at the time of the death of the decedent, and that, consequently, the basis of the property in the hands of the children of A is not governed by that sentence. This does not mean, however, that legal, as distinguished from equitable, ownership is necessarily essential at the decedent's death in order to bring the situation within the first sentence, nor is it intended to imply that the taxpayer in question must be entitled at the decedent's death to possession of the property in order that his case may be governed by the first sentence. For example, if the decedent devises real property or makes a specific bequest of personalty to X in trust for Y for Y's life, and on the death of Y to Z in fee simple, Z's basis would be controlled by the first sentence of section 113(a)5, because at the decedent's death he acquires a substantially vested interest in the property. On the other hand, it is not believed that the question of whether a particular taxpayer's interest in a specific bequest, or in real property acquired by general or specific devise, or by intestacy, is governed by the first sentence is necessarily to be determined by answering the question of whether, at the decedent's death, the taxpayer technically has a "vested" interest in the property.

For example, in some States an interest is defined by the courts as being purely contingent in the same situations in which the courts in other States would define the interest as being vested, subject to being divested, and in many of such cases it is believed the taxpayer's interest would not be substantial enough at the decedent's death to fall within the scope of the first sentence of section 113(a)5, irrespective of whether the local law defined it as contingent, or as vested, subject to being divested.

Conceding that the interests of the children in the instant case are not within the first sentence, it is evident that they must fall within the scope of the third sentence, for the second sentence of section 113(a)5 can have no application to the instant case and the third sentence, by its express terms, covers "all other cases."

It follows that the basis of the property in the hands of the grandchildren of the testatrix is "the fair market value of the property at the time of the distribution to the taxpayer." The next question, therefore, concerns the meaning of the term "distribution to the taxpayer."

In General Counsel's Memorandum 6195 (C. B. VIII–1, 99), in a case where the beneficiary of a testamentary trust had a substantially vested interest at the decedent's death, it was held that distribution to the testamentary trustee "constitutes the 'time of the distribution' to the cestui que trust," and this rule was followed in I. T. 2539 (C. B. IX–1, 139). In similar cases such a ruling is believed to be correct, and, as the published rulings do not fully present the reasons underlying this view, it is proposed to present them in the discussion immediately following, after which the issue will be considered as to when "distribution" occurs with respect to persons holding mere contingent interests at the time of distribution to testamentary trustees or to a tenant for life of the legal title.

Considering, first, the question of when distribution occurs with respect to such cestuis que trust or legal remaindermen as own substantially vested interests at the time of distribution to testamentary trustees or to a legal tenant for life, it is quite evident that Congress did not use the term "distribution" as being synonymous with *delivery*, nor in a sense which would make delivery an essential component. Section 113(a)5 purports to cover all cases of property acquired after February 28, 1913, and transmitted at death, whereas, if "distribution to the taxpayer" requires "delivery to the taxpayer," a large number of taxpayers will be provided with no basis whatever. For example, suppose T bequeathes a general legacy to L for life, remainder to R in fee. Here R acquires a vested legal remainder, but he will not be entitled to possession of the property until the death of L, which may not occur for many years. Before that event happens, however, he may sell his vested remainder, and if he does, he has no basis whatever under section 113(a)5 if "distribution" to him requires delivery to him.

Other situations in which such an interpretation would result in no basis at all exist in those cases where a general legacy is bequeathed to X in trust for others. In such cases, any cestui que trust may, in most States, sell his equitable interest before the termination of the trust, yet section 113(a)5 would provide no basis for such a sale if "distribution" requires delivery of the corpus to the taxpayer, because the cestui is the "taxpayer" in question and the corpus has never yet been delivered to him; it has been delivered only to the trustee. In fact, in any case where a general legacy is bequeathed in trust, or where life estates and remainders in such a legacy are created without the interposition of a trust, the theory that "distribution to the taxpayer" requires "delivery to the taxpayer" would leave all taxpayers unprovided with a basis who sell their interests prior to the time of receiving possession of the property from the testamentary trustee or from the preceding tenant. Yet such possession may be postponed for several decades after the testator's death, and, in the meantime, many sales of nonpossessory interests may occur. Furthermore, in the case of property bequeathed to a trustee in trust for L for life, and on his death to R in fee, L, the equitable life tenant, would *never* secure possession of the property (the trustee being entitled to possession until L dies), and therefore the cestui que trust for life would never have a basis for his equitable life estate under section 113(a)5 if "distribution" to him means delivery to him. Yet an equitable life estate may be sold, and a basis would be essential to compute profit or loss unless it be admitted that such a sale constitutes a mere assignment of future income and that the entire proceeds received for the assignment constitute income to the vendor.

Obviously, Congress did not intend to leave so many situations unprovided for, and consequently distribution can not require delivery.

Furthermore, it is evident on the face of section 113(a)5 that neither the receipt of possession nor the acquisition of legal title was regarded by Congress as important in determining the basic date. Specific legatees, under the first sentence of the subsection (unless their interests are contingent), take the time of the decedent's death as their basic date, yet they are entitled neither to possession nor to

legal title at that time. (23 C. J., 1127; 24 C. J., 204; Schouler on Wills, 5th ed., sec. 1239.) The beneficiary of a testamentary trust of realty (unless his interest is contingent) also takes the time of the decedent's death as the basic date, in spite of the fact that he then acquires neither legal title nor possession. In fact, as already noted, the committee reports specifically state that the reason why taxpayers governed by the first sentence of section 113(a)5 take as the basic date the time of the decedent's death, is not because they were thought to acquire legal title and possession then, but because they were believed to acquire *substantial ownership* then. Again quoting the words of the committee reports, it was because "in these cases it may be said, as a matter of *substance*, that the property for all practical purposes *vests* in the beneficiary immediately upon the decedent's death, and *therefore* the value at the date of death is a *proper* basis * * *." [Italics supplied.] Now if Congress, with respect to the first sentence of section 113(a)5, thought that the basic date should be fixed at the time substantial ownership is acquired by the taxpayer in question, certainly the third sentence must be an attempt to carry out the same idea, and as the first sentence abundantly shows that legal title and delivery of possession were not considered essential to the acquisition of substantial ownership under that sentence, it would be strange indeed if they were considered essential to substantial ownership under the third sentence. Yet if "distribution to the taxpayer" requires "delivery to the taxpayer," the basic date would frequently be postponed for decades after the taxpayer had become the substantial owner, and inconsistencies between the results reached under the first and third sentences of section 113(a)5 would be so illogical and unjust as to shock the conscience.

For example, suppose P bequeathes a specific legacy to L for life with vested remainder in fee to R. R's basis under the first sentence of section 113(a)5 is the value at P's death. But if the subject of an otherwise identical bequest is a *general* legacy, and if "distribution" requires delivery, then R's basis is the value when the property is delivered to him some time after the death of the life tenant, L. This event may occur many years after P's death, depending on how long L lives, and yet in each case R had a vested legal remainder in personal property, the only difference being that one is a general legacy and one is specific. Congress could not possibly have intended such an amazing, inconsistent, and unjust result. After distribution to the *life tenant* occurs, the ownership of the general legatee remainderman is exactly as substantial as is the ownership of the specific legatee remainderman, and there is no reason whatever why the basic date of the former should vary so enormously from that of the latter.

As another example of the same kind of inconsistency, suppose P bequeathes a specific legacy to T in trust to manage the property and to pay the income to R for 20 years, and then to turn over the corpus to him. R's basis under the first sentence is the value at P's death. But if P makes a bequest in all respects identical except that the subject matter is a general legacy, and if "distribution" means delivery, then R's basic date is 20 years after P's death. In each case R has an equitable fee simple in personalty, and the only difference is that one is in a specific legacy and the other is in a general legacy.

Similar arbitrary, illogical, and ridiculous inconsistencies will result as between devises of real property under the first sentence and general bequests of personalty under the third sentence, if "distribution" means, or requires, delivery.

It seems entirely clear that Congress never intended that it should have any such meaning, and as a matter of fact the term "distribution," as ordinarily used in connection with the estates of deceased persons, does not by any means necessarily contemplate delivery or change of possession. It has already been noted that the district court decision in *Brewster* v. *Gage* (25 Fed. (2d), 915), holding that the basic date for a residuary legatee is the time of "distribution" rather than the time of the decedent's death, is a substantial part of the legislative history of section 113(a)5.

The district court's decision was rendered on December 27, 1927, five months before the Revenue Act of 1928 was approved, whereas it was not until after the approval of that Act that the decisions of the Circuit Court of Appeals (30 Fed. (2d), 604) and of the Supreme Court (280 U. S., 327) were rendered in the same case. The stipulation of facts in the Brewster case expressly states that the decree of distribution of the surrogate's court was made on April 19, 1920, whereas the date of actual delivery of the stock certificates to the residuary legatee was not until June 28, 1920. Yet the district court held that the date of the surrogate's decree, rather than the date of delivery, was the time of the distribution to the taxpayer. This case was reversed by the upper courts, not on the theory that the time of distribution was not the date of the court order, but on the theory that the residuary legatee "acquired" the property at the decedent's death rather than at the time of distribution. (The Supreme Court's decision as to when "acquisition" occurs applies under Acts prior to the Revenue Act of 1928, but, of course, does not determine the basis under the later Act.) The district court in the Brewster case said:

> * * * I * * * incline to the view that the securities * * * were not acquired by plaintiff * * * until distributed to plaintiff under the surrogate's decree * * *.
>
> * * * I think * * * the basis * * * is the value of the stock at the time of distribution, and not at the time of the testator's death, or when the certificates were delivered to the plaintiff. * * * Therefore the gain or deductible loss * * * should be based on * * * their worth on April 19, 1920 * * *.

This view that "distribution" is accomplished by the decree itself and not by the later *delivery* of the property, is frequently met with. In *St. Mary's Hospital* v. *Perry* (152 Cal., 338, 92 Pac., 864) the court said:

> *By the decree* of final distribution * * * the sum of $691.56 was *distributed* to plaintiff * * *. The defendant executrix having failed to pay the same over, this action was instituted * * * to recover the same * * *.
>
> * * * Such an action against an executor or administrator is one against him individually, and not against him in his representative capacity. * * * As against the estate, the rights of the distributee are fully adjudicated by the decree of distribution. * * * [Italics supplied.]

In other words, "distribution" was accomplished by the decree itself, in spite of the fact that the executrix had not delivered possession of the legacy and was then being sued to recover it. Delivery was held to be a separate act which the executor performs in his *personal* capacity only.

The same theory may be the basis of the general rule that a decedent's representative is *personally* liable for interest after the decree of distribution (24 C. J., 506), and for the further rule that the statute of limitations for the recovery of a legacy or distributive share begins to run from the time of the decree of distribution, and that thereafter the personal representative is subject to garnishment by a creditor of the legatee or distributee. (3 Woerner, Administration, 3d ed., 1952.)

Likewise, in 24 C. J. (523, 524, 529), "distribution" is said to be accomplished by the decree itself. It is there stated:

Order or decree for distribution.—a. In general. Distribution * * * is properly *made* by a single decree * * *. The decree should generally specify the several distributees by name * * * specify the property and amount to be paid or delivered to each distributee, and make a positive and conclusive disposition * * * among all the parties * * *. Where land is to be divided, it should be described or [identified] * * *. The decree must of course conform to the will of the testator, or, in case of intestacy, to the statute of descent. * * *

* * * * * * *

As muniment of title. The order or decree is a muniment of title of the highest value, and operates to vest in each distributee an absolute right and title to the property assigned to him * * *. [Italics supplied.]

As implied by the above quotation, the decree of distribution, particularly in the Western States, frequently "distributes" real property as well as personalty (see also 3 Woerner, supra, page 1919; *William Hill Co.* v. *Lawler*, 116 Cal., 359, 48 Pac., 323; *Snyder* v. *Murdock*, 26 Utah, 233, 73 Pac., 22), for in many States the real estate, by statutory enactment, is administered, like personalty, by the decedent's personal representative.

If distribution may be accomplished by the court's decree of distribution, then distribution obviously does not require delivery, for delivery may not occur until after the decree. This fact has also been illustrated by the courts in other ways outside of tax law. Thus, it is a general rule that "distribution" to the life tenant is "distribution" to the vested remainderman, so that the decedent's executor has no right to possession after the death of the life tenant. In *Andrews* v. *Brumfield* (32 Miss., 107), the court said:

It is settled, in this court, that distribution to the tenant for life of a chattel personal, is a distribution to the remainderman, and is, as a general rule, an act of complete and final administration. * * *

To the same effect see *Judge of Probate* v. *Alexander* (31 Miss., 297); *Sydnor* v. *Graves* (119 Md., 321, 86 At., 341); *Foley* v. *Syer* (121 Md., 79, 88 At., 38); *Bates* v. *Woolfolk* (5 Ga., 329); *Weeks* v. *Jewett* (45 N. H., 540); *In re Hamlin* (126 N. Y. Supp., 396); *Posegate* v. *South* (46 Ohio St., 391, 21 N. E., 641). Likewise, under the old rule that apportionment of testate personalty (as distinguished from apportionment of intestate personalty) is accomplished by the "assent" of the executor to the legacy rather than by a decree of distribution, it was held that an assent to the interest of a tenant for life is an assent to the interest of the remainderman. (*McClanahan* v. *Davis*, 8 How. (U. S. Supreme Court), 170; *Gay* v. *Gay*, 29 Ga., 549; *Watkins* v. *Gilmore*, 121 Ga., 488, 49 S. E., 598; *Acheson* v. *McCombs*, 38 N. C., 554.) In most of the American States the decree of distribution is now substituted for the "assent" of the executor to a legacy (3 Woerner, supra, page 1952), but the principle is the same, namely,

that apportionment to the life tenant, however effected, is also apportionment to the remainderman.

Certainly if distribution to a person holding a legal estate for life is distribution to the person holding the legal remainder, then distribution to a trustee is normally distribution to the beneficiaries, because a trustee holds the property for, and represents, the beneficiaries in a much truer sense than is the case with a life tenant and remainderman. A life tenant is holding primarily for himself, his duties to the remainderman being primarily negative (not to injure the property, etc.), whereas a trustee, in substance, does not hold in his own right at all but merely as a representative of the beneficiaries.

The theory that distribution to a life tenant or to a trustee is also, under section 113(a)5, a distribution to the remainderman or beneficiary, is further substantiated by the logical connection existing between the second and third sentences of section 113(a)5. The second sentence provides that—

> If the property was acquired by the decedent's estate from the decedent, the basis in the hands of the estate shall be the fair market value of the property at the time of the death of the decedent.

The third sentence, immediately following, states that—

> In all other cases if the property was acquired either by will or by intestacy, the basis shall be the fair market value of the property at the time of the distribution to the taxpayer.

In other words, the second sentence states that the basis for the decedent's "estate" is the value at the time of the decedent's death, and the third sentence, immediately following, provides that the basis for distributees and general legatees shall be the value at the time of "distribution" to the taxpayer. Obviously, the "time of distribution" that Congress had in mind is the time of distribution of the decedent's *estate* (the "estate" just referred to in the preceding sentence), and not the time of some delivery of corpus attending the distant termination of a trust or legal life estate. It was not the latter question, moreover, which was in issue in the two cases forming the chief legislative background for the third sentence of section 113(a)5. The question in issue in those cases (the Matthiessen case, supra, and the district court's decision in *Brewster* v. *Gage*, supra) was whether a residuary legatee "acquired" any "property" from the decedent prior to the original distribution of the decedent's estate, and Congress enacted the third sentence of section 113(a)5 to settle this controversy. There was no controversy over the question of whether the time of a legatee's acquisition of property should be still further deferred until the termination of a testamentary trust or the death of a legatee for life, and Congress must have assumed that distribution to a testamentary trustee or to a tenant for life was distribution to a vested beneficiary or vested remainderman.

As a matter of common sense, moreover, there is no sound reason why delivery should be necessary to effect "distribution" of a decedent's estate. The situation is not that of a gift inter vivos where delivery is essential to transfer title. The beneficial ownership, subject to the payment of debts, etc., is in the beneficiaries from the date of the decedent's death. The function of administration is primarily to pay the decedent's debts, ascertain who the beneficiaries are, and decide what property they are entitled to have.

Even the bare legal title, which the personal representative holds after the decedent's debts are paid, is transferred to the equitable owners of the property by the decree of distribution itself and not by the later delivery. (3 Woerner, supra, page 1952.) There may possibly be cases where delivery is an essential part of distribution, as where no formal administration is had and that legatees or distributees apportion the property among themselves without a court decree, or where the executor or administrator apportions and delivers the property to the beneficiaries before a decree is entered.

However, in the Matthiessen case, supra, where the residuary legatees (who also composed the executors and testamentary trustees) apportioned the estate among themselves prior even to the probating of the will, the date of "distribution" to such legatees was held to be the date they *agreed* upon the apportionment (March 13, 1918), rather than the much later date when they came into possession of the property in their own right. The last paragraph of finding of facts No. 7 of the Court of Claims in that case shows that the certificates of stock in question "were in the joint possession, custody, and control of the *executors* of the estate * * * prior to November 12, 1918," so that F. W. Matthiessen, jr., did not acquire possession as *such* until the last-named date. To be sure he was also an executor, but joint possession with others as an executor is not individual possession as a legatee. The logical implications of such a theory would obliterate the distinction between the decedent's estate and the beneficiaries thereof, whereas the second and third sentences of section 113(a)5 expressly emphasize this distinction by providing that the basic date for the decedent's estate shall be the time of the decedent's death, while the basic date for distributees and general legatees shall be the time of distribution. That F. W. Matthiessen, jr., did not suppose he had received possession of the stocks in question in his own right on March 13, 1918, is further indicated by the fact that while he gave a receipt, dated March 13, 1918, for securities in Schedule "C," he gave no receipt, so far as appears, for securities in Schedule "G," and the stocks in question were in the latter schedule. (2 B. T. A., 925.)

It seems evident, then, from the foregoing, that the legal meaning of "distribution," as frequently used in connection with a decedent's estate, and as used in cases forming a part of the legislative history of section 113(a)5, by no means requires that the phrase "time of the distribution to the taxpayer" be interpreted to mean "delivery to the taxpayer."

Moreover, while it is possible that in popular thought the term "distribution" frequently connotes delivery, nevertheless an examination of the definitions of the term in Webster's New International Dictionary tends to show that delivery is by no means necessarily implied, even from the standpoint of the layman. The definitions are in part as follows:

1. A distributing, or state of being distributed; division or apportionment among several or many; * * *

2. Separation into parts or classes; arrangement of anything into parts; disposition; classification.

* * * * * * *

Syn.—Apportionment; allotment, dispensation, disposal, dispersion, classification, arrangement.

The essential thought presented in most of these definitions seems to be apportionment or allotment, rather than delivery, and apportionment or allotment may certainly be accomplished without delivery. That is particularly true, of course, in the case of a decedent's estate where the legatees or distributees, prior to distribution, are already the beneficial owners of the property, subject to the decedent's debts, etc., and where, therefore, the important thing to be accomplished is not transfer of title but *ascertainment* of distributive shares. Therefore, even under purely nonlegal definitions of "distribution," delivery is certainly not an essential part thereof in the case of a decedent's estate.

It may be argued that where property is bequeathed to testamentary trustees in trust for several persons, or to a life tenant with vested remainder to several persons in common, a distribution to the trustees, or to the life tenant, does not determine the respective shares of the cestuis que trust or remaindermen, and therefore, as to them, does not constitute an apportionment or allotment. The answer to this argument is that if testator had interposed no testamentary trust or life tenancy but had bequeathed the personalty directly to the parties in question as tenants in common in fee simple, "distribution" to them might unquestionably occur without making any allotment or apportionment as *between* the tenants in common. As stated by the court in *William Hill Co.* v. *Lawler* (116 Cal., 359, 48 Pac., 323), "* * * the decree [of distribution] is equally conclusive whether the estate is distributed to the persons in segregated parts or in undivided proportions." The essential thing is to determine that the property in question is not needed for the testator's debts or to pay other legacies having priority, and to separate it from the rest of the decedent's estate. When that is done, distribution of that property to the beneficiaries has occurred, irrespective of whether the property goes to one legatee or to several legatees as tenants in common. Their ownership is no less substantial, in the sense contemplated by section 113(a)5, simply because their interests are undivided, and the committee reports, the legislative history, the subsection itself, and the absurd and inconsistent results which the "delivery" theory would entail, abundantly show that Congress was attempting to fix the basic date at the time substantial ownership, as it understood the term, is acquired by the taxpayer and not at the time he secures possession of the property. To hold, therefore, that the basic date in the case of testamentary cestuis que trust and legal remaindermen is postponed until they acquire *possession*, would be to postpone such date long beyond the time Congress intended (to say nothing of the fact that, where the remaindermen or cestuis que trust sell their interests in the property before acquiring possession thereof, they would have no basis at all under such a theory), and would be as opposed to the spirit and purpose of the statute as to hold that contingent interests in specific bequests and realty are included under the first sentence of section 113(a)5.

To hold the latter would put the basic date much earlier than Congress intended; to hold that "distribution to the taxpayer" requires delivery to the taxpayer would put the basic date much later than Congress intended. Consequently, even if it were true that the term "distribution" had a recognized meaning which included delivery as an essential part thereof (and this is by no means the case), never-

theless the courts would be abundantly justified by judicial precedent in following the spirit and purpose of the statute rather than the letter; and such spirit and purpose are definitely opposed to giving the term such a meaning. (For citations to the effect that the courts should follow the spirit of the statute rather than the letter, see those given in the first part of this memorandum on the question of whether the first sentence of section 113(a)5 should be interpreted as including contingent interests in specific bequests and in real property.) Of course, "the rule that ambiguities in tax laws are to be resolved in favor of taxpayers has no application here because it is impossible to determine which basis would impose a greater burden." (See *Brewster* v. *Gage*, supra.)

As already stated, the purpose of the foregoing discussion is to present in more complete form the principal reasons underlying the position of the Bureau to the effect that contingent interests in specific bequests and realty are governed by the third sentence of section 113(a)5 rather than by the first sentence, and to perform a similar task with respect to the position that distribution to a testamentary trustee is distribution to such cestuis que trust as acquire substantial equitable ownership through the distribution to the trustees. However, under the will of B in the instant case, her grandchildren did not acquire substantial equitable ownership when the property was distributed to the trustees. As stated in the first part of this memorandum, the interests of the grandchildren were contingent until the death of A, the life beneficiary, on June —, 1926. Contingent beneficiaries or remaindermen are not regarded as having "acquired" property under the Revenue Acts, and, consequently, in such cases "distribution," as well as acquisition, is necessarily contingent until substantial ownership vests, at which time distribution to them is automatically concluded. Thus, in *Gay* v. *Gay* (29 Ga., 549), the court said:

> When the executor assents to the life estate, it is an assent to the devise over, whether it be a vested or contingent remainder. If it be a vested remainder, the assent is absolute; if contingent, it is qualified—that is, it is subject to the condition upon which the remainder is to vest. Here, the condition of contingency annexed has happened, and hence the qualified assent has become absolute.

In other words, "assent" to a life tenant is "assent" to a *vested* remainderman, but only *contingent* "assent" to the contingent remainderman, such "assent" becoming absolute, in the latter case, on the vesting of the remainder. Under the modern rule that there is no distinction between testate and intestate personalty, apportionment in both cases being effected by the decree of distribution (rather than by the executor's "assent" in one case and the decree in the other (3 Woerner, supra, page 1952)), the rule may be simply expressed by saying that distribution to a contingent remainderman is contingent upon the substantial vesting in him of the remainder, upon which event distribution is effected. In this way the spirit and purpose of section 113(a)5 are exactly observed, for the basic date of contingent remaindermen will thereby coincide with their acquisition of substantial ownership of the property.

This does not by any means amount to a rule that "distribution" is equivalent to technical "vesting" of interest. For example, suppose that P bequeaths a general legacy to L for life, and on L's

death to such of L's children as are living at L's death, and if none are then living to the X University. Suppose that after the death of P, but before the legacy is distributed to L, L dies, leaving a child living. The child's interest becomes vested, in the technical sense, immediately on L's death, but obviously "distribution" to the child has not yet occurred. The situation is now the same as though P had bequeathed the legacy to the child in the first instance, and distribution to the child must therefore still be made. In other words, the property bequeathed must be separated from the rest of the decedent's estate. Thus, it is only where a taxpayer's interest is still contingent at the time of distribution of the general legacy to the life tenant or trustee that distribution to the contingent remainderman coincides with the vesting of his interest.

Furthermore, it is the opinion of this office that in this connection the distinction between interests which are technically contingent and interests which are technically vested, subject to being *divested*, should in general be ignored. The courts of one State will hold that an interest is vested, subject to being divested, in the same situation in which the courts of another State will hold that the interest is purely contingent. The test of whether "distribution to the taxpayer" has taken place under section 113(a)5 is no more a question of technical "vesting" of interest than it is a question of legal title or receipt of possession. No one of these things is decisive; the question is whether the taxpayer has acquired sufficiently substantial ownership to satisfy the spirit and purpose of section 113(a)5, and in general, an interest which is vested, subject to being divested, does not give a taxpayer that sort of ownership.

In the instant case, since the interests of the grandchildren were contingent until A's death in 1926, and then became substantially vested (all of the grandchildren having then reached the age of 21), it is the opinion of this office that distribution to the trustee of the testamentary trust did not constitute distribution to the grandchildren but was contingent, as to them, until their interests substantially vested on A's death in 1926, and that, on her death, distribution to the grandchildren occurred. The time the trustee actually delivered the corpus to the children is immaterial.

At the beginning of this memorandum it was stated that there is no evidence whether anything was recovered by the executors of B on the debt due from the decedent's sister and her husband, or whether the M Company stock and the tract of land were retained intact until the termination of the trust or were sold and their proceeds reinvested, and it was said that it would be demonstrated later that it is immaterial to the instant question what happened in these respects. That this is so is due primarily to the fact that the grandchildren in the instant case had mere contingent interests until their mother's death in 1926, and therefore it was not until 1926 that their property "was acquired either by will or by intestacy" within the meaning of the third sentence of section 113(a)5, or was "distributed" to them, as contemplated in that sentence. Whether the property thus acquired by them in 1926 was the original property bequeathed, or was substituted property bought with the proceeds, can therefore make no difference, for whatever its form in 1926 it must still be regarded as constituting the property which they "acquired * * * by will" and which was "distributed" to them. The situation in this respect

is the same as though B had died, say, in 1925, making a general bequest of the residue of her personalty directly to the seven grandchildren in fee simple, and providing that her executor sell the residue, invest the proceeds in corporate stocks, and deliver the stocks to the grandchildren. In such a case it is clear that the basis of the stocks in the hands of the grandchildren would be the fair market value of the stocks at the time of their distribution to the grandchildren, irrespective of the fact that the stocks were not the original corpus, for the conference committee and Finance Committee reports both state that the third sentence of section 113(a)5 "would also apply in cases where the executor purchases property and distributes it to the beneficiary."

The situation in the instant case is similar, for while it is entirely clear that a testamentary trustee is not, as such, an executor, and that a testamentary trust is not the decedent's "estate," yet, if "distribution" to the cestui, due to his having only a contingent interest, does not occur until the termination of the trust, it is just as immaterial, as in the case of an executor, that the trustee may have sold the original corpus and invested the proceeds in other property, because it is the substituted property, rather than the original, which the cestui must be regarded as having "acquired * * * by will," and as having been "distributed" to him. Consequently, the cestui's basis, in the instant case, is the fair market value, on June —, 1926, of any corpus delivered to him in kind and sold in 1928 or later.

The situation in this respect would be different, however, if the interests of the grandchildren had been substantially vested when the property was distributed to the testamentary trustee. In other words, in those cases where distribution to the testamentary trustee is distribution to the cestuis que trust, it is the very corpus distributed to the trustee that forms the corpus which the cestuis have "acquired * * * by will" within the meaning of the third sentence of section 113(a)5. If the trustee delivers that corpus in kind to the cestui, the latter's basis is its fair market value at the time of distribution to the trustee, but if the trustee sells such corpus, reinvests the proceeds in other property, and delivers the latter in kind to the cestui, it is not that substituted corpus which the cestui "acquired * * * by will" and which was "distributed" to him within the meaning of the third sentence of section 113(a)5. Consequently, its basis in the hands of the cestui should not be determined under section 113(a)5 but under the ordinary rule that where a trustee delivers trust corpus in kind to the cestui the latter's basis is the basis it had in the hands of the trustee. This basis, in such a case, would ordinarily be the cost of the substituted property to the trustee. (See I. T. 1165, C. B. I–1, 30.)

II.

The second will involved in this case is that of C, who died in March, 1914. His will provides in part as follows:

Sixth: All the rest, residue and remainder of my estate, real, personal and mixed, I give * * * to my wife, A, and my sons G and H, * * * in trust, * * *.

a. [Permission is here given the trustees to sell and reinvest, etc.]

b. * * * to pay over to my wife * * * for the term of her natural life, a sufficient sum, not less than * * * 90.1x dollars * * * per annum, from the income * * * to maintain a home * * *.

c. * * * to pay over quarterly to my wife * * * one-third of the remaining net income * * * and * * * to my children, share and share alike, the remaining two-thirds of the net income * * * during the natural life of my said wife, * * *.

d. * * * upon the death of my said wife, * * * to pay over quarterly the net income * * * to my children, share and share alike, for the term of 10 years after the decease of my said wife.

e. * * * at the end of 10 years from the date of the decease of my said wife, to pay over the principal or corpus of the trust estate to my children, share and share alike, absolutely.

* * * in the event that any of my children shall die before receiving his full share of the corpus or principal of my estate, leaving issue, that such issue shall represent and take the share of income and principal which the parent would have taken * * * and * * * [if] * * * without issue, the interest of such a one shall go to and be divided among the remaining brothers and sisters, issue to always represent the parent, provided that any of my sons * * * by their last will and testament or by writing in the nature thereof, may appoint the persons or person who shall receive the interest to which they would have been entitled if living.

* * * at any time after my wife's death my trustees may, by the unanimous consent of all the children then living, terminate the trust estate and divide the corpus among the same persons that would have received the same had the said 10 years then expired.

* * * * * * *

I appoint the said A, G and H, executors of this my last will * * *.

A died on June —, 1926, leaving seven children living, and it is stated that "the various stocks" were "distributed" to the children on August —, 1926, September —, 1926, and September —, 1926. Apparently the term "distributed" is used to mean "delivered." It is assumed, therefore, in accordance with the next to the last paragraph quoted above from the decedent's will, that the trustees must have secured the unanimous consent of the children and terminated the trust soon after A's death.

The only question concerns the basis of the certificates of stock in the hands of the children. As there is no evidence of any sales having been made prior to 1928, the basis under the Revenue Act of 1928 will alone be considered, and in the absence of evidence whether the certificates delivered to the children were the original trust corpus or were purchased with the proceeds of sales of original corpus, it will be assumed, for the present, that they were the original corpus or a portion thereof. Later on, the effect of a contrary assumption will be discussed.

In view of the facts that the testator did not die until after February 28, 1913, that the basis of personalty is being considered, and that the bequest, being an ordinary residuary bequest, is clearly not a "specific bequest," it is clear that the basis is to be computed under the third sentence of section 113(a)5 of the Revenue Act of 1928, which provides that "in all other cases if the property was acquired either by will or by intestacy, the basis shall be the fair market value of the property at the time of the distribution to the taxpayer."

It has already been shown in an earlier part of this memorandum that "the time of the distribution to the taxpayer" is the time when the taxpayer acquires substantial ownership of the property, "substantial ownership," that is, in the sense contemplated by the committee reports on section 113(a)5 and the legislative history thereof; that in the ordinary case of general bequests, the acquisition of sub-

stantial ownership, in that sense, occurs at the time the probate court decrees distribution of the decedent's estate (rather than when the executor or administrator later delivers the property); that "distribution" to testamentary trustees is distribution to the beneficiaries of the trust when the interests of the beneficiaries, at the time of distribution to the trustees, are substantially vested; and that with respect to such beneficiaries as do not then have substantially vested interests, distribution is contingent until the interests of the beneficiaries substantially vest, at which time "distribution" to them occurs.

Applying these principles to the instant case, the question first to be considered is whether the interests of the children, as testamentary cestuis que trust, were substantially vested at the time the trust corpus was distributed to the testamentary trustees. In this connection it is not sufficient merely to find that under the State law the interests are technically considered to be vested, subject to being divested, rather than purely contingent. The question is one of substantial ownership, considered from the standpoint of section 113(a)5, as revealed by the committee reports and the legislative history, and this standpoint is clearly a practical rather than a technical one. So approached, it seems to this office that the interests of the sons were sufficiently secure at the time of distribution to the testamentary trustees to warrant the view that distribution to such children occurred at the same time. It is true that the remainder interest of each child was subject to being divested by his death "before receiving his full share of the * * * principal." The will provided, however, that "any of my sons may by their last will and testament or by writing in the nature thereof * * * appoint the persons or person who shall receive the interest to which they would have been entitled if living."

For estate tax purposes the Bureau has treated a power to appoint by will as a "general" power of appointment, and a general power of appointment as being equivalent to a fee, so that the gross estate of a decedent possessing such a power includes the property over which the decedent has the general power of appointment. In *Bullen* v. *Wisconsin* (240 U. S., 625), and again in *Chase National Bank* v. *United States* (278 U. S., 327, Ct. D. 40, C. B. VIII–1, 308), the Supreme Court quoted with approval the words of Lord St. Leonards that "To make a distinction between a general power and a limitation in fee, is to grasp at a shadow while the substance escapes," and the same thought is back of the statutory provisions holding the income of revocable trusts taxable to the grantor, and of the recent cases sustaining that doctrine under Revenue Acts containing no such provisions. (*Grace Whitney Hoff*, 20 B. T. A., 86.)

It is true that the recent case of *Leser* v. *Burnet* (46 Fed. (2d), 756) holds that if, in a particular State, a power to appoint by will is construed by the courts not to include a power to appoint to one's *creditors*, the power is not a "general" power and the property should not be included in the decedent's gross estate, and the Bureau has recommended that no petition for certiorari be filed. Under this test, however, the power in the instant case is a "general" power, for the courts of Pennsylvania hold that a power to appoint by will includes the power to appoint to one's executors and thereby subject the property to the debts of the one exercising the power. (*In re McCord's Estate*, 276 Pa., 459, 120 At., 413; *In re Forney's Estate*,

280 Pa., 282, 124 At., 424; *In re Twitchell's Estate*, 130 At., 324.) It is the opinion of this office, therefore, that so far as the sons are concerned, their equitable ownership was sufficiently substantial so that distribution to the testamentary trustees constituted distribution to the sons as beneficiaries.

There is no evidence as to when distribution to the testamentary trustees occurred, but if the testator's estate was handled in the ordinary manner it probably occurred within a year or two after C's death, at the time of the probate court's decree of distribution. The fact that the testator's executors and his testamentary trustees appear to have been the same persons is immaterial in this connection.

Assuming, therefore, that the certificates of stock finally delivered to the sons on the termination of the trust were a part of the original trust corpus, the basis of such certificates in the hands of the sons is the fair market value of the "property" when distributed to them—that is, at the time of distribution to the trustees. The "property" then distributed to the sons, however, was not the complete equitable fee simple, and the value of the stock itself at the basic date must therefore be reduced to reflect the fact that the widow was entitled during her life to not less than $90.1x$ dollars a year to maintain her home and to one-third of the remaining net income. (Compare *William Huggett*, 24 B. T. A., 669, and I. T. 1622, C. B. II–1, 135.)

If certificates of stock were delivered to the sons which did not compose part of the original trust corpus but were purchased by the trustees with proceeds of the sale of such corpus, then the basis of such stock in the hands of the sons is the same basis the purchased stock had in the hands of the trustees—which basis, presumably, would be the cost to the trustees. (See I. T. 1165, C. B. I–1, 30.) In other words, with the exception of cestuis que trust whose interests are contingent (ordinarily including in the exception those whose interests are vested, subject to be divested), the basis of property which has been purchased by testamentary trustees with the proceeds of original trust corpus, and which has later been delivered in kind to the cestuis que trust, is not to be regarded under the first sentence of section 113(a)5 as personal property "acquired by specific bequest," or as real property "acquired by general or specific devise or by intestacy," nor is it to be regarded under the third sentence as property "acquired either by will or by intestacy," for in such cases it is the original trust corpus that the cestuis que trust "acquired" under section 113(a)5, and where the trustees sell the original corpus and invest the proceeds in other property, there is no reason why the substituted property should also be considered as having been acquired "by will," or in any of the other ways specified in the subsection. On the other hand, where the interests of the cestuis are originally contingent, the property they acquire "by will" is the property as it exists when their interests become substantially vested, and, as to them, *prior* changes in form are immaterial. However, if the trustee sells and reinvests after the substantial vesting of their interests, and delivers the substituted property to the cestuis, the basis of such property in their hands will be the basis it had in the hands of the trustee.

In cases, therefore, where the testamentary cestuis que trust in question originally have substantially vested interests, and where the trustee sells the original corpus, reinvests the proceeds, and delivers

the substituted property to the cestuis que trust, it is ordinarily immaterial, so far as the basis in the hands of the cestuis is concerned, whether the original corpus constituted a specific bequest, a general bequest, or a devise of realty, for in any event the basis in the hands of the cestuis will be the basis the *substituted* property had in the hands of the trustee.

With respect to the basis of the stock certificates delivered to the daughters, it is the opinion of this office that different considerations prevail. While it is probable under Pennsylvania law (see *Billings' Estate*, 268 Pa., 71, 110 At., 768; *Groninger's Estate*, 268 Pa., 184, 110 At., 465; *Hood* v. *Maires*, 255 Pa., 128, 99 At., 481; *Jenning's Estate*, 266 Pa., 60, 109 At., 544) that their equitable interests at the testator's death in 1914 were technically vested rather than contingent, still the interest of each was subject to being divested by her death before "receiving" her "full share of the * * * principal," and, unlike the sons, the daughters had no power of appointment. Consequently, it is believed that their interests were not sufficiently substantial, at the time of distribution to the testamentary trustees, so that distribution to the daughters then occurred. Moreover, due to the peculiar phrasing of the will their interests did not become secure even on A's death in 1926. C's will stated that "in the event that any of my children shall die before *receiving his full share of the corpus or principal of my estate*" it should go to others, thereby apparently making *receipt* the occasion of the first acquisition by the daughters of a substantial ownership which could not be divested by their death. However, this office is not prepared to say that actual delivery of the certificates would be necessary, under the will, in order to give the daughters such ownership. It is possible that before actual delivery to the daughters the trustees made the shares of stock unqualifiedly subject to their demand in some manner which would satisfy the "receipt" requirement of the will. However, in the absence of any evidence on this point, it may be assumed that the basis of the stock in the hands of the daughters is the fair market value thereof at the time the certificates were delivered to them by the trustees.

Since it is assumed that the daughters did not acquire substantial ownership of the corpus until it was delivered to them, it is immaterial whether the shares of stock in question formed part of the original corpus of the trust, because, as already explained, it is the actual corpus delivered to them that must be regarded as constituting the "property" they "acquired * * * by will" under the third sentence of section 113(a)5. This is true, moreover, even if the original corpus of the trust, or a part thereof, was the subject of a devise or specific bequest, for in any event, due to the insubstantial nature of the daughters' interests at the time of C's death, the basis of property delivered to them in kind is to be determined under the third sentence of section 113(a)5 rather than under the first sentence. See, in this connection, the first part of this memorandum with reference to the will of B.

III.

The third will involved in this case is that of A, who died on June —, 1926, leaving seven children and appointing her three sons as her executors. The question here in issue concerns only

the last sentence of the fifth clause of said will, which provides in part as follows:

* * * The rest, residue and remainder of my estate * * * I give, devise and bequeath to my children, I, J, G, L, N, H and P, share and share alike, absolutely.

Here, again, the only question asked is with respect to the basis of the personalty in the hands of the children, and, as there is no evidence that any sales were made prior to 1928, the answer will have reference only to the basis under the Revenue Act of 1928.

Since it is clear that this residuary bequest of personalty is a "general," and not a "specific," bequest, the basis of such personalty in the hands of the legatees is governed by the third sentence of section 113(a)5, which provides that "In all other cases if the property was acquired either by will or by intestacy, the basis shall be the fair market value of the property at the time of the distribution to the taxpayer." According to the letter of inquiry, "distributions were made under date of May —, 1928, May —, 1928, and June —, 1928," none of them being by court order. The letter does not state what the writer means by the term "distribution," but does inquire whether the Commissioner considers that it would mean "the actual date of the mailing of the various securities to the seven children," and it is believed, therefore, that the writer of the letter has used the term "distribution" to mean the time the securities were mailed to the legatees.

With respect to the issue arising under this will, there is no question involved whether distribution to testamentary trustees constitutes distribution to the beneficiaries. The residue was bequeathed directly to the children in fee simple, and distribution to them unquestionably occurred whenever the securities ceased to form a part of the decedent's estate. The letter of inquiry states that there was no court decree of distribution, but contains no evidence as to what did occur other than that the securities were finally mailed to the children. If, as in the Matthiessen case, the residuary legatees, after providing for the decedent's debts, other legacies, etc., apportioned the securities among themselves by agreement, it is believed that the date of such agreement should, as in the Matthiessen case, be considered the date of distribution, even though the legatees did not receive individual possession of the physical property until a later date. If the three sons, in their capacity as executors, after providing for the decedent's debts, other legacies, etc., apportioned the property among the residuary legatees, the date of such apportionment should govern, even though physical delivery came later.

For example, it may well be that the executors mailed original certificates of stock, constituting a part of the residue and standing in the name of the decedent, to the corporations in question, requesting the corporations to transfer the stock on their books to the residuary legatees in certain specified proportions and to mail new certificates to the legatees, and that the corporations acted accordingly. In such an event, it is the opinion of this office that distribution of such stock to the legatees would occur not later than the mailing of the original certificates to the corporations (and it might well occur earlier than that), and would not be postponed until the new cer-

tificates were mailed or delivered to the legatees. (See the Matthiessen case, supra, 65 Ct. Cls., 484, cert. denied, 278 U. S., 609, and the decision of the district court in *Brewster* v. *Gage*, supra, 25 Fed. (2d), 915.) Obviously, however, the information given is too meager to enable this office to state definitely when distribution to the residuary legatees occured under the third will in this case.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

ARTICLE 596: Property transmitted at death. XI-14-5432
G. C. M. 10299

REVENUE ACT OF 1928.

The residuary estate of A was devised to a trustee in fee simple to pay the net income therefrom to the widow, and upon her death or remarriage to make sale thereof and divide the net proceeds among his heirs at law. The widow's death having occurred in 1929, the trustee disposed of the principal asset of the trust estate and distributed the proceeds to the residuary legatees.

Held, the proper basis for determining gain or loss from the sale by the trustee is the value of the property at the time of the death of the decedent, undiminished by the value of the widow's life interest in the income.

An opinion is requested relative to the method of determining gain or loss from the sale by a trustee of real property forming a part of the trust estate, under the following circumstances:

A died testate in 1914 leaving a widow and children surviving. After providing for a number of specific bequests all the rest and residue of his estate was disposed of under paragraphs of his will as follows:

The rest and residue of all property, real and personal, owned by me at the time of my death, as well as any property in which I have a vested or contingent remainder, situated in said State of R or elsewhere, I give and bequeath to —— in fee simple, in trust to collect and receive all rents from said real estate, and all interest and dividends from said personal property, and after the payment of all proper costs, interest upon all mortgages or deeds of trust upon said property, taxes, insurances, and repairs, then

To pay monthly, or at such periods as may be most convenient, the net income thereof to my said wife so long as she remains unmarried—I having full confidence that she will, in all things, have the true interests of our children at heart—and upon her remarriage or death, whichever shall first occur, to sell and convey all of said property, either at public or private sale, for such prices and upon such terms and conditions as he may think best and divide the net proceeds thereof equally among my heirs at law.

Under the terms of the will the trustee also had power to sell and convey in fee simple any or all of the property during the existence of the trust, if in his opinion such action was advisable.

After the death of the testator the income of the trust created by the will was paid to his widow until the date of her death in 1929. Immediately thereafter, and in the same year, the trustee disposed of the principal asset of the trust estate, consisting of the real property here in question, for the sum of $8x$ dollars. The proceeds of the sale were distributed to the residuary legatees during the year 1929. In computing the profit derived from the sale of the real property the trustee used as the basis for determining gain or loss the amount of $5x$ dollars, which represents the value of the real property

at the time of the decedent's death in 1914. The revenue agent has raised the question whether this basis should not be reduced by the value of the widow's life interest in the income of the trust property by taking into consideration her life expectancy.

It is contended by the taxpayer's representative that a reduction of the agreed value of the property at the time of A's death by the value of the widow's life interest, in order to ascertain the basis for determining gain or loss, would be erroneous for the reason that such action would completely ignore the fact that the widow had no interest in the corpus of the trust and that the sale was made by the trustee as specifically directed in the will. It is also pointed out that the trustee had legal title to the entire property; that he conveyed the fee simple title as distinguished from the interest of the residuary legatees; that such disposition was in accordance with the directions contained in the will whereby the trustee was to sell the property and distribute the proceeds to those persons entitled thereto; that the trustee's duties were not completed until the sale was made; and that the trust continued until the trustee's duties were performed.

The basis for determining gain or loss from the sale of real property in the year 1929 is governed by section 113(a)5 of the Revenue Act of 1928, which reads in part as follows:

Property transmitted at death.—If personal property was acquired by specific bequest, or if real property was acquired by general or specific devise or by intestacy, the basis shall be the fair market value of the property at the time of the death of the decedent. If the property was acquired by the decedent's estate from the decedent, the basis in the hands of the estate shall be the fair market value of the property at the time of the death of the decedent. In all other cases if the property was acquired either by will or by intestacy, the basis shall be the fair market value of the property at the time of the distribution to the taxpayer. * * *

There is no doubt that under the second sentence of section 113(a)5 the value of real property at the time of the death of the decedent is the proper basis to be used in determining gain or loss from the sale of the property. The question in the instant case is whether the agreed value of $5x$ dollars at the time of the decedent's death should be reduced by the value of the widow's interest as life beneficiary of the income, based upon her life expectancy, on the theory that only the interest of the residuary legatees rather than the entire property was sold by the trustee.

In General Counsel's Memorandum 6811 (C. B. IX–1, 136) the facts were that the testator, B, died in 1921 possessed of certain real estate which under the residuary clause of his will was devised in trust for the support of C during her lifetime, with remainder over to A in fee. If necessary, the corpus could also be used for the support of C. The life tenant (C) died in the year 1927 and the taxpayer (A) to whom the property passed upon the death of C sold the property in the year 1928. It was held in that case that the basis to A, the remainderman, was the value of his interest at the date of the testator's death in 1921. In that case the property passed to the remainderman upon the termination of the life estate and the remainderman sold the property in his individual capacity. In the instant case the property did not pass to the residuary legatees upon the death of the widow but it was sold by the trustee as directed by the will. The purchase price, including the profit realized by the trustee, was then distributed to the residuary legatees.

In the case of *William Huggett* v. *Commissioner* (24 B. T. A., 669), Mrs. Huggett's grandmother died testate in 1912 leaving her daughter a life interest in half of the income from certain securities with a part of the remainder over to the granddaughter, wife of the petitioner. The life beneficiary (mother of Mrs. Huggett) died in May, 1924. In the years 1925 and 1926 Mrs. Huggett sold stock distributed to her as remainderman after the death of the life beneficiary. The Board held that March 1, 1913, was the basic date for determining gain or loss, but held further that the proper basis was the *value of the remainderman's interest* as distinguished from *the value of* the stock itself on March 1, 1913. In other words, it was held that the value of the stock at the basic date must be reduced by the value of the life estate. The decision in the Huggett case, supra, sustains the consistent position of the Bureau which has been followed for many years in cases where sales are made by remaindermen after the termination of the life estate. (Sol. Op. 35, C. B. 3, 50; O. D. 694, C. B. 3, 53.)

The question arises whether the conclusion in the Huggett case, supra, is controlling under the facts in the instant case, where the property was sold by the trustee to carry out the specific provisions of the will instead of a distribution in kind and a subsequent sale by the residuary legatees. It is admitted that had the residuary legatees sold their interests prior to the date of death of the life beneficiary of the income, or had the property been distributed in kind to the residuary legatees upon the death of the life beneficiary and then sold by them, the proper basis for gain or loss purposes would have been the value of their interests at the time of the death of the decedent. But such a situation does not exist in the instant case. The determination of the issue must be based upon stern facts and realities. (*Weiss* v. *Stearn*, 265 U. S., 242, T. D. 3609, C. B. III-2, 51.) The sole issue in the instant case is the determination of the amount of profit realized by a trust created under a will upon the sale by the trustee of the corpus of the trust and a distribution of the proceeds to the residuary legatees.

In Solicitor's Opinion 35, supra, it was held that if real estate is devised by a testator to his widow for her life with a direction that upon her death the property shall be sold and the proceeds divided among their children, the basis for ascertaining gain or loss on a sale of such real estate and distribution of the proceeds to the children is the value of their rights at the time they vested, or on March 1, 1913, if they vested prior thereto. Upon examination of the facts in Solicitor's Opinion 35, supra, it appears that no trust was created under the provisions of the will. The real estate was devised to the widow for life with a direction that upon her death the property should be sold and the proceeds distributed to the children, who under the terms of the will were the remaindermen. Their interest was such that had they so elected prior to its sale they could have taken the land itself after the death of the life tenant instead of the proceeds from its sale. (Jarman on Wills, page 562, Volume I, sixth American edition, page 592, and cases there cited.) In other words, the question in that case was the same as though the land had been devised to the widow for life, with remainder in fee to the children without direction for sale of the property. As previously stated, there was no trust created under the terms of that will. It does ap-

pear, however, that after the death of the life tenant a trustee was appointed by the court to sell the property. Such a trustee was in effect acting as agent for the remaindermen in the sale of the property, and the result in that case was held to be the same as though the remaindermen had made the sale. In such a case the decision of the Board of Tax Appeals in the Huggett case, supra, would be controlling, with the result that the proper basis for gain or loss purposes would be the value of the property at the basic date, diminished by the value of the life estate on that date.

The facts in the instant case differ in that the trustee named in the will sold the property after termination of the widow's interest as life beneficiary of the income, in accordance with the directions contained in the will, and then distributed the proceeds to the residuary legatees. After the death of the testator the trustee held legal title to the property. The death of the life beneficiary gave the trustee nothing more nor less than he had from the date of death of the testator. He was not acting as agent of the residuary legatees in making the sale but was carrying out his duties as trustee. It is true that the widow's interest as life beneficiary had terminated and only the interests of the residuary legatees were left, but the trustee's position in regard to the property did not change at any time. He held legal title from the date the trust came into existence in 1914. In other words, Solicitor's Opinion 35, supra, General Counsel's Memorandum 6811, supra, and the Huggett case, supra, are each to be distinguished from the instant case on the ground that the sale in each of those cases was made by the remaindermen or their agent and not, as in the instant case, by the testamentary trustee during the continuance of the trust.

If an executor of an estate sells property upon the death of a decedent, the basis for determining gain or loss under the Revenue Act of 1928 is "the fair market value of the property at the time of the death of the decedent." Such a basis is specifically provided by section 113(a)5 of the Revenue Act of 1928. Both an executor and trustee act in a fiduciary capacity. As stated by the Board of Tax Appeals in the case of the estate of Horace E. Dodge (25 B. T. A., 29), the duties of an executor are those of a trustee. In addition, the trustee holds legal title to the real estate. The basis of property in the hands of a trustee is not affected by the right of a life tenant or life beneficiary to receive the income from the trust property.

Since a trust is recognized as a taxable entity under the statute and the property remained as an integral part of the trust res from the time of the creation of the trust until the conversion by the trustee, the basis in his hands must be held to be the value of the property at the date of the death of the decedent.

It is, therefore, the opinion of this office that the proper basis for determining gain or loss from the sale of the real estate in question by the trustee named in the will of A is the value of the property at the time of the death of the decedent, undiminished by the value of the widow's life interest in the income.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

ARTICLE 596: Property transmitted at death. XI-25-5518
G. C. M. 10607

REVENUE ACT OF 1928.

The second paragraph of the twenty-second clause of the will of A provides as follows:

"I further direct that in case any bonds, stocks, or other securities held by me at the time of my decease shall not be listed upon the —— Stock Exchange, or shall have no established market value, that said bonds, stocks, or other securities be divided in kind among my residuary legatees and devisees and not sold."

Held, that the above clause in the will did not result in specific bequests to the residuary legatees of the classes of securities named in that clause. Accordingly, the third sentence of section 113(a)5 of the Revenue Act of 1928 governs the basis for determining gain or loss from the sale or other disposition of the securities falling under that provision of the will.

An opinion is requested whether property transmitted under the second paragraph of the twenty-second clause of the will of A constituted a specific or general bequest. A decision on this point is stated to be necessary in order to ascertain the basis for determining gain or loss from the sale or other disposition of the classes of property mentioned in that clause of the will.

Section 113(a)5 of the Revenue Act of 1928 provides in part as follows:

(5). *Property transmitted at death.*—If personal property was acquired by specific bequest, or if real property was acquired by general or specific devise or by intestacy, the basis shall be the fair market value of the property at the time of the death of the decedent. If the property was acquired by the decedent's estate from the decedent, the basis in the hands of the estate shall be the fair market value of the property at the time of the death of the decedent. In all other cases if the property was acquired either by will or by intestacy, the basis shall be the fair market value of the property at the time of the distribution to the taxpayer. * * *

Under the first 18 clauses of the will of A a large number of specific devises and bequests were made, as well as a number of general legacies which are not here involved. The nineteenth clause of the will reads in parts as follows:

Subject to the payment of my debts and funeral expenses and the above-mentioned legacies, bequests, and devises, or such of them as may become effectual, I direct my executors to divide all the rest and residue of my estate and all my property not otherwise specifically disposed of by this will among my children, B, C, D, and E and the M Company, as trustee for my daughter, F, and her issue as hereinafter provided.

The twenty-second clause of the will reads as follows:

I direct that my executors and trustees have power to continue any investment in the stock or shares of the N Company, or in any stock of any other corporation, company, or enterprise which I have made during my lifetime and which they shall find to exist at the time of my decease and that they may continue my holdings in any such company, corporation, or enterprise in their discretion; and I direct that none of my executors shall at any time be subject to any liability for having failed to sell or dispose of any shares of stock or other securities or property which may form a part of my estate at the time of my death. * * *

I further direct that in case any bonds, stocks, or other securities held by me at the time of my decease shall not be listed upon the —— Stock Exchange, or shall have no established market value, that said bonds, stocks, or other securities be divided in kind among my residuary legatees and devisees and not sold.

It is the second paragraph of the twenty-second clause of the will quoted above which is directly involved in the question presented to this office. It is noted that in the first paragraph of the twenty-second clause the testator gave to his executors and trustees the power to continue in their discretion any investment in the stock of any corporation, company, or enterprise made during his lifetime which existed at the time of his decease. Then in the second paragraph of the twenty-second clause he directed that any bonds, stocks, or other securities held by him at the time of his decease which were not listed upon the —— Stock Exchange, or had no established market value should be divided in kind among the *residuary* legatees and devisees who were the children named in the nineteenth clause of the will. If under the provisions of the second paragraph of the twenty-second clause of the will the testator made specific bequests, then the value of the securities as of the date of death of the decedent will govern in accordance with the first sentence of section 113(a)5, supra. If that paragraph of the will resulted in general bequests, the basis for gain or loss purposes will be governed by the third sentence of section 113(a)5, supra—that is, the fair market value at the time of distribution to the taxpayer.

The following definitions of specific and general bequests or legacies are taken from 40 Cyc., page 1869, et seq.:

(I) Specific legacies. A specific legacy is a bequest of some definite, specific thing, capable of being designated and identified; one which separates and distinguishes the property bequeathed from the other property of the testator so that it can be identified, and delivered to the legatee as a particular thing or fund bequeathed. Such a legacy can be satisfied only by a delivery to the legatee of the particular thing bequeathed to him, and if that thing is not in existence when the bequest would otherwise become operative the legacy has no effect.

(II) General legacies. A general legacy is one which does not direct the delivery of any particular thing or paying of money out of any particular portion of the estate, but which may be paid or satisfied out of general assets; and so a legacy is general where it does not amount to a bequest of a particular thing as distinguished from others of the same kind. Accordingly a bequest of stock without any attempt at a definite description is a general legacy.

Section —— of the Revised State of R Code, in which State the taxpayer's will was probated, defines a specific legacy as follows:

A legacy of a particular thing, specified and distinguished from all others of the same kind belonging to the testator, is specific * * *.

A legacy is specific when it is a bequest of a specific article of the testator's personal estate distinguished from all others of the same kind. (*In re Campbell's Estate*, 27 Utah, 361, 75 Pac., 851.) A "specific legacy" is a gift by will of a specific article of testator's estate distinguished from all other things of the same kind, and which can be satisfied only by the delivery of such particular thing. (*In re Snyder's Estate*, 217 Pa., 71, 66 Atl., 157.) A "specific bequest" is a testamentary gift of a part of the donor's personal property, which corporal object or chose in action is so accurately described that it can be identified from all other things of its kind. (*In re Noon's Estate*, 49 Oreg., 286, 88 Pac., 673.)

In the case of *Kramer* v. *Kramer* (201 Fed., 248) it was stated that a specific legacy is a gift by will of a specific article of testator's

estate distinguished from all other things of the same kind and which can be satisfied only by the delivery of such particular thing.

The question was also considered in *In re Grosvenor's Estate* (173 N. Y. S., 203), and it was held that a bequest of specific personal property, which was to be appraised and divided between two legatees, was not a "specific bequest" which is a legacy of a particular thing, specified and distinguished from all others of the same kind belonging to the testator. The court pointed out that while the bequest contained in the first paragraph of the will of the testatrix in that case was a specific part of her personal estate, it was not a bequest of any particular part of her property to any particular legatee; that title to any particular article did not, upon the death of the testatrix, pass to either of the legatees; and that the executrix could not, until the appraisal and division provided for in the will had been made, deliver any particular article. It was stated by the court that "only a legacy of a particular thing, specified and distinguished from all others of the same kind belonging to the testator, is specific."

It was also stated in *In re King et al.* (106 N. Y. S., 1073) that a legacy is general when it does not amount to a bequest of a particular thing as distinguished from others of the same kind. Where a testator bequeaths a sum of money, or shares of stock, without further description or reference and which may be satisfied by the delivery to the legatee of any stock of the designated kind, such a legacy is general.

Legacies are presumed to be general or demonstrative, rather than specific, where the language of the will permits of that construction, and a court will lean against construing legacies specific. (*Roquet* v. *Eldridge*, 118 Ind., 147, 20 N. E., 733.) The technical rule of construction is, of course, that while a legacy will be deemed to be general rather than specific this rule must yield to the fundamental rule that the intention of the testator governs. (*In re Hunt's Will*, 189 N. Y. S., 55.)

It is well established that a gift of the residue of an estate is ordinarily a general legacy. (40 Cyc., 1877; *Bradford* v. *Haynes*, 20 Maine, 105; *Le Rougetel* v. *Mann, Ex.*, 63 N. H., 472, 3 Atl., 746.) In the last-named case the will provided in part that the decedent gave to Mann, the defendant, "also, all and singular my household furniture, wearing apparel, cattle, horses, carriages, tools * * * and all the rest and residue of my estate." The court held that the mere enumeration of certain articles in a bequest to the residuary legatees, followed by the words "and all the rest and residue of my estate," does not necessarily make the bequest specific as to the things enumerated.

In the case of *Stehn* v. *Hayssen et al.* (124 Wis., 583, 102 N. W., 1074) the decedent in his will gave to his wife all of his property, "including my interest in the firm of Kohler, Hayssen & Stehn." It was held that there was not a specific bequest of that interest.

The following language is found in *In re Painter's Estate* (150 Cal., 498, 89 Pac., 98, 101):

> And no doubt it is the general rule that the enumeration of specific articles in a residuary clause will not necessarily make the bequest specific as to such articles. * * * This rule has been repeatedly applied to wills which pur-

ported to give certain specified property, "and all the rest and residue of my estate" * * *.

In *Kemp* v. *Dandison* (169 Mich., 578, 135 N. W., 270) the testator's will contained the following provision:

All the rest, residue and remainder of my property real and personal, consisting in part of notes against my said son, William H. Kemp, amounting to seventeen hundred dollars principal, I give, devise and bequeath to my daughter, Fanny Dandison.

The court held in that case that the notes were a part of the residuary estate and that an enumeration of specific articles in a residuary clause does not make the bequest specific as to such articles; but that a gift is specific, where the specified things are so enumerated as to distinguish them from the residue. It was pointed out in that case that it is an unusual practice in the preparation of wills to create a specific bequest in a residuary clause but that, of course, if it was the clear intention of the testator so to do the provision should be given such effect. The general rule is, however, that such an enumeration of specific articles will not make the bequest specific as to such articles.

In the case of *In re Avery et al.* (150 N. Y. S., 429) the residuary clause of the will reads as follows:

All the rest, residue and remainder of my estate * * *, and all lapsed and void legacies, I give, devise and bequeath to Edward S. Avery, Helen F. Avery and Theodore S. Avery equally share and share alike.

It was contended in that case that there was a separate gift of all lapsed legacies to the three individuals named in the will, and that any legacy which had lapsed by reason of the death of the named beneficiary should be paid to these three individuals before any payment therefrom is made to make up the deficit in the payment of general legacies. The court refused to sustain the contention that the bequest of a legacy which lapsed was a specific bequest. It was held that it was clearly the intention of the testatrix to create a large number of general and specific legacies to the children, and the rest, residue, and remainder was to go to the residuary legatees especially mentioned.

A residuary bequest may be divisible and part be specific and part general, and if the testator clearly intended to make a specific bequest in the residuary clause of the will effect will be given thereto. The fact, however, that in giving the residue the testator describes certain specific property owned by him as forming a part thereof does not alter the character of the residuary gift. While it is possible that the nineteenth and twenty-second clauses of the will in the instant case could be interpreted as providing for both specific and general bequests, the definitions of specific and general bequests together with the reasoning in the several decisions cited above lead this office to the conclusion that the testator did not intend to make a specific bequest of the particular classes of securities mentioned in the twenty-second clause of the will.

Under the nineteenth clause the testator provided for the division of his residuary estate among his five children. Later in that particular portion of the twenty-second clause now under consideration he directed that certain classes of securities should be divided in kind among his *residuary* legatees. It was the apparent intent of

the testator, after providing for numerous specific and general devises and bequests in the first 18 clauses of the will, that there should be a division among his children of the rest and residue of his estate, including securities not listed on the —— Stock Exchange, or having no established market value. In other words, he merely directed in the second paragraph of the twenty-second clause of his will that instead of selling the securities of the classes mentioned, when a division of the residuary estate was made, these securities should be distributed in kind among his five children. The nineteenth clause was a residual granting clause while the second paragraph of the twenty-second clause was merely directory as to the distribution of a portion of the residuary estate. The testator did not, in that clause of the will, mention or describe any particular securities nor did he provide that any particular stocks, bonds, or securities should be distributed to any particular child. In the opinion of this office the wording of the will does not indicate that the testator intended the legacies bequeathed to his residuary legatees to take precedence over all of the general legacies contained in the first 18 clauses of his will, including certain charitable bequests and a bequest to his wife of x dollars. Such an interpretation of the will clearly would not be a reasonable one.

After consideration of the entire will of A, and especially the nineteenth and twenty-second clauses thereof, this office is of the opinion that the last paragraph of the twenty-second clause of the will did not result in specific bequests to the residuary legatees of the classes of securities named in that clause of the will. Accordingly, the third sentence of section 113(a)5, supra, governs the basis for determining gain or loss from the sale or other disposition of the securities falling under that provision of the will.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

ARTICLE 597: Property acquired upon an exchange. XI-8-5394
I. T. 2615

REVENUE ACTS OF 1926 AND 1928.

Determination of the basis of property acquired by exchange illustrated.

Inquiry is made relative to the decision rendered by the United States Board of Tax Appeals in the case of *W. H. Hartman Co.* v. *Commissioner of Internal Revenue* (20 B. T. A., 802, C. B. X-1, 27) and the effect of that decision upon the basis for determining subsequent depreciation and for determining subsequent gain or loss in similar cases.

Section 203(b)1 of the Revenue Act of 1926 and section 112(b)1 of the Revenue Act of 1928 provide "No gain or loss shall be recognized if property held for productive use in trade or business or for investment * * * is exchanged solely for property of a like kind to be held either for productive use in trade or business or for investment."

In Senate Report No. 398, page 14, on the Revenue Act of 1924 (which Revenue Act contains a subsection identical with the same provisions of the Revenue Acts of 1926 and 1928), it was stated:

* * * The existing law provides that no gain or loss is recognized if property held for investment or for productive use in trade or business is exchanged for property of a "like kind or use." The contention was made that this provision divided all property into two classes: Property held for investment and property held for productive use in trade or business; and, consequently, that if any property held for investment was exchanged for other investment property, or if any property held for productive use was exchanged for other property to be held for productive use, the exchange was for property of a "like kind or use," and the gain was exempt from tax. In the bill the language is changed to provide that the property held for investment or for productive use must be exchanged for a like kind of property. If the property received is of a like kind, it is immaterial whether it is to be held for investment or for productive use. The intention of the party at the time of the exchange is difficult to determine, is subject to change by him, and does not represent a fair basis of determining tax liability. Consequently it is provided in the bill that no gain or loss is realized if the property received is of a like kind, to be held either for investment or for productive use. * * *

In the Hartman case, supra, the old printing press and auxiliary machinery "held for productive use" in the business of the taxpayer were exchanged "solely" for a new press and auxiliary machinery, the latter being "property of a like kind" and for use in the same trade or business for which the former was held and used. While money was paid in addition to the exchange of the machines, no property whatsoever other than the new press and equipment was received. The Board held that no taxable gain resulted from the transaction.

The decision of the Board in the case of W. H. Hartman Co., supra, is correct under the provisions of law referred to above and has been accepted by the Bureau as a precedent. (See I. T. 2573, C. B. X–1, 215.)

In computing the basis for determining subsequent depreciation allowances and for determining subsequent gain or loss in similar cases, the purchase price of the new machine or equipment should be decreased or increased according to whether the trade-in value of the old machine or equipment is greater or less than the depreciated cost of the old machine or equipment.

To illustrate:

OLD PRESS.		NEW PRESS.	
Cost	$7,000	Purchase price	$58,124
Depreciation allowed	5,425	Subtract:	
		Excess of trade-in allowance over depreciated cost	16,549
Depreciated cost as at date of exchange	1,575		
Trade-in allowance	18,124		
Excess of trade-in allowance over depreciated cost	16,549	Basis for depreciation on subsequent sale or disposition of new press	41,575

In the above illustration, if the trade-in allowance was less than the depreciated cost as at the date of the exchange, the excess of depreciated cost over the trade-in allowance for the press should be added to the purchase price of the new press in order to arrive at the basis.

ARTICLE 604: Readjustment of partnership interests. XI-2-5349
G. C. M. 10092

REVENUE ACT OF 1928.

The basis of computing gain or loss upon the sale by a partnership of an asset contributed in kind to the partnership enterprise is the cost or other basis thereof to the contributing partner. Any gain or loss computed on such basis should be taken into account for income tax purposes at the time of sale of the asset and any gain should be taxed to the partners in accordance with their distributable shares of the partnership income.

An opinion is requested concerning the determination of profit from the sale of securities contributed as capital to a partnership and subsequently sold by the partnership during the year 1928, the year in question.

The partnership in question (A, B & Co.) was organized on January —, 1928, to take over certain securities that had been accumulated by a long line of successive business partnerships, which have operated under the name of A and B for a number of years. Each of these business partnerships had in turn accumulated certain securities as a reserve fund and, as new business partnerships replaced the old, this reserve of each partnership was carried forward on the books of the new partnership as belonging to the respective members of the partnership which had accumulated it. Due to the large number of these partnerships that had preceded the particular partnership that was dissolved on December 31, 1927, there were substantial bookkeeping difficulties in keeping straight the accounts of the numerous partnerships and of the respective accounts of the partners of each.

At the time a new business partnership of A and B was organized, in the beginning of the year 1928, to admit one C to membership, the partners organized the instant security-holding partnership of A, B & Co. to take over and hold the securities in the above-mentioned reserve accounts, which were contributed by the owners thereof as partnership capital. The membership in the business partnerships and the security-holding partnerships has since remained the same. The share rights of the members in the respective business partnerships were identical and, at least so far as the instant A, B & Co. is concerned, have no relationship to the amount of capital contributed, except that a — per cent credit on capital contributions was allowed to the contributors before earnings were available for division among the members in accordance with their proration agreement. C, the new member taken into the business partnership at its organization in 1928, had no share in the earlier reserve accounts, nor the securities represented thereby, and, therefore, made no capital contribution to A, B & Co. during the year 1928. However, he was entitled to share in the earnings of A, B & Co. after allowance of the — per cent credit on capital accounts. The securities contributed were set up on the books as capital contributions in amounts equal to the then value of the securities. Subsequently, in 1928 some of these securities were sold for an amount greater than either their cost to the contributing partners or their value at the time contributed to A, B & Co.

The questions presented by the instant case include questions as to the time of realization of profits, by whom realized, and bases for computing gain or loss to the partnership and the members thereof.

It has been the consistent position of the Bureau that no gain or loss is realized upon the contribution of assets in kind by partners to a partnership enterprise, nor upon what is obviously the exact converse—a liquidation in kind from the partnership to the partners. (See S. O. 42, C. B. 3, 61; article 1570 of Regulations 45 and 62; article 1603 of Regulations 65 and 69; and article 604 of Regulations 74.) Solicitor's Opinion 42, supra, makes it clear that this position is based upon the proposition that such transactions between a partnership and its members were not closed transactions resulting in realization of gain or loss. Technical legal conceptions that regard assets contributed or liquidated in kind as being transfers between partnership and partner or transfers of fractional interests between partners (depending upon the vagaries of State laws) were disregarded in favor of a uniformly applicable rule, which interpreted the contribution and liquidation of assets in kind as not constituting closed transactions, thereby making the realization of gain or loss await subsequent events.

It should be noted that such position rests essentially on nonrealization of income rather than on nonrecognition of income, which in theory serves to postpone the time such income is subjected to taxation. That is necessarily true for the reason that nonrecognition or postponement (being an exception to the general scheme of taxing statutes) is warranted only when the statute expressly provides for such exceptional treatment—and Congress has not seen fit to make such statutory concept applicable to transactions involved in the partnership form of business association. It should also be noted that the position consistently expressed in the regulations is hardly open to question, and apparently is not questioned at this late date, in view of the repeated reenactment of the statutory partnership provisions without substantial change. Since the rule announced in the regulations has become settled law, it follows that the underlying theory is a part thereof, for one may not accept the rule and question its basic reasoning or attendant principles which must be resorted to in the application of the rule to varying facts.

The proposition that, unless there is such a disposition as amounts to a closed transaction respecting a particular asset, the capital basis for computing gain or loss remains unchanged, is elementary. Accordingly, when a partner contributes an asset in kind to the partnership without realization of gain or loss, the asset retains the same basis in the hands of the partnership. The contention that to treat the partnership as having the same basis as that of the contributing partner will in effect disregard the proper capital cost of the other partners in cases where the cost to the contributing partner and the value at date of contribution differ is without foundation if due force is given to the partnership agreement. This may best be demonstrated by reference to an illustrative case.

Suppose A owns a mill, having a basis of $10,000 in his hands, which has greatly appreciated in value while held by him. Assume that it had a value of $100,000 in 1928 when he entered into a partnership agreement with B, under which A contributed the mill worth $100,000, B contributed cash of $100,000, and they were to operate a mill business in which each was to share equally. Then suppose after the partnership was formed and before operations were

begun, they sold the mill for $200,000 and invested their capital in another enterprise which they operated as a partnership business.

Under the principles stated above, which establish the basis of the mill in the hands of the partnership at $10,000 (the basis to A), the partnership realized $190,000 income upon the sale of the mill for $200,000. Actually B's distributable share thereof is but $50,000 under his partnership agreement which includes the agreement that the mill was worth $100,000 when contributed, and that A, accordingly, be credited with that amount in his capital account with the firm. In other words, the effect of the agreement, so far as the above-described transaction is concerned, was that A and B would share equally in any proceeds from the sale of the mill in excess of $100,000. As such excess in the stated case was $100,000, B was entitled to only one-half thereof, or $50,000, which was distributable to him. Manifestly the remaining $140,000 must be regarded as distributable to A for income tax purposes, even though the partners considered and agreed to treat $90,000, the measure of appreciation in value while held by A, as partnership capital which was not subject to withdrawal. The taxing Acts (sections 181 to 183 of the Revenue Act of 1928 and the corresponding sections of prior Revenue Acts) measure the income taxable to A by the "distributable," rather than the "distributed," amounts, and such measure may not be varied by agreement between the parties.

It has been urged that the $90,000 is not taxable to A until liquidation of the partnership, when it will be reflected in the difference between the cost basis of his interest in the partnership and the amount liquidated to him. Such contention necessarily rests upon strangely inconsistent fundamental concepts—i. e., (1) that upon formation of the partnership A exchanged the mill property for a partnership interest without realization of gain or loss (a proposition that fails to distinguish between the interpretative expression "nonrealization" of income and the statutory expression "nonrecognition" of income), and (2) that despite the fact that upon formation of the partnership there was no disposition of an asset resulting in gain or loss, the asset thereafter takes a new basis in the hands of the partnership which thereby acquired it (a proposition to which Congress has assented only in rare instances even where nonrecognition of income was authorized). The sum and substance of the contention urged when applied to the general questions presented seem to be that the concept of nonrealization of income is applicable to transactions involving contributions in kind upon formation and liquidations in kind upon dissolution to obtain the advantages of "nonrealization" to participating members of the partnership, but the concept of nonrecognition is applicable to the same transactions to avoid the correlative disadvantages to the partnership as such. In other words, that contention accepts the Bureau's position which permits contributions without realization of gain or loss to the partners; discards the Bureau's position which requires the partnership to take the contributed property up at the same basis that it had in the hands of the contributing partner, for an inconsistent theory which would give the partnership a new basis for computing its gain or loss; and in turn accepts the Bureau's position which permits liquidation of partnership property in kind without realization of gain or loss to the partners.

The securities in question in the instant case were distributed in kind pro rata among the members of the business partnership firm which acquired them (which partners as individuals have since continued their common ownership therein) and they were not again contributed to partnership capital until the instant security-holding partnership of A, B & Co. was organized, though they were carried for convenience on the books of intervening business partnerships. The bases of such securities to the instant security-holding partnership are the bases of such securities in the hands of the members of the acquiring business partnerships after liquidation to them in kind, namely, the adjusted bases of their respective interests in those partnerships.

The underlying principles discussed in connection with the basis of computing gain, and its allocation among the partners in the illustrative case stated above, are also applicable to the determination of loss and its allocation among the partners. For example, if the mill had cost A $200,000, had had a value of $100,000 at the time contributed, and had been sold for $10,000, the partnership loss would have been $190,000—that is, the excess of the partnership's basis of $200,000 (A's basis) over $10,000, the selling price. Under the principles above stated with respect to the case where gain resulted, $45,000 would be an allowable loss deduction to B and $145,000 to A. This is the exact converse of the illustrative gain case stated above.

Again, assume that the mill cost A $10,000; had a value of $100,000 at the time contributed; and was sold for $50,000, the partnership's gain would have been $40,000—that is, the excess of the selling price of $50,000 over the partnership's basis of $10,000 (A's basis). Under the principles stated above all of such gain is taxable to A, since the gain was less than the appreciation in value that occurred while the asset was held by A. The $40,000 gain thus realized by A serves to increase the cost of his partnership interest to $50,000. Manifestly, under the stated facts A's only possibility of realizing on the remainder of the appreciation in value of $50,000 ($90,000 unrealized appreciation less $40,000 appreciation realized on the sale of the mill by the partnership), occurring in his hands prior to his contribution of the mill to the partnership, would result from the reflection of such appreciated value in his capital account with the firm, which realization depends upon the success of the general partnership business. That is, such $50,000 unrealized appreciation represents the difference between the adjusted cost of A's interest in the partnership, or $50,000, and his partnership capital account of $100,000 (the agreed basis for division of partnership assets and profits among the members upon liquidation), and will be taxable upon liquidation only to the extent the assets received by A in liquidation exceed the adjusted basis of his partnership interest.

It has been suggested that complications will arise in computing either gain or loss where partnership property is purchased by one of the partners. However, such a transaction, whatever form it may take and however it may be designated, is in reality nothing more than one partner buying the interest of his partner in such property. That is, in effect the property in question is liquidated in kind pro rata among the partners and then one partner buys the undivided interest of the other partner. The gain or loss to the partner who sells his undivided interest will be measured by the difference be-

tween the basis of such interest in the property and the proceeds from the sale of such interest. The purchasing partner does not, of course, realize gain or loss upon the liquidation of an undivided one-half interest in the property in kind or the purchase of the other undivided one-half interest in the property, but the basis which the entire property takes in his hands will be the basis to him of the interest in the property which he acquired upon liquidation, plus the amounts actually expended by him in the purchase of the other partner's interest. For example, in the illustrative gain case first stated above assume that A reacquired the mill at its then value of $200,000. The bases of the undivided interests of A and B in the mill upon liquidation to them in kind are $5,000 in the case of A (one-half of his original cost basis of $10,000) and $50,000 in the case of B (one-half of his original cash contribution). The basis of the mill in A's hands is $5,000, the basis of the undivided interest liquidated to him, plus $100,000 paid to B for the undivided interest liquidated to him, or a total basis of $105,000. The gain to B upon the sale of his undivided interest to A is $50,000.

The Bureau's position is similarly applicable in connection with depreciation and other like deductions designed to return capital cost tax free. They differ from the recovery of capital cost on a sale (which is required by the Constitution before income can arise) only in that they are mere statutory allowances that may not be adequate in the aggregate (either because the allowances made in some of the Revenue Acts were not sufficient or because the estimates which measure the deductions may not coincide with the facts) to permit recovery of cost. (See *United States* v. *Ludey*, 274 U. S., 295, T. D. 4046, C. B. VI–2, 157, as interpreted and modified in *Burnet* v. *Thompson Oil & Gas Co.*, 283 U. S., 301.) That is, the cited cases treat depreciation as being in effect a partial disposition of the mill asset, with the qualification that such disposition may give rise to income before recovery of all the cost of the portion of the asset used up. Suppose the mill (which in the first illustrative case above cost A $10,000 and was contributed at $100,000) was operated for one year before it was sold by the partnership, with a resultant allowable depreciation of 10 per cent and a gross partnership income of $20,000 after all deductions except depreciation.

The depreciation allowable to the partnership would be 10 per cent of its cost basis of $10,000, or $1,000, leaving a taxable income of $19,000 from the operations that in effect disposed of 10 per cent of the mill. Of this $19,000, $9,000 (as indicated in the discussion above relating to the sale of the whole) has already been recognized by the partnership agreement as A's capital and set aside for him before any income is available for division between the partners. That is, the $19,000 income (the partnership agreement that part thereof is capital not being controlling for income tax purposes) is distributable $14,000 to A and $5,000 to B. Thus the capital interest of partners other than the contributing partner is protected by the partnership agreement which measures their distributable shares of gain or loss by using the value at the time turned in as the basis of sharing gain or loss.

The fact that a partnership may be an organization of substantial size operating a group of assets acquired from various sources does not unduly complicate the accounts as respects one or more assets

contributed by the partners. As between themselves, they have set up a capital account in such assets equal to the value they recognized in them at the date of contribution. In all probability a partnership depreciation account computed on such value will be carried on the books. For example, using the case just stated, such depreciation account for the year of operations would be $10,000, or one-tenth of the $100,000 value of the asset at contribution. In effect that amount is set aside to keep intact the recognized capital contribution of A. For income tax purposes, however, such $10,000 is not all capital, as in it is reflected $9,000 realized income distributable to A. If such $9,000 is included in A's current income, the $10,000 partnership depreciation account then truly represents capital for income tax as well as other purposes and its use will accomplish the proper allocation of the remaining profits in accordance with the partnership agreement. It thus becomes manifest that a consistent application of the logic underlying the Bureau's position maintains the ordinary distinctions between capital and income as respects all parties.

It is, therefore, the opinion of this office that the basis of computing gain or loss upon the sale by a partnership of an asset contributed in kind to the partnership enterprise is cost or other basis to the contributing partner; that gain or loss computed on such basis is taxable at the time of such sale; and that such gain or loss should be taxed to the partners in accordance with their distributable share thereof as indicated by the above illustrative cases.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

SECTION 116.—EXCLUSIONS FROM GROSS INCOME.

ARTICLE 643: Compensation of State officers and employees. XI-21-5486 I. T. 2627

REVENUE ACT OF 1928.

The compensation of the taxpayer as director of parks and forestry of the city of ———, Kans., was not received as an officer or employee of a political subdivision of a State engaged in the exercise of an essential governmental function and such compensation is subject to the Federal income tax.

Advice is requested relative to the application of Mimeograph 3838 (C. B. IX-2, 137) to the salary received by A as director of parks and forestry of the city of ———, Kans. The question is presented whether such salary is subject to Federal income tax.

Mimeograph 3838 reads in part as follows:

Public parks and playgrounds.—A city in maintaining parks and recreation playgrounds is not acting in a governmental capacity. The compensation of officers and employees received in connection with such activities is taxable. * * *

In the case of *Augustine* v. *Town of Brant* (249 N. Y., 198, 163 N. E., 732), upon which the above-quoted provisions of Mimeograph 3838 are based, the court said:

* * * In *Edinger* v. *City of Buffalo* (213 N. Y., 674, 107 N. E., 1076) it was held that an action would lie against the city of Buffalo for negligence

in the maintenance of a municipal playground established under a permissive statute. The unreported opinion of Lambert, J., at special term stated the ground of liability. He concluded that the establishment of municipal playgrounds is in no sense a governmental function. The establishment of town parks and playgrounds stands on the same footing. They are established for the pleasure and convenience of such towns as see fit to avail themselves of the legislative permission. We can draw no satisfactory distinction between a town park or playground and a city playground. The establishment of town parks is not a public duty imposed upon the town, and the town does not act as an agent of the State when it avails itself of the privilege of maintaining them.

Public duties properly styled governmental in character include, among others, the functions of fire and police protection, the protection of health, and the administration of public charities. * * *

* * * * * * *

* * * The establishment of a town park may incidentally benefit the public health, but that fact does not make the acts of the town in maintaining the park the exercise of a governmental function. * * *

A, the taxpayer in the instant case, is employed by the city of ———, as director of parks and forestry at an annual salary. His duties consist of superintending the cultivation, planning, and maintenance of the public park system. It is contended that the above-quoted language of Mimeograph 3838 is not applicable to A's case because under the laws of the State of Kansas the city of ——— is required to maintain a system of parks, parkways, and boulevards, whereas such activities are optional under the laws of the State of New York.

In the protest filed on behalf of the taxpayer it is stated that the director of parks and forestry is an appointive office; that it is created under statutory enactment and his employment is pursuant to duly executed ordinances of the city of ———; and that his duties are provided under a very elaborate ordinance pertaining to the control of trees and shrubs along the public highways of the city. It is also stated that the ordinance is directory, administrative, and penal in its nature; that A's employment is not the result of a contract; and that his position carries a fixed salary. The following is quoted from the case of *Hibbard* v. *City of Wichita* (98 Kans., 498, 159 Pac., 399):

A number of States follow a principle contrary to the one that has been followed in this State, so far as negligence in the maintenance of parks is concerned; while a number of other States adhere to the rule declared in this State. A collation of these authorities at this time will not serve any good purpose. The rule herein announced is firmly fixed in our jurisprudence and must be followed, unless distinctly overruled.

In the Hibbard case a child, while in the zoological part of a public park maintained by the city of Wichita, wandered to the animal cages where her hand was seized and badly bitten by a coyote. Suit was filed against the city to recover damages and the plaintiff received judgment in the lower court. On appeal the case was reversed and the Supreme Court of the State of Kansas, in the syllabus by the court, stated as follows:

The maintenance of a zoological garden in a public park by a city is a "governmental function," and the city is not liable in damages for injuries inflicted on visitors by animals through the negligence of the city's officers or agents in not properly confining the animals.

Other decisions are cited and quoted in the protest filed on behalf of the taxpayer to show that the Supreme Court of the State of

Kansas holds that the maintenance of a park by a city for the sole benefit of the public, and not for the profit or benefit of the municipal corporation, is a governmental or public function.

Inasmuch as the taxpayer in the instant case is an officer or employee of the city of ———, Kans., the question to be determined is whether his services are rendered in connection with the exercise of an essential governmental function.

The decisions of the courts of the several States are at variance upon this question, and, in order to obtain a uniform rule for Federal income tax purposes, this office has followed the decisions of the State courts which hold that the maintenance and operation of parks and recreational grounds is the exercise of a proprietary and not an essential governmental function. In regard to whether the maintenance and operation of parks by a city is an essential governmental function, the following excerpt is quoted from the decision in the case of *State ex rel. Wood, Attorney General*, v. *Schweickardt et al.* (109 Mo., 496, 19 S. W., 47):

* * * And it must also be borne in mind * * * that in relation to the property in question, and the discretionary control of the city over it, it must be regarded as a matter of purely local concern, as held and owned by the city not in its political or governmental capacity, but in a *quasi* private capacity, in which the municipal authorities act for the exclusive benefit of the corporation whose interests they represent. This position is abundantly sustained by authority, as shown by briefs of counsel. On the point of the different capacities in which municipal corporations may act, an eminent jurist and author observes: "They may be endowed with peculiar powers and capacities for the benefit and convenience of their own citizens, and in the exercise of which they seem not to differ in any substantial degree from the private corporations which the State charters. They have thus their public or political character, in which they exercise a part of the sovereign power of the State for governmental purposes, and they have their private character, in which, for the benefit and convenience of their own citizens, they exercise powers not of a governmental nature, and in which the State at large has only an incidental concern, as it may have with the action of private corporations. It may not be possible to draw the exact line between the two, but provisions for local conveniences for the citizens, like water, light, public grounds for recreation, and the like, are manifestly matters which are not provided for by municipal corporations in their political or governmental capacity, but in that *quasi* private capacity, in which they act for the benefit of their corporators exclusively. In their public, political capacity they have no discretion but to act as the State which has created them shall, within constitutional limits, command; and the good government of the State requires that the powers should at all times be ample to compel obedience, and that it should be capable of being promptly and efficiently exercised. In the capacity in which they act for the benefit of their corporators merely there would seem to be no sufficient reason for a power in the State to make them move and act at its will, any more than in the case of any private corporation. * * *"

In the case of *Proprietors of Mount Hope Cemetery* v. *City of Boston* (158 Mass., 509, 33 N. E., 695) the court said:

* * * The city of Boston is possessed of much other property which in a certain sense, and to a certain extent, is held for the benefit of the public, but in other respects is held more like the property of a private corporation. Notably among these may be mentioned its system of waterworks, its system of parks, its market, its hospital, and its library. In establishing all of these, the city has not acted strictly as an agent of the State government, for the accomplishment of general public or political purposes, but rather with special reference to the benefit of its own inhabitants. * * *

In view of the foregoing, it is held that the city of ———, Kans., in operating a system of parks is acting in a proprietary capacity and is not discharging an essential governmental function. The fact

that under the laws of the State of Kansas the city is required to maintain a system of parks, parkways, and boulevards does not change the nature of the activity. Accordingly, it is held that the compensation received by A as director of parks and forestry of the city of ———, Kans., was not received by him as an officer or employee of a political subdivision of a State engaged in the exercise of an essential governmental function, and such compensation is, therefore, subject to the Federal income tax.

SUPPLEMENT C.—CREDITS AGAINST TAX.

SECTION 131.—TAXES OF FOREIGN COUNTRIES AND POSSESSIONS OF UNITED STATES.

ARTICLE 691: Analysis of credit for taxes.

REVENUE ACT OF 1928.

Tax imposed by law of Mexico, effective August 1, 1931. (See I. T. 2620, page 44.)

SUPPLEMENT D.—RETURNS AND PAYMENT OF TAX.

SECTION 144.—WITHHOLDING OF TAX AT SOURCE.

ARTICLE 761: Withholding tax at source. XI–19–5472 I. T. 2624

REVENUE ACT OF 1928.

Withholding of income tax on royalties paid to a nonresident alien author.

A ruling is requested upon several questions arising in connection with the payment of royalties to a nonresident alien author. The questions and the replies thereto are as follows:

1. Normally the M Company (an American publishing company) deducts a 5 per cent income tax when paying royalties to a nonresident alien author. In case such author visits the United States and during his stay here is paid an amount representing royalties already earned, or is paid an amount representing future royalties on a new book, shall the M Company deduct the tax of 5 per cent?

An alien, by reason of his alienage, is presumed to be a nonresident alien. (Article 1024 of Regulations 74.) Unless an alien author acquires a residence in the United States, his status during his stay in the United States is that of a nonresident alien. The M Company is required to withhold a tax of 5 per cent from the royalties paid to a nonresident alien author which are already earned. Royalties are considered fixed or determinable income, and are subject to withholding. (See section 144(b) of the Revenue Act of 1928 and article 762 of Regulations 74.) Royalties paid to an author in advance of the publication of his work constitute income for the year in which they are paid. Consequently, the M Company is required to withhold

a tax of 5 per cent from royalties advanced to a nonresident alien author, and the author is required to report such royalties as income for the year in which received by him. The M Company should furnish the nonresident alien author who is visiting in the United States with a memorandum showing the name of the author, the date of the payment, and the amount of tax withheld, so that the author, prior to his departure from the United States, may exhibit such memorandum to the internal revenue officer when making an application for a certificate of compliance with the income tax law. (See section 147(e) of the Revenue Act of 1928.)

2. In the event that the same author, instead of receiving the check, requests the M Company to deposit such check to his account in an American bank, shall the M Company deduct the tax before making the deposit?

A check, representing royalties, deposited to a nonresident alien's account in an American bank is the payment of income the same as if the check were forwarded direct to the alien abroad. Under such circumstances, the M Company is required to withhold a tax equal to 5 per cent of the amount of income represented by the check.

3. If an alien author residing abroad directs the M Company to deposit all checks for his royalties in an American bank, shall the M Company deduct the 5 per cent before depositing?

The answer to the second question is applicable.

4. A nonresident alien author making a lecture tour in the United States is paid for his services while in this country. Is that author required, before leaving the country, to personally declare such income and to pay the United States income tax on such earnings, or is the tax withheld by the promoters of his lecture tour?

The income which a nonresident alien author on a lecture tour in the United States receives for his services is subject to withholding at the rate of 5 per cent. In connection with such compensation, the author may enjoy the benefit of the personal exemption of $1,500, and if he is a resident of Canada or Mexico a credit of $400 for each dependent, by filing with the payor of the income Form 1115. In that case the payor of the income is not required to withhold any tax from the compensation unless and until the total amount paid exceeds the amount of the personal exemption and the amount of the credit for dependents, in cases where the author is entitled to such credit. The author, whether or not tax has been withheld from his income, is required to obtain a certificate of compliance before departing from the United States. He will be required to declare his income for the three preceding years from sources within the United States, as well as his entire income from sources within the United States for his taxable period—that is, from January 1 up to and including the last day of the month preceding that of his intended departure. In computing his income tax liability credit is allowed for the amount of tax withheld at the source, and if any additional tax is due it will be collected before he departs from the United States.

5. A nonresident alien author is represented in this country by a resident agent, to whom all royalty payments are made. Who is responsible for the withholding of the income tax, the publisher or the author's agent?

If the publisher is aware of the status of the author to whom he pays royalties through an agent in the United States—that is, that

the author is a nonresident alien—the publisher is required to withhold a tax equal to 5 per cent of the royalties paid to the resident agent. Otherwise the duty of withholding the tax will devolve upon the agent.

SECTION 148.—INFORMATION AT SOURCE.

ARTICLE 818: Information as to actual owner. XI–11–5414 Mim. 3942

Dividends credited by brokers and reported on Form 1087.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C., March 4, 1932.

Collectors of Internal Revenue, Internal Revenue Agents in Charge, and Others Concerned:

Reference is made to I. T. 2590 (C. B. X–2, 195) and I. T. 2606 (C. B. X–2, 196), relating to information returns, Form 1087, which brokers are required to prepare and file in respect of dividend payments credited to their customers' accounts.

It has come to the attention of the Bureau that some taxpayers have interpreted these rulings as relating to dividends required to be reported in their individual returns. Such interpretation is in error, as the rulings relate only to information returns, Form 1087. The law and regulations require taxpayers to report in their returns all items of income, including dividends received during the entire taxable year, regardless of the amount of each item or the particular date during the taxable year on which received or credited to the taxpayer's account by a broker.

Correspondence and inquiries regarding this mimeograph should refer to the number and the symbols IT: E: JCW.

DAVID BURNET, *Commissioner.*

SUPPLEMENT G.—INSURANCE COMPANIES.

SECTION 204.—INSURANCE COMPANIES OTHER THAN LIFE OR MUTUAL.

ARTICLE 992: Gross income of insurance companies other than life or mutual. XI–24–5509 Ct. D. 496
(Also Section 113, Article 591.)

INCOME TAX—REVENUE ACT OF 1928—DECISION OF SUPREME COURT.

GAIN OR LOSS—BASIS—CONSTITUTIONALITY—INSURANCE COMPANY OTHER THAN LIFE OR MUTUAL.

In the case of a stock fire and marine insurance corporation, in determining the amount of "gain during the taxable year from the sale or other disposition of property" acquired before January 1, 1928, which is gross income of the corporation under section 204(b)1, clause B, of the Revenue Act of 1928, the basis to be used is that provided by section 113 of that Act. That clause in requiring the inclusion in gross income of the corporation of the gain so determined is constitutional.

SUPREME COURT OF THE UNITED STATES. NOS. 548 AND 547.—OCTOBER TERM, 1931.

548. *Joseph S. MacLaughlin, Collector of Internal Revenue for the First District of Pennsylvania*, v. *Alliance Insurance Co. of Philadelphia.*

547. *The Insurance Co. of the State of Pennsylvania* v. *Joseph S. MacLaughlin, Collector of Internal Revenue for the First District of Pennsylvania.*

On certificates from the United States Circuit Court of Appeals for the Third Circuit.

[May 16, 1932.]

OPINION.

Mr. Justice STONE delivered the opinion of the court.

Appellee in No. 548, a Pennsylvania stock fire and marine insurance corporation, brought the present suit in the District Court of Eastern Pennsylvania, to recover income tax for the year 1928, alleged to have been illegally exacted. Under the Revenue Acts of 1913, 1916, 1917, and 1918, stock fire insurance companies were taxed upon their income, including gains realized from the sale or other disposition of property, accruing subsequent to March 1, 1913; but by the Revenue Acts of 1921, 1924, and 1926, gains of such companies, from the sale or other disposition of property, were not subject to tax, and losses similarly incurred were not deductible from gross income.

Supplement G of the Revenue Act of May 29, 1928 (45 Stat., 791, 844, ch. 852, section 204(a)1), effective as of January 1 of that year, taxed the income of insurance companies, and by section 204(b)1, applicable to insurance companies other than life or mutual, gross income was defined as including "gain during the taxable year from the sale or other disposition of property." In 1928 appellant received a profit from the sale of property acquired before that year, upon which the Commissioner assessed a tax computed, on the basis prescribed by section 113 of the Act, by including in the taxable income all the gain attributable to increase in value after March 1, 1913, and realized in 1928. The district court held that only the accretion of gain after January 1, 1928, was taxed, and gave judgment in the company's favor for the tax collected in excess of the amount so computed. (49 F. (2d), 361.) On appeal, the Court of Appeals for the Third Circuit certified a question to this court under section 239 of the Judicial Code, as amended by the Act of February 13, 1925, as follows:

"Under the Revenue Act of 1928, is the basis to be used by an insurance company (other than a life or mutual insurance company) in computing 'gain during the taxable year from the sale or other disposition of property,' acquired before and disposed of after January 1, 1928, its fair market value as of January 1, 1928, the effective date of the Act?"

The company contends that so much of the gain as accrued before the effective date of the taxing Act was capital, which could not constitutionally be taxed under the sixteenth amendment, and that in any case the constitutionality of a tax upon the previously accrued gain is so doubtful as to require the taxing Act to be construed as not authorizing such a levy.

In No. 547, decided by the same district court, and involving similar facts and the same taxing statutes, the Court of Appeals for the Third Circuit certified the following question:

"If the basis to be used by an insurance company (other than a life or mutual insurance company) in computing 'gain during the taxable year from the sale or other disposition of property,' acquired before and disposed of after January 1, 1928, the effective date of the Revenue Act of 1928, be the fair market value of such property as of March 1, 1913, or other basis provided by section 113 of the Act, is the quoted provision (section 204(b)1, clause (B)) unconstitutional because it taxes capital?"

The tax under this and earlier Revenue Acts was imposed upon net income for stated accounting periods, here the calendar year 1928 (see *Burnet* v. *Sanford & Brooks Co.*, 282 U. S., 359, 363 [Ct. D. 277, C. B. X–1, 363]), and it is only gain realized from the sale or other disposition of property, which is included in the taxable income. Realization of the gain is the event which calls into operation the taxing Act, although part of the profit realized in one accounting period may have been due to increase of value in an earlier one. While increase in value of property, not realized as gain by its sale or other

disposition, may, in an economic or bookkeeping sense, be deemed an addition to capital in a later period (see *Merchants' Loan & Trust Co.* v. *Smietanka*, 255 U. S., 509 [T. D. 3173, C. B. 4, 34]), it is nevertheless a gain from capital investment which, when realized, by conversion into money or other property, constitutes profit which has consistently been regarded as income within the meaning of the sixteenth amendment and taxable as such in the period when realized. (See *Lynch* v. *Hornby*, 247 U. S., 339; *Merchants' Loan & Trust Co.* v. *Smietanka*, supra; *Eldorado Coal & Mining Co.* v. *Mager*, 255 U. S., 522 [T. D. 3175, C. B. 4, 38]; *Goodrich* v. *Edwards*, 255 U. S., 527 [T. D. 3174, C. B. 4, 40]; *Walsh* v. *Brewster*, 255 U. S., 536 [T. D. 3176, C. B. 4, 41]; *Taft* v. *Bowers*, 278 U. S., 470 [Ct. D. 49, C. B. VIII–1, 226]; *Lucas* v. *Alexander*, 279 U. S., 573 [Ct. D. 76, C. B. VIII–2, 273]; *Willcuts* v. *Bunn*, 282 U. S., 216 [Ct. D. 280, C. B. X–1, 309].)

Here there is no question of a tax on enhancement of value occurring before March 1, 1913, the effective date of the income tax Act of that year, for the collector asserts no right to tax such increase in value. The fact that a part of the taxed gain, represented increase in value after that date, but before the present taxing Act, is without significance. Congress, having constitutional power to tax the gain, and having established a policy of taxing it (see *Milliken* v. *United States*, 283 U. S., 15, 22–23 [Ct. D. 320, C. B. X–1, 472]), may choose the moment of its realization and the amount realized, for the incidence and the measurement of the tax. Its failure to impose a tax upon the increase in value in the earlier years, assuming without deciding that it had the power, can not preclude it from taxing the gain in the year when realized, any more than in any other case, where the tax imposed is upon realized, as distinguished from accrued, gain. If the gain became capital by virtue of the increase in value in the years before 1928, and so could not be taxed as income, the same would be true of the enhancement of value in any one year after the adoption of the taxing Act, which was realized and taxed in another. But the constitutionality of a tax so applied, has been repeatedly affirmed and never questioned. The tax being upon realized gain, it may constitutionally be imposed upon the entire amount of the gain realized within the taxable period, even though some of it represents enhanced value in an earlier period before the adoption of the taxing Act. (*Cooper* v. *United States*, 280 U. S., 409 [Ct. D. 163, C. B. IX–1, 272]; compare *Taft* v. *Bowers*, 278 U. S., 470 [Ct. D. 49, C. B. VIII–1, 226].) See also *Glenn* v. *Doyal* (285 U. S. 526) (March 21, 1932), dismissing *per curiam*, for want of a substantial Federal question, an appeal from a decision of the Georgia Supreme Court (reported sub nom. *Norman* v. *Bradley*, 173 Ga., 482), that a State income tax on the profits realized from a sale of corporate stocks, after the passage of the Act, was constitutional, though the gains had accrued prior to its enactment.

Doyle v. *Mitchell Bros. Co.* (247 U. S., 179) and *Hays* v. *Gauley Mountain Coal Co.* (247 U. S., 189), on which the taxpayers rely, involved the construction, not the constitutionality of the Corporation Excise Tax Act of 1909, and considerations which, in *Lynch* v. *Turrish* (247 U. S., 221) and *Southern Pacific Co.* v. *Lowe* (247 U. S., 330), led to the construction of the income tax Act of 1913 as not embracing gains accrued before the effective date of that Act, are not present here.

We think it clear that the Revenue Act of 1928 imposed the tax on the entire gain realized within the taxable year. Section 204(b)1 of Supplement G, which includes gain from the sale of property in the gross income of insurance companies (other than life or mutual), states no method of computing the gain. But the 1928 Act, like its predecessors, prescribed in other sections, sections 111–113, that taxable gains from the sale of property should be determined by deducting from the net sales price the cost or the fair market value on March 1, 1913, if acquired before that date. These provisions are general in their terms, without any stated exception, and on their face are applicable alike to all gains from the sale of property taxed by the Act. They either control the computation of the gain referred to in section 204(b)1 or the word "gain" in that section, construed without their aid, must be taken in its ordinary sense as embracing the difference between net cost and net selling price, and so upon established principles would include in the taxable realized gain all which had accrued since the effective date of the income tax Act of 1913, the first enactment adopted under the sixteenth amendment. (See *Eisner* v. *Macomber*, 252 U. S., 189, 207 [T. D. 3010, C. B. 3, 25]; *Merchants' L. & T. Co.* v. *Smietanka*, supra, 519, 520.) For present purposes, the Revenue Act of

1928 must be regarded as substantially an amendment and continuation of the Act of 1913.

The taxpayers insist that the omission from section 204(b)1 of any reference to sections 111–113, in contrast to the inclusion in section 204(c) of cross references to the general provisions of the Act defining deductions, evidences an intention to exclude the method of computing gains prescribed by sections 111–113, and to adopt a different method with respect to gains taxed by Supplement G. But this argument disregards the function of the general provisions of the Act, including sections 111–113, as complementing the provisions of Supplement G, and ignores the obvious necessity of defining the deductions authorized by section 204(c), either by cross references made in that section to the general provisions of the Act or by other appropriate means, which did not obtain with respect to the definition of gains in 204(b)1.[1]

This becomes evident upon an examination of the structure of the 1928 Act, which differed from that of any earlier revenue measure. "Title I—Income Tax," with which we are now concerned, is divided into three subtitles designated:

"Subtitle A—Introductory provisions."
"Subtitle B—General provisions."
"Subtitle C—Supplemental provisions."

Section 4 of Subtitle A provides in part: "The application of the General Provisions and of Supplements A to D, inclusive, to each of the following special classes of taxpayers, shall be subject to the exceptions and additional provisions found in the supplement applicable to such classes, as follows: * * * (c) Insurance companies—Supplement G * * *." The Act, by this section and by operation of its structural arrangement, thus provided that all of the general provisions of Subtitle B, and all the general provisions of Supplements A to D, including Supplement B, in which sections 111–113 occur, were to apply to the special classes of taxpayers referred to in Supplements E to K, unless the provisions relating to a special class restrict the operation of the general provisions or are necessarily inconsistent with them. That such was the purpose to be accomplished by the rearrangement of the taxing provisions in the 1928 Act sufficiently appears from its legislative history.[2]

Section 204 is not, as the district court thought, "a scheme or code of taxation complete in itself, * * * without reference to the general provisions of the Act," unless specifically referred to and included by cross reference to such general provisions. An inspection of the Act discloses that Supplement G, dealing with insurance companies as a special class of taxpayers, would be unworkable without resort to the general provisions of the Act not specifically referred to in the supplement.[3]

It would be going very far in the circumstances to say that the mere omission from section 204 of a cross reference to the definition of gain in sections

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[1] It is true that sections 204(c), 205, and 206, relating to allowed deductions from gross income, define the deductions by specific cross references to like deductions defined in the general provisions of other sections, but as the listed deductions were intended to be exclusive, and as those allowed to insurance companies differ in many respects from those allowed to other corporations, it was an appropriate, if not necessary precaution, in enumerating them, to describe those which were allowed, either by repeating the appropriate language contained in the general sections or to incorporate it by reference. No such precaution was necessary with respect to section 204(b). The "gain" included in gross income by that section was adequately defined by sections 111–113, made applicable, by section 4 of Subtitle A, to the provisions of Supplement G.

[2] See report of the Joint Committee on Internal Revenue Taxation, December 22, 1927, Document No. 139, Seventieth Congress, first session, page 2, appendix page 7; report of the Committee on Ways and Means, December 17, 1927, H. R. No. 2, Seventieth Congress, first session, pages 1, 2, 11, 12; report of Committee on Finance, Senate Report No. 960, May 1, 1928, Seventieth Congress, first session, pages 17, 18. Although the bill, as originally introduced, did not contain the provision for taxing gains of stock fire insurance companies, the bill was amended by the addition of section 204(b)1(B) to Supplement G, for the declared purpose of placing such insurance companies on the same basis as mutual companies, which were already taxed upon gains from the sale or other disposition of property. (Congressional Record, May 21, 1928, volume 69, part 9, page 9337; conference report No. 1882, page 18.)

[3] Neither section 204, which deals with the taxation of insurance companies other than life or mutual, nor the other provisions of Supplement G, contain any directions concerning such essential parts of a system of taxation as the filing of returns, time of payment, or penalties for nonpayment; and no express reference is made to the obviously applicable general provisions touching upon these matters (sections 52, 56, 146). Other important and necessarily applicable general provisions, not included or referred to in Supplement G, may be found in sections 105, 118, 141, 142, 271–277. The provision in section 207 of Supplement G that "gross income shall not be determined in the manner provided in section 119," is a plain indication that the general provisions contained in section 119 would apply to insurance companies in the absence of the express exception.

111–113, made applicable by the general provisions of the Act, not only excluded that definition from section 204, but substituted a different one not specifically mentioned in that or any other section. The gain taxed by section 204(b)1 is therefore that defined by sections 111–113, which may constitutionally be taxed.

Both questions are answered, No.

Mr. Justice ROBERTS took no part in the consideration or decision of this case.

SUPPLEMENT L.—ASSESSMENT AND COLLECTION OF DEFICIENCIES.

SECTION 274.—BANKRUPTCY AND RECEIVERSHIPS.

ARTICLE 1191: Bankruptcy and receiverships. XI–21–5487
Ct. D. 488

FEDERAL TAXES—REVISED STATUTES—DECISION OF COURT.

RECEIVERSHIP—PRIORITY OF THE UNITED STATES.

Section 3466 of the Revised Statutes entitles the United States to priority of payment of a debt due the United States out of the assets of a corporation in receivership by consent where the corporation is insolvent when the claim of the United States for the debt is allowed, even though it is solvent at the inception of the receivership.

UNITED STATES DISTRICT COURT, SOUTHERN DISTRICT OF NEW YORK.

Robert L. Hatch, plaintiff, v. *The Morosco Holding Co., Inc., defendant; United States of America, claimant; Irving Trust Co., receiver.*

[January 28, 1932.]

OPINION.

CAFFEY, Judge: It is curious that considerably more than a hundred years after its enactment the meaning of a general statute, of frequent application, should be in serious controversy. Yet that is what is involved on this motion. If there were available time I should like to discuss the subject fully. In view, however, of the importance of disposing of the matter promptly, my comment will be somewhat summary.

This court may take notice of its own records (*National Fire Insurance Co.* v. *Thompson*, 281 U. S., 331, 336). It happens that since 1929 I have been in charge of the present case, in which the receiver for the defendant was appointed in 1923. Parts of the files, which have been brought to my attention in the course of performing my duties heretofore, indicate, and I am convinced, that when suit was brought the defendant was solvent. (Cf. *In re Morosco Holding Co., Inc.*, 296 Fed., 516.) For the purpose of the motion, therefore, I shall assume this to be a fact—although if the Government had requested opportunity to litigate the issue as to whether, despite the showing in the record to the contrary, the defendant was actually insolvent at the beginning of the receivership, I should perhaps feel that I ought to send the matter to a special master for hearing and report.

If the Government be entitled to a priority, the right does not rest on sovereign prerogative, but is founded entirely on R. S. 3466 (31 U. S. C. A., section 191; *United States* v. *State Bank of North Carolina*, 6 Peters, 29, 35; *Price* v. *United States*, 269 U. S., 492, 499 [T. D. 3820, C. B. V–318]; cf. *Spokane County* v. *United States*, 279 U. S., 80, 92).

Under R. S. section 3466, to establish priority one of the conditions therefor prescribed in the second branch of the section must be shown. These conditions, so far as now pertinent, are (1) insolvency in the bankruptcy sense,

coupled with a voluntary assignment, and (2) commission of an act of bankruptcy. This was conceded by counsel at the argument and is borne out by the authorities. (*United States* v. *Oklahoma*, 261 U. S., 253, 259–265; *Nolte* v. *Hudson Nav. Co.*, 8 Fed. (2d), 859, 865–866; cf. *Bramwell* v. *United States Fidelity Co.*, 269 U. S., 482, 488–489.)

One feature of the issue turns on the appointment of the receiver having been by consent of the defendant. It is clear that consent to a receivership does not constitute an act of bankruptcy (*Nolte* v. *Hudson Nav. Co.*, 8 Fed. (2d), 859, 866; cf. *United States* v. *Middle States Oil Corporation*, 18 Fed. (2d), 231, 235–238, and *In re Guardian Building & Loan Association*, 53 Fed. (2d), 412, 415), but that, within the meaning of the statute, it is the legal equivalent of a voluntary assignment (*Price* v. *United States*, 269 U. S., 492, 500; *United States* v. *Butterworth Corporation*, 269 U. S., 503, 513–514 [T. D. 3825, C. B. V–1, 321]). In consequence, the whole question is finally resolved exclusively into whether or not there was insolvency, within the requirement of the first clause of the second branch of the section.

Insolvency did not exist at the inception of the receivership in 1923. It did exist, however, when the Government's claim was allowed in 1929 and it has continued ever since. We are, therefore, to determine whether insolvency which comes about only during the receivership—that is, was nonexistent at the commencement, but arose before the termination, of the receivership—entitles the Government to priority. So far as I can discover, the question has not been squarely determined and I am somewhat in doubt what the answer should be.

In *Price* v. *United States* (269 U. S., 492), the chief thing decided and dwelt on was that, within R. S. 3466, taxes are debts. With a single exception, the facts are substantially identical with the facts of the case at bar. There, as here, the receivership was by consent upon a bill which alleged solvency of the defendant. In that case a temporary receiver was appointed on October 2, 1923. This was the day on which suit began and on which an answer, admitting the allegations of and joining in the prayer of the bill, was filed (pages 498–509). On January 9, 1924—more than three months later—a permanent receiver was appointed. "Thereupon," as recited in the opinion (page 499), "the assets were found insufficient to pay all the claims," there being available enough only for a dividend not exceeding 40 per cent. It was further said (page 502), "While in effect the complaint alleged that the defendant was solvent, the facts set forth indicate that it was in a failing condition, and it was found to be insolvent within a short time after the appointment of the receiver." Upon this statement, it was held that the Government was entitled to priority. While the point was not emphasized, or even specifically talked about, I think the ruling can not be construed otherwise than that, even though a defendant in a consent receivership be solvent at the start, insolvency three months thereafter, during the receivership, satisfies the insolvency requirement of R. S. 3466 as a condition of Government priority. If so, I must follow it. Despite the manifest differences of detail, the holding that, where insolvency appeared "within a short time after the appointment of the receiver," governs where, as in the case at bar, insolvency began a substantially longer time after the receiver was appointed but before the receivership was at an end. I can see no basis in principle for discrimination between three months and six years as the period for intervention of insolvency during the receivership.

Moreover, I think it must be confessed that, at best, the language of R. S. 3466 is ambiguous. If so, there are two considerations which tend to sustain the interpretation I have put on the Price case. The first is that the statute must be liberally construed in favor of the Government, so as to effect the general purpose, as at common law, of according the sovereign preference, by virtue of the Crown prerogative, in the collection of revenue (*United States* v. *State Bank of North Carolina*, 6 Peters, 29, 35; *Bramwell* v. *United States Fidelity Co.*, 269 U. S., 483, 487; *Price* v. *United States*, 269 U. S., 492, 499–500). The second is that R. S. 3466 must be construed *in pari materia* with R. S. 3467, which subjects fiduciaries to personal liability for debts due the Government if they distribute assets in their hands without first paying those debts. (*United States* v. *Butterworth*, 269 U. S., 504, 513; cf. *Bramwell* v. *United States Fidelity Co.*, 269 U. S., 483, 490.) Liberal interpretation of R. S. 3466 alone, alike with interpretation of R. S. 3466–3467 together and in harmony so as to assure collection of its debts by the Government, can be certainly accomplished only by holding that R. S. 3466 entitled the Government to priority of payment out of the assets of a defendant in any consent receivership, whenever, without

regard to its date, insolvency of the defendant occurs during the course of the receivership.

The allowance of interest on the Government claim was by a previous order of this court, which has been affirmed by the Circuit Court of Appeals. It is, therefore, beyond my power to alter it.

Motion to deprive the Government of priority denied. Settle order on two days' notice.

SUPPLEMENT O.—OVERPAYMENTS.

SECTION 322.—REFUNDS AND CREDITS.

ARTICLE 1251: Authority for abatement, credit, and refund of tax. XI–4–5366 Ct. D. 443

INCOME TAX—REVENUE ACTS OF 1926 AND 1928—DECISION OF SUPREME COURT.

REFUND—COMMISSIONER'S AUTHORITY—ADDITIONAL TAX DUE BUT BARRED FROM ASSESSMENT.

Upon consideration of a claim for refund, the ultimate question presented by the claim is whether the taxpayer has overpaid his tax and the Commissioner has the power to redetermine the entire tax liability of the taxpayer. Where, therefore, after the statutory period for assessment of an additional tax has expired he determines that a refund is allowable on the grounds asserted in the claim but that the correct computation by reason of other items results in an additional tax which is barred from assessment, the taxpayer is not entitled to a refund, section 284(a) of the Revenue Act of 1926 and section 322(a) of the Revenue Act of 1928 limiting refunds to overpayments.

SUPREME COURT OF THE UNITED STATES. No. 115.—OCTOBER TERM, 1931.

Edgar Percy Lewis and Richard F. Cooper, as Trustees under the Will of Arthur Francis Thomas Cooper, Deceased, petitioners, v. *Marshall S. Reynolds, Individually and as Collector of Internal Revenue.*

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

[January 4, 1932.]

OPINION.

Mr. Justice MCREYNOLDS delivered the opinion of the court.

Petitioners sued the respondent collector in the United States District Court for Wyoming, September 20, 1929, to recover $7,297.16 alleged to have been wrongfully exacted as income tax upon the estate of Cooper.

February 18, 1921, the administrator filed a return for the period January 1 to December 12, 1920, the day of final settlement. Among others, he reported deductions for attorney's fees, $20,750, and inheritance taxes paid to the State, $16,870. The amount of tax as indicated by the return was paid.

November 24, 1925, the Commissioner, having audited the return, disallowed all deductions except the one for attorney's fees and assessed a deficiency of $7,297.16. This sum was paid March 21, 1926; and on July 27, 1926, petitioners asked that it be refunded.

A letter from the Commissioner to petitioners, dated May 18, 1929, and introduced in evidence by them, stated that the deduction of $20,750 for attorney's fees had been improperly allowed. He also set out a revised computation wherein he deducted the State inheritance taxes. This showed liability greater than the total sums theretofore exacted. The Commissioner further said:

"Since the correct computation results in an additional tax as indicated above which is barred from assessment by the statute of limitations your claim will be rejected on the next schedule to be approved by the Commissioner."

The trial court upheld the Commissioner's action and its judgment was affirmed by the circuit court of appeals.

Counsel for petitioners relies upon the 5-year statute of limitations (Revenue Act 1926, section 277).[1] He maintains that the Commissioner lacked authority to redetermine and reassess the tax after the statute had run; also that at the time of his last decision he was restricted to consideration of the demand for refund and determination of whether the trustees were entitled to deduct the State inheritance taxes.

After referring to section 284, Revenue Act of 1926 (44 Stat., 66) and section 322, Revenue Act of 1928 (45 Stat., 861) the circuit court of appeals said—

"The above-quoted provisions clearly limit refunds to overpayments. It follows that the ultimate question presented for decision, upon a claim for refund, is whether the taxpayer has overpaid his tax. This involves a redetermination of the entire tax liability. While no new assessment can be made, after the bar of the statute has fallen, the taxpayer, nevertheless, is not entitled to a refund unless he has overpaid his tax. The action to recover on a claim for refund is in the nature of an action for money had and received, and it is incumbent upon the claimant to show that the United States has money which belongs to him."

We agree with the conclusion reached by the courts below.

While the statutes authorizing refunds do not specifically empower the Commissioner to reaudit a return whenever repayment is claimed, authority therefor is necessarily implied. An overpayment must appear before refund is authorized. Although the statute of limitations may have barred the assessment and collection of any additional sum, it does not obliterate the right of the United States to retain payments already received when they do not exceed the amount which might have been properly assessed and demanded.

Bowit Teller & Co. v. *United States* (283 U. S., 258 [Ct. D. 334, C. B. X-1, 328]) says nothing in conflict with the view which we now approve.

Affirmed.

TITLE IV.—ADMINISTRATIVE PROVISIONS.

SECTION 606.—CLOSING AGREEMENTS.

ARTICLE 1301: Closing agreements relating to tax liability in respect of internal-revenue taxes. XI-4-5367 G. C. M. 10100

REVENUE ACT OF 1928.

After a closing agreement was entered into for the year 1928 it was discovered that part of the funds intrusted to the taxpayer's care had been misappropriated by one of its officers. Had the defalcation been known at the time the 1928 return was filed, there would have been no tax liability for that year and the closing agreement in its present form would not have been entered into by the taxpayer.

Held, that there is no evidence of fraud or malfeasance, or misrepresentation of a material fact which would suffice to invalidate the closing agreement.

An opinion is requested relative to the claim for refund in the amount of x dollars filed by the taxpayer, the M Building and Loan Association, covering the taxable year 1928.

On May —, 1930, the taxpayer signed a closing agreement for the year 1928. This agreement was listed on Schedule No. — and ap-

[1] SEC. 277. (a) Except as provided in section 278 [not here important]—* * * (3) The amount of income, excess-profits, and war-profits taxes imposed by * * * the Revenue Act of 1918, and by any such Act as amended, shall be assessed within five years after the return was filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period.

proved by the Secretary of the Treasury on October —, 1930. The M Building and Loan Association was incorporated in May, 1921. From the date of incorporation to December, 1930, the taxpayer accepted total deposits of some 4,370*x* dollars. The taxpayer claims that following the usual custom in building and loan associations its organization was in the hands of one person, in this case A, whose authority extended beyond that usually conferred to a building and loan executive. Subsequent to the time the closing agreement was entered into it was discovered that approximately 1,309*x* dollars of the funds intrusted to the taxpayer's care had been misappropriated by A. Had the defalcation for 1928 been known at the time the income tax return was filed for that year, there would have been no tax liability and the closing agreement in its present form would not have been entered into by the taxpayer. The closing agreement had been signed by one B at the direction of A, the manager. B admits that at the time he signed the closing agreement the records showed a large indebtedness by A to the association. Subsequent to the time the closing agreement was entered into other officials of the association ascertained the true conditions of the taxpayer. Suit was instituted and on December —, 1930, C was appointed receiver. The receiver timely filed on behalf of the association a claim for refund in the amount that was specifically covered by the closing agreement. In a letter addressed to the taxpayer under date of August —, 1931, the taxpayer was advised that its claim for refund had been examined and rejected, inasmuch as the question of tax liability was closed for the year in question by an agreement executed under the provisions of section 606 of the Revenue Act of 1928.

The taxpayer's representative contends that the misappropriation perpetrated by A against his principal, the taxpayer, amounts to fraud and misrepresentation within the purview of section 606 and, therefore, the closing agreement should be set aside. Section 606 of the Revenue Act of 1928, in so far as applicable, provides as follows:

> (a) *Authorization.*—The Commissioner (or any officer or employee of the Bureau of Internal Revenue, including the field service, authorized in writing by the Commissioner) is authorized to enter into an agreement in writing with any person relating to the liability of such person (or of the person or estate for whom he acts) in respect of any internal-revenue tax for any taxable period ending prior to the date of the agreement.
>
> (b) *Finality of agreements.*—If such agreement is approved by the Secretary, or the Undersecretary, within such time as may be stated in such agreement, or later agreed to, such agreement shall be final and conclusive, and, except upon a showing of fraud or malfeasance, or misrepresentation of a material fact * * *.

The taxpayer admits that there has been no fraud or misrepresentation of a material fact on the part of the Government, but insists that the fraud or misrepresentation of the taxpayer's agent, A, goes to the very existence of the closing agreement.

In conference the taxpayer's representative suggested that it might be possible that B, who signed the closing agreement in his capacity as vice president of the association, had not been properly elected and qualified and that he was acting without authority. After allowing B to act as its vice president over a specified period the taxpayer can not at this time object to the regularity of his appointment. (*Barrell* v. *Lake View Land Co.*, 122 Cal., 129, 54 Pac., 594.) The

taxpayer had knowledge of the vice president's act and the corporate seal was affixed to the closing agreement. Therefore, it is too late to deny the validity of the agent's act.

It is the opinion of this office that there is no evidence of fraud or malfeasance, or misrepresentation of a material fact which would suffice to invalidate the closing agreement. Therefore, the closing agreement entered into by the taxpayer and the Commissioner should be considered final and conclusive. It follows that the action taken by the Income Tax Unit in rejecting the taxpayer's claim for refund is correct and should be adhered to.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

ARTICLE 1301: Closing agreements relating to tax liability in respect of internal-revenue taxes. XI-12-5418 G. C. M. 10307

REVENUE ACT OF 1928.

In January, 1930, the taxpayer executed an agreement on Form 866 under section 606 of the Revenue Act of 1928 as to a final determination of income tax liability for 1927. In May, 1930, the taxpayer filed a claim for refund on the ground that it was entitled to a credit against 1927 taxes on account of taxes paid to foreign countries, which claim was rejected because of the closing agreement.

Held, the "principal amount" of tax liability for 1927 set forth on Form 866, as signed by the taxpayer, is the amount of its tax liability to the Government after all credits have been made for taxes paid to foreign countries.

An opinion is requested whether a taxpayer is entitled to a credit for foreign taxes for the year 1927 after its case for that year has been closed under a final closing agreement.

In January, 1930, the taxpayer entered into an agreement with the Commissioner as to a final determination of tax liability, under the provisions of section 606 of the Revenue Act of 1928. This agreement was duly approved in accordance with the requirements of section 606. It included not only the amount of tax shown to be due on the original return, but also a deficiency in tax. This agreement, on Form 866, reads, in part, as follows:

Whereas, there has been a determination of the tax liability of said taxpayer in respect of Federal income tax for the calendar year 1927 in the principal sum of ——, exclusive of any penalty or interest properly applicable thereto as provided by law;

Now, this agreement witnesseth, that said taxpayer and said Commissioner of Internal Revenue hereby mutually agree that the principal amount of such liability so determined shall be final and conclusive if this agreement is approved by the Secretary of the Treasury, or the Undersecretary, within six months from the date this agreement is signed by the taxpayer.

Despite the signing of this closing agreement the taxpayer in May, 1930, filed a claim for refund on the ground that it was entitled to a credit against 1927 taxes on account of taxes paid to foreign countries. This claim was rejected because of the closing agreement referred to above.

The taxpayer contends that the amount of this credit for taxes paid to foreign countries may be allowed without abrogating the terms of or in any manner disturbing the closing agreement. In

support of its contention the taxpayer alleges that the principal tax liability contemplated by the closing agreement is the amount of the tax imposed by section 230(a) of the Revenue Act of 1926, at the rate of 13½ per centum upon the gross income, as defined in section 233 of that Act, less the deductions allowed by sections 234 and 236, and without regard to section 238(a) of that Act, which provides that in the case of a domestic corporation the tax imposed by the statute shall be credited with the amount of any income, war-profits, and excess-profits tax paid or accrued during the same taxable year to any foreign country. The taxpayer further contends that the principal tax liability referred to in the closing agreement relates solely to the amount of tax imposed by the Act, and that since taxes paid to a foreign country are to be credited against the tax imposed and not against net income, the principal tax liability may be adjusted to take care of such credits even though a closing agreement for the year has been executed.

In view of this contention by the taxpayer the specific question presented is whether the principal tax liability contemplated by the final closing agreement refers to the taxes imposed by section 230(a) of the Revenue Act of 1926, prior to the crediting of the taxes paid to foreign countries, or whether it refers to the tax liability to the United States Government after proper credits have been made for taxes paid to foreign countries.

Section 606 of the Revenue Act of 1928, in so far as pertinent to this case, reads as follows:

(a) *Authorization.*—The Commissioner (or any officer or employee of the Bureau of Internal Revenue, including the field service, authorized in writing by the Commissioner) is authorized to enter into an agreement in writing with any person relating to the liability of such person (or of the person or estate for whom he acts) in respect of any internal-revenue tax for any taxable period ending prior to the date of the agreement.

(b) *Finality of agreements.*—If such agreement is approved by the Secretary, or the Undersecretary, within such time as may be stated in such agreement, or later agreed to, such agreement shall be final and conclusive, and, except upon a showing of fraud or malfeasance, or misrepresentation of a material fact—

(1) the case shall not be reopened as to the matters agreed upon or the agreement modified, by any officer, employee, or agent of the United States, and

(2) in any suit, action, or proceeding, such agreement, or any determination, assessment, collection, payment, abatement, refund, or credit made in accordance therewith, shall not be annulled, modified, set aside, or disregarded.

It will be noted that the statute uses the language "the *liability* of such person * * * in respect of any internal-revenue tax." [Italics supplied.]

Bouvier's Law Dictionary (Baldwin's Library edition) defines the term "liability" as "responsibility; the state of one who is bound in law and justice to do something which may be enforced by action * * *. The state of being bound or obliged in law or justice."

In this sense of an obligation to pay, the term "liability" is consistently employed in many places in the Revenue Act of 1928. (For example, sections 54(c), 141(b), 311(a), 311(a)1, 311(a)2, 311(b), 311(b)1, 311(b)2, 311(b)3, 311(d), 311(e), 312(b), 403(a), 505(a), 602, 604, 609(a), 613.)

The language of section 606, supra, clearly evidences an intention on the part of Congress that closing agreements, executed in compliance with that section, should be construed as ending definitely any controversy between the taxpayer and the Government as to the

total tax liability of the taxpayer, or as to any one or more separate items affecting the tax liability of the taxpayer. (See article 1301, Regulations 74.) If the agreement relates to the total tax liability, the amount stated in the agreement is in fact the tax liability of the taxpayer for the given year. If he has paid all the tax at the time when the agreement is entered into he has no more to pay. If he has paid only part of the tax at that time, he is obligated to pay the difference between the amount of tax agreed upon and the amount already paid.

The Government, in turn, is obligated not to seek to collect more than the amount of tax named (exclusive of any penalty or interest applicable thereto). When executed, this agreement is final and conclusive as to both parties, and, in the absence of fraud or malfeasance, or misrepresentation of a material fact, the case may not be reopened, directly or indirectly, by a claim for refund which would, in effect, lessen the amount which the taxpayer has obligated itself to pay.

It is clear that a closing agreement is not intended to determine an amount that may afterwards be adjusted with respect to credits or with respect to a deficiency in tax. It is intended as a final sum agreed upon by both parties as the net tax liability for the given year. In executing such an agreement a taxpayer agrees to pay such part of the stipulated tax as has not already been paid. And in computing this final sum, all deficiencies and all credits must be assumed to have been taken into consideration. In this connection compare *Stover* v. *McCaughn* (28 Fed. (2d), 1005, T. D. 4245, C. B. VII–2, 218).

This office is of the opinion that the "principal amount" of tax liability for 1927 set forth on Form 866, as signed by the taxpayer, is the amount of its tax liability to the Government after all credits have been made for taxes paid to foreign countries, and that the claim for refund was properly rejected.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

SECTION 611.—COLLECTIONS STAYED BY CLAIM IN ABATEMENT.

SECTION 611.

REVENUE ACT OF 1928.

Tax paid involuntarily after the effective date of section 611 of the Revenue Act of 1928. (See Ct. D. 489, page 256.)

SECTION 613.—LIEN FOR TAXES.

SECTION 613. XI–1–5342
G. C. M. 9991

REVENUE ACT OF 1928.

Procedure relative to outstanding assessments against a decedent and liens against property in the hands of his administrator or executor. General Counsel's Memorandum 619 (C. B. V–2, 79) is revoked in so far as it indicates property so held should be seized under a distraint warrant.

Request is made for a reconsideration of General Counsel's Memorandum 619 (C. B. V–2, 79), which involved the seizure by distraint

warrant of a registered Liberty bond to satisfy an assessment levied against an estate. In that memorandum it was held that the Liberty bond in question should be advertised and sold in the manner provided in section 3190, Revised Statutes, et seq. It was also held that the exclusive jurisdiction given to the probate court in the settlement of a decedent's estate can not affect the claims of the Federal Government nor the remedies given to it under its own laws. As authority for that conclusion there were cited the court decisions rendered in *United States* v. *Backus* (24 Fed. Cas. 932, Fed. Cas. No. 14491); *Pond* v. *United States* (111 Fed., 989); *United States* v. *Bean et al.* (120 Fed., 719, 720).

The United States Government may resort to either the State or Federal courts to collect taxes due. (See *Pratt et al.* v. *Dean et al.*, 246 Mass., 300, 140 N. E., 924; *Claflin* v. *Houseman, Assignee*, 93 U. S., 130; *Merryweather et al.* v. *United States*, 12 Fed. (2d), 407; *United States* v. *Snyder*, 149 U. S., 210.)

If the United States elects to sue in a Federal court it may obtain judgment, but assets in the custody of a probate court may not be seized to satisfy such judgment. (*Byers* v. *McAuley*, 149 U. S., 608; *Porter* v. *Sabin*, 149 U. S., 473; *U. S.* v. *Snyder*, 149 U. S., 210; *Security Trust Co.* v. *Black River National Bank*, 187 U. S., 211; *Farrell* v. *O'Brien*, 199 U. S., 89; *Ingersoll* v. *Coram*, 211 U. S., 335; *Waterman* v. *The Canal-Louisiana Bank & Trust Co., Executor*, 215 U. S., 33.) The cited cases are to the effect that assets in the hands of an administrator or executor who must account to the probate court which appointed him are not subject to levy to satisfy a judgment of another court, and that such judgment claim is subject to the administrative jurisdiction of the probate court. See also *In re Tyler* (149 U. S., 164), where the United States Supreme Court held that assets in the hands of a receiver appointed by a Federal court were not subject to levy under process issued by a State court.

In the cases relied upon in support of General Counsel's Memorandum 619, supra, no question was directly presented as to limitations on levy following the judgment obtained therein in the Government's favor. There is, however, some language in the Backus case indicating that that court expected execution to follow judgment as a matter of course, and such language is quoted in the Pond case. The Backus case was decided, however, in the year 1855, long prior to the decision of the leading cases cited above. The cases of *Byers* v. *McAuley*, supra; *In re Tyler*, supra; *Porter* v. *Sabin*, supra; and *U. S.* v. *Snyder*, supra, were all considered and decided by the Supreme Court during its October term, 1892. In those cases the principles controlling limitations on executive and judicial process and the right of the United States Government to sue in its own courts are restated and proper distinctions drawn. If the earlier decision in the Backus case can be interpreted to be in conflict with the Tyler case, it must be recognized as overruled by that decision.

There is no statutory provision which specifically or by clear implication authorizes the institution of distraint proceedings against assets in the hands of an administrator or executor, and in view of the doubt as to the constitutional power of Congress to authorize distraint proceedings against assets in the custody of a probate court, as indicated in the leading cases cited above, the Bureau as a matter

of policy will refrain from attempting distraint proceedings against assets in the hands of an administrator or executor. General Counsel's Memorandum 619, supra, is revoked in so far as it indicates that property so held should be seized under a distraint warrant.

Accordingly, the conclusions of this office concerning the proper procedure against an administrator or executor are as follows:

1. Liens for Federal taxes in such cases should be perfected at the earliest possible date. Whether such liens should be made specific by compliance with the filing provisions of Revised Statutes, section 3186(b), depends upon the exigencies of the particular case, having due regard for the embarrassment caused the administration of the estate by such action.

2. In the ordinary case notice and demand should be promptly served on the administrator or executor to prevent distribution without notice. Such notice, as distinguished from proof of claim in accordance with the State practice, has two advantages, to wit:

(a) It makes it clear that the statutory limitation period continues to run, as such notice does not constitute the beginning of a suit or proceeding; whereas filing of proof of claim with the person or court designated by the State statutes may or may not be the beginning of a suit or proceeding to stay the statute.

(b) Since it does not amount to a suit or proceeding it does not constitute an election to submit the question to a State rather than a Federal court.

This general rule may be varied in the particular case by filing proof of claim and presenting the question to the State court in accordance with State probate procedure. However, such departure from the general rule indicated requires strict compliance with State procedure, and leaves the operation of the Federal statute of limitations dependent upon whether the action taken constitutes a suit or proceeding under State law.

3. If the administrator or executor does not voluntarily pay the tax upon notice and demand within the statutory period of limitation, suit should be timely brought in a Federal court. Execution on any judgment thus obtained should not be attempted but the judgment claim, which is binding on the probate court, should be filed as a claim with the person designated to receive claims by the State probate statutes.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

SECTION 613. XI–13–5425
I. T. 2619

REVENUE ACT OF 1928.

The act of April 29, 1931 (Act 220 of 1931), enacted by the Legislature of the Territory of Hawaii, effective as of July 1, 1931, is accepted by the Bureau as the legislation authorized under section 3186, Revised Statutes, as amended by section 613(b)1 of the Revenue Act of 1928, authorizing the filing of notices of Federal tax liens with certain designated county or other officials

TITLE V.—GENERAL PROVISIONS.

SECTION 701.—DEFINITIONS.

ARTICLE 1314: Association distinguished from trust.

XI-22-5494
Ct. D. 490

FEDERAL TAXES—REVENUE ACT OF 1928—DECISION OF COURT.

TRUST—ASSOCIATION—DEFINITION.

An organization operating under a declaration of trust which provides for beneficial interests therein that are transferable as personal property, which vests in a board of managers power like that conferred upon corporate directors and which by the joint action of the trustee and beneficiaries carries on for profit a business pursuant to the purpose for which it was created as set forth in the declaration of trust is an association within the meaning of section 701(a) of the Revenue Act of 1928.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT. No. 6582.

Trust No. 5833, Security-First National Bank of Los Angeles, Successor to Security Trust & Savings Bank, Trustee, appellant, v. *Galen H. Welch, Collector of Internal Revenue for the Sixth Collection District of California, appellee.*

Appeal from the District Court of the United States for the Southern District of California, Central Division.

[December 7, 1931.]

OPINION.

WILBUR, Circuit Judge: This is an appeal from a judgment in favor of the defendant. The facts are stated clearly and briefly by the district judge in his memorandum opinion, and for that reason we quote therefrom as follows:

"This is an action to compel refund of $4,147.93, representing Federal income taxes computed at the prevailing corporate rate for the calendar year 1928. The amount sued for was paid under protest by plaintiff Security-First National Bank of Los Angeles as trustee, to the defendant collector. The sole question for decision is whether the project or enterprise denominated Trust No. 5833, as it is disclosed by the evidence, is an association within the purview of section 701(a)2 of the Revenue Act of 1928. The pertinent part of that section reads, 'the term "corporation" includes associations, joint stock companies and insurance companies.' The defendant collector demanded and collected the tax from plaintiffs upon the ground that it was an association as described in the Revenue Act aforesaid. The plaintiffs contend that such ruling was erroneous and illegal and that the enterprise under consideration is shown by the evidence herein not to be an association within the aforesaid section, but that it is to be considered solely as a fiduciary for income tax purposes. It is admitted that if the enterprise is properly classified as an 'association' the amount sued for can not be recovered by plaintiff herein.

"The following facts have been established. In October, 1924, one Cotton, a real estate operator in Los Angeles, Calif., in association with other persons undertook to acquire by purchase a tract of approximately 90 acres of land, to improve the same by laying out streets and other ways, to install sidewalks, water, electricity and other utilities therein, and to subdivide the tract into city lots and to sell them to the public at a substantial profit. The scheme involved an outlay of capital both for the purchase price of the acreage and also to pay for the improvements and subdivision expenses. The land was owned by the Southern California Edison Co., which agreed to sell it to Cotton and his associates for $810,000. The contemplated improvements amounted to approximately $250,000. A written contract of sale of the tract was accordingly entered into by one Farran acting as the agent of the buyers and promoters, Cotton and his associates, and the Southern California Edison Co., the seller. The

agreement provided for the payment of $100,000 in cash and the balance of the purchase price within 90 days of the date of the contract. In order to finance the project, a syndicate of some 40 persons was organized. These persons were invited by Cotton and his associates to subscribe and invest various amounts of money in the undertaking ranging from $1,000 to $15,000 each. The purpose of the syndicate as well as the invitation to join therein was to enable the participants to realize a profit upon their investments in the project. The aggregate amount realized from such subscriptions was $250,000. The contract with the Edison company was assigned to the Security Trust & Savings Bank, predecessor of one of the plaintiffs herein as trustee. Concurrently, the subscribers of the $250,000 paid their money to said trustee. The Security Trust & Savings Bank as such advanced the further sum of $400,000 to the project and took a first lien upon the assets of the enterprise as its security for payment of such loan with interest. An additional sum of $212,500 was advanced by Cotton and an associate Bryan and these two took a second mortgage on the assets of the enterprise as security for the payment of their loan with interest. The moneys thus obtained in accordance with a written instrument denominated as a declaration of trust, Trust No. 5833, were applied on the purchase price of the 90-acre tract of land.

"The declaration of trust under which the project was so launched and carried out is a lengthy document that has been introduced in evidence herein and that has been carefully considered by the court. I consider it unnecessary to set it forth in extenso. Suffice it to say that it conforms generally to similar instruments common in the realty subdivision activities of Los Angeles, Calif., and is what is popularly known therein as a 'real estate subdivision trust.' It was executed by the Security Trust & Savings Bank as trustee, Dean Farran, acting on behalf of Cotton and associates as trustor, and the subscribers or investors of the $250,000 as beneficiaries. It provided a complete and to some extent a self-executing scheme for the payment of the purchase price of the property; the payment of the two mortgage loans; the reimbursement of those who had subscribed and invested money therein; the payment of all expenses attendant upon the improvement and subdivision of the tract of land and for the sale of the entire subdivided parcel of real property. It declared that all beneficial interest in the trust is owned by the investors of the $250,000, and that such interest be divided into units of $1,000 each and that each beneficiary shall be deemed to hold one of such units for each $1,000 that he had paid into the trust or should thereafter pay into it. It provided that in all dealing with the trustee and the beneficiaries, the trustee shall be bound by the written direction of any three of the board of five beneficiaries termed the 'board of syndicate managers' which board was chosen by the subscribers of the $250,000 and had power to establish the price at which the real property was to be sold by the trustee; to fix the terms of sale; the manner, method, and time of disposition of the proceeds of such sale; the person to whom all money coming into the hands of the trustee under the declaration was to be paid after certain payments rigidly fixed by the declaration of trust had been made; the amount of such payments; to fix the restrictions, covenants, conditions and reservations under and upon which the property or any part of it shall be sold; the form of deeds and contracts to be executed by the trustee in case of any sales; to fix and determine the manner, method, cost and improvement of the property; and in all other respects to have the power to bind each and every beneficiary in all dealings with the trustee and with other parties in connection with the subdivision and sale of the property. It provided that no lot is to be sold by the trustee for less than the minimum price thereof fixed by a schedule of minimum prices that was annexed to said declaration and made a part thereof, but as before stated, it gave to the syndicate managers the power of fixing the prices at which the property of the subdivision might be sold. A real estate firm of Los Angeles was irrevocably constituted the agent of the beneficiaries for the sale of the property for a period of two years from the date of the declaration of trust but as just adverted to, the sales agency could sell the real property only upon such price, terms, restrictions, and covenants as were fixed by the board of managers by written direction to the trustee and subject to such conditions. The sales agency could direct the trustee to convey the property with the same force and effect as if such direction had been given by the board of managers direction. At the expiration of two years, the board of managers were authorized to designate some other agency if it so desired for the sale of the trust property.

"The trustee is directed to apply the proceeds of sales to the payment of taxes, costs, charges and expenses, etc.; to the payment of its own services; to the

payment of money loaned the project by the bank, by Cotton and by others and to the payment to the subscribers to the amount that they had subscribed to the project and certain additional amounts specifically mentioned and designated in the trust instrument, and in addition to pay as directed by the board of managers any further amount of money that would be received by them on account of sales of real property of the trust as directed by the board of syndicate managers.

"The declaration provided that the beneficiaries agreed that they would subdivide and improve the real property as provided in the trust instrument and that such work of improvement would be installed and completely and fully paid for within two years of the date of such instrument.

"It also provided that the trustee may resign and discharge itself of the trust by a written notice to the board of managers 30 days before such resignation shall take effect and successor may thereupon be appointed by an instrument in writing executed by the beneficiaries and accepted by the successor trustee. Should the beneficiary fail to make such appointment before the expiration of such 30-day period, then the trustee may thereupon appoint a temporary successor trustee to fill such vacancy until such successor be appointed by the beneficiaries, and it further provided that any such successor should be vested with all the estates, rights, powers, and duties of its predecessor trustee. It was also stated in the declaration of trust that no sale or transfer of beneficial interests under the trust shall be valid or binding upon the trustee until the instrument making such assignment or transfer shall have been approved by and deposited with the trustee excepting only where such interest may pass or be transferred by a judgment or decree of court and then only upon proof satisfactory to the trustee of the legality and validity of the procedure in such matters being presented to the trustee. It stated that the legal and equitable title to the real property was vested in the trustee for the purposes of administering the trust, and that no person beneficially interested in the trust has any right, title, interest, or estate in the property covered by the declaration, nor has any person beneficially interested under said declaration of trust any right or power to apply for or secure a dissolution or termination of the trust or partition or division of any of the trust estate, it being further recited that the entire beneficial interest of any and all beneficiaries under the declaration of trust is personal property only consisting of the right to enforce the performance of this trust according to its terms. It was further provided in the declaration that the trust shall continue to and until the sale and disposition in fee of all the property subject to the trust and the disposition of all proceeds thereof in accordance with the terms of said declaration of trust or until the expiration of 25 years, whichever event shall happen first. There are other and further provisions in the declaration of trust, but sufficient has already been stated to designate the character of the instrument as well as the classification of the component entities and persons that are described therein. * * *

"* * * The evidence shows that the owners of beneficial interest frequently sold the same, and that a legal form was provided for the purposes of sale and transfer, and it appeared that 10 units were assigned during the calendar year 1928, and that there were other units assigned by the owners for collateral purposes. It is true that the enterprise sold only one lot during the year 1928, but during that period the sales agency was actively engaged in an effort to dispose of the unsold lots and that in the period approximately $340,000 was collected on lot sales, interest, etc., and that the total expenses for administration for the same period amounted to approximately $30,000. It is unnecessary to review all of the evidence as to the financial operations of the enterprise. Suffice it to say that it was a very profitable venture and resulted not only in the payment in full of all obligations incurred on account of the purchase, improvement, subdivision, and sale of the tract of land, but in addition made a handsome profit to all who invested or were interested in the enterprise. * * *"

The problem to be solved in this litigation is whether or not the appellant is an association within the meaning of the Act of Congress above referred to (section 701(a)2 of the Revenue Act of 1928). This subdivision of the Revenue Act is a reenactment without change of language used in the Revenue Acts of 1918, 1921, 1924, 1926, and 1928. After the enactment of the Revenue Act of 1918 the Commissioner of Internal Revenue acting under the authority and direction of said Act requiring him to prescribe and publish all needful rules and regulations for the enforcement of the Act adopted articles 1502 and 1504, amended August 31, 1925, of Regulations 65, pertaining to the Revenue

Act of 1924, articles 1502 to 1504 of Regulations 60 [69], pertaining to the Revenue Act of 1926, which are identical with articles 1312 and 1314 adopted under the Revenue Act of 1928. In view of the adoption of these interpretative regulations by the Commissioner, Congress, in the adoption of the Revenue Act of 1928, must be deemed to have considered and adopted the interpretation placed upon the statute by the Commissioner of Internal Revenue, in a matter as indefinite as the definition of "an association." Upon this subject the Supreme Court, in an opinion written by Justice Butler, in *Brewster* v. *Gage* (280 U. S., 327 [Ct. D. 148, C. B. IX–1, 274]), stated:

"It is the settled rule that the practical interpretation of an ambiguous or doubtful statute that has been acted upon by officials charged with its administration will not be disturbed except for weighty reasons. (*Logan* v. *Davis*, 233 U. S., 613; *Maryland Casualty Co.* v. *United States*, 251 U. S., 342; *Swendig* v. *Washington Water Power Co.*, 265 U. S., 322.) * * *

"* * * The regulations promulgated under that section are substantially the same as the earlier regulations. (Regulations 65, article 1594. Regulations 69, article 1594.) The substantial reenactment in later Acts of the provision theretofore construed by the Department is persuasive evidence of legislative approval of the regulation. (*National Lead Co.* v. *United States*, 252 U. S., 140; *United States* v. *Cerecedo Hermanos y Compania*, 209 U. S., 337; *United States* v. *G. Falk & Bro.*, 204 U. S., 143.) The subsequent legislation confirmed and carried forward the policy evidenced by the earlier enactments as interpreted in the regulations promulgated under them."

The regulations referred to first adopted, in their present form, by the amendment of Regulations 65, August 31, 1925, are as follows:

"ART. 1312. *Association.*—Associations and joint-stock companies include associations, common law trusts, and organizations by whatever name known, which act or do business in an organized capacity, whether created under and pursuant to State laws, agreements, declarations of trust, or otherwise, the net income of which, if any, is distributed or distributable among the shareholders on the basis of the capital stock which each holds, or, where there is no capital stock, on the basis of the proportionate share or capital which each has or has invested in the business or property of the organization. A corporation which has ceased to exist in contemplation of law but continues its business in quasi corporate form is an association or corporation within the meaning of section 701.

"ART. 1314. *Association distinguished from trust.*—Where trustees merely hold property for the collection of the income and its distribution among the beneficiaries of the trust, and are not engaged, either by themselves or in connection with the beneficiaries, in the carrying on of any business, and the beneficiaries have no control over the trust, although their consent may be required for the filling of a vacancy among the trustees or for a modification of the terms of the trust, no association exists, and the trust and the beneficiaries thereof will be subject to tax as provided by sections 161–170 and by articles 861–891. If, however, the beneficiaries have positive control over the trust, whether through the right periodically to elect trustees or otherwise, an association exists within the meaning of section 701. Even in the absence of any control by the beneficiaries, where the trustees are not restricted to the mere collection of funds and their payment to the beneficiaries, but are associated together with similar or greater powers than the directors in a corporation for the purpose of carrying on some business enterprise, the trust is an association within the meaning of the Act."

These regulations in the present form are said to be based upon the decision of the Supreme Court in *Hecht* v. *Malley* (265 U. S., 144 (1923) [T. D. 3595, C. B. III–1, 489]) dealing with the Revenue Acts of 1916 and 1918. The court in that case said:

"We think that the word 'association' as used in the Act clearly includes 'Massachusetts trusts' such as those herein involved, having quasi corporate organizations under which they are engaged in carrying on business enterprises. What other form of 'associations,' if any, it includes, we need not, and do not, determine. * * *

"We conclude, therefore, that when the nature of the three trusts here involved is considered, as the petitioners are not merely trustees for collecting funds and paying them over, but are associated together in much the same manner as the directors in a corporation for the purpose of carrying on business

enterprises, the trusts are to be deemed associations within the meaning of the Act of 1918; this being true independently of the large measure of control exercised by the beneficiaries in the Hecht and Haymarket cases, which much exceeds that exercised by the beneficiaries under the Wachusett Trust. We do not believe that it was intended that organizations of this character—described as 'associations' by the Massachusetts statutes and subject to duties and liabilities as such—should be exempt from the excise tax on the privilege of carrying on their business merely because such a slight measure of control may be vested in the beneficiaries that they might be deemed strict trusts within the rule established by the Massachusetts courts."

If we accept, as we think we should, the interpretation placed upon the word "association" by the Commissioner of Internal Revenue, inferentially approved and adopted by Congress in subsequent legislation based upon the decision of the Supreme Court in *Hecht* v. *Malley*, supra, it follows that there are two criteria for determining whether or not an organization or combination of individuals is taxable as an association. The first test found in article 1312 is the business test, that is to say, the test as to whether or not the organization formed "to do business in an organized capacity" and for the distribution of the profits among the shareholders in proportion to the investment or shares. The second test, contained in article 1314, is for the purpose of distinguishing an association from a trust, and depends upon the question of whether or not "the beneficiaries have positive control over the trust, whether through the right periodically to elect trustees, or otherwise." It appears from the terms of the trust, as stated in the foregoing excerpts from the memorandum opinion of Judge McCormick that while the ordinary business of the trust or association is carried on by agents designated in the trust and appointed by the trustees, the board of managers had at all times effective control of the business, and that the beneficiaries of the trust had the control over the syndicate managers indicated as the test in article 1314, that is, they had the power to select the managers. The language of the declaration of trust in that regard is as follows:

"That said board of syndicate managers shall consist at the outset of John T. Cooper, H. H. Cotton, Godfrey Edwards, Otto G. Wildey, and C. C. C. Tatum, and until the trustee receives a notice in writing, signed by beneficiaries holding at least three-fourths of the entire number of said units of beneficial interest, changing the personnel of said board of syndicate managers the trustee shall act upon the written direction of any three (3) of said named persons; but from and after receipt by it of such notice in writing notifying it of change in personnel of said board of syndicate managers, it shall act only upon the written directions of any three (3) of the persons comprising said board of syndicate managers as changed by such written notice."

It would seem clear that under the terms of the declaration of trust the syndicate organized for the purpose of purchasing, subdividing, improving and selling, a large tract of land, was engaged in doing business for profit and that the trust was distinguishable from a simple trust by reason of the control exercised over matters of its management and business by the board of managers and beneficiaries.

The appellant contends, however, that notwithstanding the existence of such powers they were not actually exercised during the tax year 1928, and that the true test is whether or not such powers were exercised, citing *Gardiner* v. *United States* (49 F. (2d), 992, 996 [Ct. D. 324, C. B. X–1, 483]). The answer to this contention, we think, is found in the statement of facts by the trial court as to the business done in the year 1928. Under these circumstances it can hardly be said that the powers of the managers or beneficiaries were not exercised during that time. The business of the association was active and was participated in by the agents and managers thereto authorized.

The appellant insists that the enterprise of the syndicate here involved was a joint adventure, citing 33 C. J., 841; *Peterson* v. *Nichols* (90 Wash., 398, 156 Pac., 406); *Sander* v. *Newman* (174 Wis., 321, 171 N. W., 822); *Central Trust Co.* v. *Creel* (184 Ky., 114, 211 S. W., 421); *Camp* v. *United States* (15 Ct. Cl., 469); *Barton* v. *Wamsley* (194 Iowa, 591, 190 N. W., 18); *Discus* v. *Scherer* (277 Ill., 168, 115 N. E., 161).

Of course it is quite immaterial as to whether or not the organization under consideration is a joint adventure within the meaning of that term as defined by the foregoing authorities. The question here is whether or not the organization is an association within the meaning of that term as used by Congress in its revenue laws. (*Burk-Waggoner Oil Assn.* v. *Hopkins*, 269 U. S., 110

[T. D. 3790, C. B. V-1, 147].) It is claimed, however, by the appellant that this distinction between a joint adventure and an association has been recognized in the administration of the revenue law and to sustain this proposition appellant cites *Appeal of Florida Grocery Co.* (1 B. T. A., 412); *Appeal of Ernest Woodruff* (4 B. T. A., 842); *Alger Melton* v. *Commissioner* (7 B. T. A., 717); also article 1317 of Regulations 74, Revenue Act of 1928, as follows:

"*Joint ownership.*—Joint investment in and ownership of real and personal property not used in the operation of any trade or business and not covered by any partnership agreement does not constitute a partnership. Coowners of oil lands engaged in developing the property through a common agent are not necessarily partners."

In *E. A. Landreth Co.* (11 B. T. A., 1), the Board of Tax Appeals held that the agreement under which funds were secured by the owner of an oil lease for the development of property was a joint adventure and not an association.

In *Myers, Long & Co.* (14 B. T. A., 460) it was held that persons associating themselves for the development of oil and gas lands without definite organization did not constitute a corporation within the meaning of section 2 of the Revenue Acts of 1918, 1921, and 1924, but were joint adventurers and must be taxed as individuals. Similar ruling was made in *Royal Syndicate* (20 B. T. A., 255). In *Sugg* v. *Hopkins* (11 F. (2d), 517) it was held that there was no partnership for the handling of 10,000 sheep jointly owned. In *McCausey* v. *Burnet* (50 F. (2d), 491), a syndicate to purchase bank stock, was held to be a joint adventure and not an association.

These cases indicate that there are some joint adventures which are not associations within the meaning of the revenue law, but they are far from sustaining the proposition that all joint adventures are not taxable as associations. Every association of individuals, whether a partnership or corporation or syndicate, is in a broad sense a joint adventure, although not strictly such within the meaning of that term as usually employed in textbooks and judicial opinions. In determining whether or not a joint adventure is taxable as an association we must look to the nature of the business and character of the organization to determine whether or not it is taxable.

It is claimed by the appellant that the enterprise does not sufficiently resemble a corporation to justify being classed as a corporation. This is a mere restatement of the proposition that the organization under consideration is not an association within the meaning of the statute. We have recently had occasion to consider the question of whether or not a trust created for liquidation of the affairs of a corporation was an association within the meaning of the statute. (*Commissioner* v. *Atherton*, 50 F. (2d), 740.) Our decision in that case is cited as authority for the proposition that the organization in the case at bar is not taxable because in legal effect it is a liquidating organization. An examination of the two trusts indicates clearly that there is a very definite distinction in the case at bar; the trust or syndicate or association was organized for the purpose of purchase and sale of a tract of land which was to be improved for the purpose of rendering the land salable and augmenting the profits to be derived therefrom. In the trust under consideration in *Commissioner* v. *Atherton*, supra, the sole and only purpose of the trust was to convey to these trustees assets which could no longer be profitably held by the public utility corporation in connection with its business as a public utility. Other differences can be readily ascertained by an examination of the decision in that case.

Appellant cites in his brief a number of cases in which the Board of Tax Appeals has distinguished between an association and a joint adventure or partnership. We think it unnecessary to consider these cases separately or determine their applicability to the case at bar. It is sufficient in that regard to call attention to a more recent decision of the Board of Tax Appeals in passing upon the taxability of a California subdivision real estate syndicate similar to that involved here. (*Sloan* v. *Commissioner* (Prentice Hall Fed. Tax Serv., 1931, p. 1831), 24 B. T. A., 61.) The trust was held to be an association taxable under the internal revenue laws, and in that connection the Board of Tax Appeals stated:

"* * * the courts and this Board have uniformly held that a trust operating a business for profit is an association taxable as a corporation. * * * Up to the date of the declaration of the trust, only two, if any, of the beneficiaries herein were owners of any interest in the parcel of land * * *. Everything in the record indicates that the beneficiaries herein entered into a

voluntary association for the purpose of acquiring, subdividing, improving and selling Dominquez Harbor Tract No. 2, with the expectation of realizing a profit therefrom."

Appellant contends that this latest decision of the Board of Tax Appeals is contrary to the current trend of the decisions of the Board and of the courts. It is sufficient to say that this opinion was deliberately arrived at and represents the present view of the Board of Tax Appeals upon the exact question here involved.

We conclude that the association, or syndicate, organized for the purpose of subdividing the 90 acres of land in question was an association within the meaning of the revenue law of 1928, doing business as such during the year 1928, and taxable as an association.

Judgment affirmed.

INCOME TAX RULINGS.—PART II.

REVENUE ACT OF 1926.

TITLE II.—INCOME TAX.

PART I.—GENERAL PROVISIONS.

SECTION 200.—DEFINITIONS.

ARTICLE 1523: "Taxable year," "withholding agent," "paid or incurred," and "paid or accrued."

REVENUE ACT OF 1926.

Interest on bonds paid annually or paid upon redemption or maturity of the bonds, where taxpayer's books are kept on the accrual basis. (See G. C. M. 10384, page 49.)

SECTION 203.—RECOGNITION OF GAIN OR LOSS FROM SALES AND EXCHANGES.

ARTICLE 1574: Exchanges in connection with corporate reorganizations. XI–24–5510 G. C. M. 10624

REVENUE ACT OF 1926.

In view of the Commissioner's partial acquiescence in the decision of the Board of Tax Appeals in the case of *Robert D. Green* v. *Commissioner* (24 B. T. A., 719, page 3, this Bulletin), General Counsel's Memorandum 8991 (C. B. X–1, 215), holding that the entire gain realized by the common stockholders of the M Company who participated in the transaction with the N Company should be treated as taxable income for the year 1927, the year in which the transaction occurred, is revoked.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

SECTION 204.—BASIS FOR DETERMINING GAIN OR LOSS, DEPLETION, AND DEPRECIATION.

ARTICLE 1596: Property acquired upon an exchange.

REVENUE ACT OF 1926.

Determination of the basis of property acquired by exchange. (See I. T. 2615, page 112.)

SECTION 206.—NET LOSSES.

ARTICLE 1622: Claim for allowance of net loss. XI–4–5368 Ct. D. 442

INCOME TAX—REVENUE ACT OF 1926—DECISION OF COURT.

DEDUCTION—NET LOSS—AFFILIATED CORPORATION—NET LOSS BEFORE AFFILIATION.

A net loss, as defined by section 206 of the Revenue Act of 1926, sustained in 1925 and 1926 by a corporation without an affiliated

status in those years, which without the application of the net loss had no net income in 1927 when it was affiliated with another corporation within the meaning of section 240 of that Act, may not be deducted in determining the consolidated net income of the corporations for the latter year.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT.

Woolford Realty Co., Inc., appellant, v. *J. T. Rose, Collector of Internal Revenue for the District of Georgia, appellee.*

Appeal from the District Court of the United States for the Northern District of Georgia.

Before BRYAN, HUTCHESON, and WALKER, Circuit Judges.

[November 13, 1931.]

OPINION.

HUTCHESON, Circuit Judge: In 1925 the Piedmont Savings Co. sustained a statutory net loss of $43,478.25; in 1926 it sustained a further statutory net loss of $410.82; it was in those years unaffiliated. In 1927 appellant and the Piedmont Savings Co. having become affiliated, a consolidated return for that year was filed. This return disclosed a combined net income for that year of $37,128.83 made up of appellant's net taxable income of $37,582.63 and a loss of Piedmont, $453.80. The Commissioner because Piedmont had no net income in 1927, refused to allow appellant to deduct from the combined net income the statutory net losses of Piedmont incurred in 1925 and 1926, and carried over because of having had no net income in 1926, into the third and second year respectively. The district judge, taking the same view, denied the claim that because of this disallowance there was an overpayment.

This appeal presents the single question whether statutory net losses, accruing to a corporation when unaffiliated, may be used by it in a subsequent year when affiliated with another, in computing not simply its own net income, but the net income of the other member of the affiliated group. Or, putting it another way, whether the words "net income" used in section 206(b) may mean "minus net income" or loss, so as to permit a statutory net loss to be availed of by the affiliated group not merely to the extent of reducing the amount of the net income of the corporation entitled to it on which the affiliated group must pay taxes, but of producing a loss or minus quantity which the affiliated group may use as a deduction from the net income of the other member.

Respondent insists that the whole structure of the taxing system with its emphasis upon gains and losses incurred in the taxable year by the taxpayer, "a person subject to a tax imposed by the Act," makes it plain that both losses and gains must, in order to be taken account of in a return, be the losses and gain of the persons subject to the tax, and except in the single case of section 206 the amortization in prosperous years by the taxpayer incurring it of his statutory net loss, they must be the losses and gains of the taxable year. He declares that the purpose of the taxing statutes as to each person subject to the tax is as to each taxable year, to ascertain, set down and fix what taxable income has accrued to him in that year. That nowhere in the statutes is there any warrant for the view that losses incurred in one year and carried over by statute as net losses by one taxpayer, may be purchased and dealt in, or in any manner acquired by another taxpayer, and used by him as deductions against his own net income. He contends that the taxing statutes use the term "net income" in its real, its natural sense, of a plus, not a minus quantity, meaning "that portion of the receipts of a business which remains after making the deductions allowable by law from its gross income." That it is just as unthinkable to say that net income means either net loss or minus net income as to say that plus and minus are the same.

Appellant on its part insists that to permit respondent's contention to prevail would be to permit a literal construction of the words "net income" in 206(b) to defeat the clear purpose and intent of that section; that the deduction may be used as one of the factors in ascertaining whether the taxpayer made a loss or gain for the year, and how much; that the result of this literal construction would be, as to this particular deduction, to deprive an affiliated corporation entitled under section 240 to make a consolidated return, of the

full benefit of the deductions to which each member of the group is entitled, contrary to the clear intent of section 240 and the regulations and practices under it. Appellant cites generally, in support of its position, the proposition first advanced by the Board of Tax Appeals in *Alabama By-Products Corporation* (18 B. T. A., 919), and repeated in later decisions of the Board, that "the statutory net loss is by the plain language of the statute put in the same category as any other deduction allowed by statute in determining an operating gain or loss of one corporation in an affiliated group for the taxable year." It declares, as the Board did in *Pittsburgh Gasoline Co.* (21 B. T. A., 302), that in determining the net income of a corporate taxpayer the deduction of the net loss of a prior year allowed by section 206 is to be treated the same as the deduction allowed by section 234 whether this deduction produces a net loss, or as the Board calls it, a minus net income. Appellant cites in support of its position the opinions of the Board of Tax Appeals in *Alabama By-Products Corporation* (18 B. T. A., 919), *Ginsburg Co.* (19 B. T. A., 81), *Buckie Printers Ink Co.* (19 B. T. A., 943), *Pittsburgh Gasoline Co.* (21 B. T. A., 297), *General Box Corporation* (22 B. T. A., 725), *Arrow Coal & Ice Co.* (22 B. T. A., 1341), *Tolerton & Warfield Co.* (23 B. T. A., 892), *Hawley Investment Co.* (23 B. T. A., 953), and *National Slag Co.* v. *Comr.* (47 Fed. (2d), 846).

On the face of it, a ruling which permits a corporation with a consistent record of gains, to affiliate with one having a large accumulation of statutory net losses for the purpose and with the result of using these losses in the year of affiliation as deductions from its income in that year, appears generally inappropriate to the Federal scheme of income taxation, designed as it is with the sole exception of the statutory net loss provision, to make each person subject to the tax, pay taxes on his income for the year in which it accrues. The district judge was impressed with this general inappropriateness; it impresses us. The particular inappropriateness of the contention that in using the words in section 206(b) "shall be used as a deduction in computing net income" Congress intended to emphasize not as the object of computation the ascertainment of the net income of the taxpayer for the purpose of determining the tax he should pay, but merely the fact that a computation was to be had for the purpose of finding out whether the taxpayer made a loss or a gain, and the setting down of this figure whether a plus or a minus one, also impresses us.

It seems to us that to give this effect to the words would be to do violence not only to the words themselves, but to the general purpose of the section, which was to give to a taxpayer which had sustained it, the purely personal right (*Bush* v. *Comr.*, 50 Fed. (2d), 800) to amortize out of earnings in the second and third years following, losses of the first year, not to give to this statutory net loss a substantive character as an asset which could be traded in through the device of affiliation, and thus, acquired by another taxpayer, used by him as a deduction against his own income.

Were it not for the fact urged upon us by appellant with such earnestness that the Board of Tax Appeals and the Circuit Court of Appeals for the Third Circuit have by construction found that the words in question do have the meaning which appellant contends for, we should take the simple view which Alice took before her encounter with the master logomachist, that words mean what they say, and not the opposite, and simply say, without more ado, that the words "net income" mean net income; they do not, they can not mean minus net income or loss. That when Congress in section 206(b) declared that the statutory net loss "shall be allowed as a deduction in computing the net income for the succeeding taxable year" it used these words in their natural, their ordinary sense, to mean "that portion of the receipts of a business which remains after making the deductions allowable by law from the gross income." That they were used with the practical end of taxation in view, determining the amount which the taxpayer will contribute to the support of the Government in the taxable year.

In the light, however, of the contrary view so strongly presented, it is desirable, we think, to examine the words used in the statutes relied on, both in themselves and in their context, to determine whether it is we, or the appellant, who see them through the looking-glass.

The applicable statutes and regulations on which the structure of appellant's argument rests are Revenue Act 1926:

Determination of net income. "In the case of a corporation subject to the tax imposed by section 230, the term 'net income' means the gross income as defined in section 233 less the deductions allowed by sections 234 and 206."

Section 206 (a) and (b) provides: "(a) As used in this section the term 'net loss' means the excess of the deductions allowed by section 214 or 234 over the gross income, with the following exceptions and limitations * * * (b) If for any taxable year it appears upon the production of evidence satisfactory to the Commissioner, that any taxpayer has sustained a net loss, the amount thereof shall be allowed as a deduction in computing the net income of the taxpayer for the succeeding taxable years (hereinafter in this section called 'second year') and if such net loss is in excess of such net income (computed without such deduction) the amount of such excess shall be allowed as a deduction in computing the net income for the next succeeding taxable year (hereinafter in this section called 'third year')."

Section 240: "(a) Corporations which are affiliated * * * may for any taxable year make separate returns, or under regulations * * * make a consolidated return of net income for the purpose of this title, in which case the taxes thereunder shall be computed and determined upon the basis of such return." (b) Provides that the total tax shall be computed in the first instance as a unit, and shall then be assessed upon the respective corporations as they shall agree, or on the excess of the net income properly assessable to each.

In Regulations 69, article 635, Consolidated net incomes of affiliated corporations, it is provided—

"Subject to the provisions covering the determination of taxable net income of separate corporations, * * * the consolidated taxable net income shall be the combined net income of the several corporations consolidated. * * * In respect of the statement of gross income and deductions * * * a corporation filing a consolidated return must show * * * the details of the items of gross income and deductions for each corporation included in the consolidation."

Appellant supplements its contention that the words themselves simply and plainly mean that the statutory net loss shall be allowed as any other deduction is, in arriving at the result of the taxpayer's business for that year whether it is a plus or a minus quantity, by arguing that there is in neither 206(b), the net loss section, nor in section 240, or any regulation under either, any provision directing that this deduction be differently treated in making up consolidated returns. He declares that though no new taxpayer has resulted from the affiliation, and the individuals who compose the group are still the statutory taxpayers, the affiliated group in reality constitutes a tax unit, a quasi taxpayer, "a person subject to the tax," "whose income and capital stock are really the income and capital stock of a single enterprise" (*Ice Service Co.* v. *Comr.*, 30 Fed. (2d), 230; *National Slag Co.* v. *Comr.*, 47 Fed. (2d), 846; *Flanary* v. *Comr.*, 42 Fed. (2d), 11), and that since it is the combined net income which is being sought in the case of a consolidated return, and that income is the result of the deduction from the aggregate of the gross income of all of the affiliates of their gross allowable deductions, it is to impress a too literal and arbitrary meaning upon the words "net income" as used in the net loss statute, to limit it to a plus quantity, when the same term as to all other deductions is used both in a plus and minus sense, to mean a profit or a loss.

Of course if appellant is right in its assumption that the statutory net loss deduction must be treated like any other deduction in making up a consolidated return, it is right in its conclusion that it should have had the benefit of it here. If, on the other hand, as we think, this is a special deduction available only in strict accordance with the terms of the statutes which give it, appellant is wrong and it should have been disallowed.

We think the assumption of appellant and its argument in support of it overlooks the point that taxes go by years, and that though in the taxable year in question the individual corporations are still taxpayers, the business is really regarded for the purpose of taxation, as a unit, and as such subject to tax on the business of that year. Because the income on which the tax shall be paid in the taxable year, though made up of the results of the business of each affiliate, is not the income of each individual taxpayer, but the income of the unit for that year, the Commissioner was right in allowing against the aggregate gross income of the business for that year the aggregate deductions applicable to that year. This treatment gives full effect to the purpose of the statute to allow affiliates to transact their business as freely as though they were one corporation acting through departments, with the assurance to the Government and the taxpayer alike that the taxes payable as the result of the business done by the taxable unit in that year will, without reference to the bookkeeping of the individual corporations, be paid upon the whole business done by

the unit, taking into consideration all of the earnings and all of the deductions of the branches of the business, not separately but in the aggregate, just as though in that year there was no separate corporate structure, but one corporation maintaining many departments.

When, however, it is sought to extend the grant of the statute authorizing a taxpayer to offset the earnings of subsequent years against the loss of a prior year so as to confer upon an affiliated group the extraordinary privilege of deducting from its earnings actual losses, which neither it nor its affiliates incurred in the taxable year of the affiliated group, the one making this claim must be able to point to clear and unmistakable language authorizing that extension.

Apart from the nice verbal construction of sections 206 and 240 which supports the view that section 206 may not be so extended, we think no other view consonant with the general intent and purpose of the two statutes. The view we take gives full effect to them both. It does not permit affiliation to deprive the taxpayer of his net loss privilege or in any manner diminish it. It does not permit affiliation to enlarge or in any manner change it. This personal privilege, extended to the individual taxpayer to palliate the rigidity of the annual system of taxation, and to spread over the two succeeding years for the purpose of deduction in them from the net income which the taxpayer might make in those years, losses which though not actually accruing in the one year, were perhaps the foundation of the income of the following years, we think should be given the full effect intended. It should not be by construction extended to the unreasonable result of permitting a corporation having no connection whatever with the losses, to avail itself of them as a positive deduction through the device of affiliation.

While the appellant does find support for the position which it takes, in the opinions of the Board of Tax Appeals, we can not agree with the view which the Board takes. Whether the decision in the National Slag Co. case, supra, was or not correct, it did not decide the point before us. That case merely decided that since one Buckland had during the years in which the statutory net losses were sustained, as well as during the year of affiliation, owned both of the enterprises, the loss was really his loss, and the statute should be construed so as to give him the benefit of it.

Decisions which though not directly in point, in principle support the position we take, that statutory net loss is individual to the taxpayer incurring it and may be availed of by him to the extent of his net income, are *Swift* v. *United States* (38 Fed. (2d), 365); *The Sweets Co. of America* v. *Comr.* (40 Fed. (2d), 346); *Burnett* v. *Moore Cotton Mills* (49 Fed. (2d), 239); cf. *Planters Oil Co.* v. *Hopkins* (47 Fed. (2d), 659 [Ct. D. 358, C. B. X–2, 231]; *Bush* v. *Comr.* (50 Fed. (2d), 800); *First National Bank of Chicago* v. *U. S.* (283 U. S., 142).

The judgment of the court below is affirmed.

ARTICLE 1622: Claim for allowance of net loss. XI–6–5380
Ct. D. 446

INCOME TAX—REVENUE ACT OF 1926—DECISION OF COURT.

DEDUCTIONS—NET LOSS—AFFILIATED CORPORATION—NET LOSS BEFORE AFFILIATION—STOCK OWNED BY ONE PERSON.

A net loss, as defined by section 206 of the Revenue Act of 1926, sustained by a corporation in a year when it is unaffiliated may not be deducted under that section in a subsequent year, in which it is affiliated with another corporation and in which without the application of the net loss it has no net income, in determining the consolidated net income of the corporations for the subsequent year, even though one person is the owner in the first year of substantially all the stock of the corporation sustaining the net loss and the owner in the subsequent year of substantially all the stock of the two corporations.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT.

Planters Cotton Oil Co., Inc., Waxahachie, Tex., et al., appellants, v. *George C. Hopkins, Collector of Internal Revenue, appellee.*

Appeal from the District Court of the United States for the Northern District of Texas.

[November 20, 1931.]

OPINION.

HUTCHESON, Circuit Judge: The consolidated return for the fiscal year ending June 30, 1924, of Planters Cotton Oil Co., Waxahachie, and Planters Cotton Oil Co., Ennis, unincorporated associations, 98 per cent of the stock of which was owned by Chapman, showed a net loss of $206,031.03. Of this total $182,284.86 was the loss of the Waxahachie company, $23,746.17 of the Ennis company. For reasons of his own not disclosed by the stipulation on which the case was tried Chapman in August and September, 1924, caused to be formed under the laws of Texas three corporations, Planters Cotton Oil Co., Inc., Waxahachie; Planters Cotton Oil Co., Inc., Ennis; and Farmers Gins, Inc., and to be transferred to them certain of the assets of the associations. In consideration of their transfer there was issued to Chapman substantially all of the stock of the three corporations. These assets so transferred constituted the entire assets of the corporations.

For the fiscal year ending June 30, 1925, the three corporations and the two joint stock companies filed a consolidated tax return reporting a net income of $69,237 made up of a net income of the three corporations of $147,636.25, a loss of the two associations of $78,399.25. The tax assessed upon this return was paid for the group by Planters Cotton Oil Co., Inc., Waxahachie. No claim to a deduction for the net losses sustained by the unincorporated companies was then or in fact until 1927 made by plaintiff. In 1927 claim for refund of taxes overpaid in 1925, because these net losses were not taken into account in the return and the assessment for that year, was made. The claim was rejected on the ground that the statutory net loss deduction was personal to the taxpayer which had sustained it and could be used only in computing its net income. That since neither association had net income in 1925, but in that year, as in 1924, each had sustained a net loss, it could not be availed of by any other of the affiliates having net income to diminish the net income of the group. The district judge took the same view. (*Planters Cotton Oil Co.* v. *Hopkins*, 47 Fed. (2d), 659 [Ct. D. 358, C. B. X–2, 231].) This appeal has resulted.

In *Woolford Realty Co.* v. *Rose* (decided November 13 [Ct. D. 442, page 145],) this court had occasion to consider generally the question here involved. There after full consideration we decided that the statutory net loss deduction was personal to the taxpayer sustaining it, could be availed of in the following year by that taxpayer alone, and by him only to the extent that he had net income in that year. That it could not be availed of to create a minus net income or loss which might be used by a member of the group which did have net income as a positive deduction against that income.

Were this a case as that one was, of corporate affiliation of interest theretofore distinct, brought about after the net losses had been sustained, we should dispose of this case by a mere reference to that opinion. Since, however, the differentiating facts appear here as they did in the case of *National Slag Co.* v. *Commissioner* (47 Fed. (2d), 846), that one person has at all times been substantially the owner of all of the stock in all of the companies involved, and the tax ultimately fell on him because he at all times owned all of the companies, in the Slag case two companies so owned having been consolidated, in this case five companies so owned having been created by carving three out of the two which had sustained the net loss, it becomes necessary for us now to determine whether these differences of fact require a different legal conclusion. We do not think they do.

It is true that the facts of this case and of the National Slag Co. case do present a situation of which if the matter were to be determined upon considerations of general fitness, it might be well said, as the court did in the Slag case, "It seems on principle that the provisions of section 206 should apply to the consolidated return of these affiliated companies"; but the question may not be decided upon such considerations. The rights of the claimants here must rest upon the express terms of the statute. They have no natural spring. "A deduction from gross income can be claimed only as authorized by the

statute." (*Pugh* v. *Commissioner*, 49 Fed. (2d), 76; *Darby Lynde Co.* v. *Commissioner*, 51 Fed. (2d), 32.) The statutory net loss deduction has been definitely decided to be a deduction purely personal to the individual taxpayer sustaining it. (*Busch* v. *Commissioner*, 50 Fed. (2d), 800; *First National Bank of Chicago* v. *United States*, 283 U. S., 142 [Ct. D. 335, C. B. X–1, 406]; *Woolford Realty Co.* v. *Rose*, supra.)

Unless therefore the fact that Chapman is and has at all times been substantially the sole owner of the stock both of the unincorporated associations from which the corporate taxpayers sprang and of the corporations gives him warrant to assert that in reality he has at all times been the taxpayer, and the losses and gains alike have been his, the deduction may not be allowed.

It is the general rule that the corporation and the stockholders are essentially distinct entities, and though to circumvent fraud the corporate entity may be regarded as a fiction, ordinarily it must be regarded as having a real, a substantial existence. (*Donald* v. *Herring-Hall*, 208 U. S., 267; *Klein* v. *Board of Supervisors*, 282 U. S., 19.) Nor does the fact that one person owns all or substantially all of the stock of the corporation at all change the rule. (*Aiello* v. *Crampton*, 201 Fed., 891; *Georgia Railway Co.* v. *Georgia*, 289 Fed., 878; *Winfield* v. *Wichita*, 267 Fed., 47.) Particularly is it true as regards taxation and matters of Government fisc, that the members of a corporation and the corporation itself are essentially different entities. (*Darby Lynde Co.* v. *Commissioner*, 51 Fed. (2d), 32; *Marr* v. *U. S.*, 268 U. S., 536 [T. D. 3755, C. B. IV–2, 116]; *Klein* v. *Board of Supervisors*, 282 U. S., 19.) The whole structure of the Federal taxing system is based upon a recognition of and an exact compliance with these distinctions. Fraudulent pretense absent, the Government accepts the taxpayer as it represents itself to be and one may not, chameleon-like, change that appearance to suit his necessity or his convenience. Especially may he not, as here, for the purpose of obtaining a deduction which he could have had if the matter had taken individual form, deny that substance to these entities which in the conduct of the business, the making of the tax returns, and in all other respects he at all times has consistently and definitely affirmed.

Though, then, it is true in a sense as the district judge said it was that "the result of the year's work was a benefit or a loss to Chapman and the tax was in reality paid by him because he owned the companies," this is not the kind of reality of which he may avail. It is but an ultimate reality, the result of direct, of immediate realities, the operation of corporations which though created by him from the assets of unincorporated associations which he owned, are none the less in law separate and distinct from each other and from him, with whom, and not with him, the Government has dealt and must continue to deal. The judgment of the court below is affirmed.

ARTICLE 1622: Claim for allowance of net loss. XI–18–5468
Ct. D. 479

INCOME TAX—REVENUE ACT OF 1926—DECISION OF COURT.

1. DEDUCTION—NET LOSS—AFFILIATED CORPORATIONS—NET LOSS BEFORE AFFILIATION.

A net loss as defined by section 206 of the Revenue Act of 1926 sustained in 1926 by a corporation without an affiliated status in that year, which without the application of the net loss had no net income in 1927, when it was affiliated with another corporation within the meaning of section 240 of that Act, may not be deducted in determining the consolidated net income of the corporations for the latter year.

2. DECISION REVERSED.

The decision of the Board of Tax Appeals (19 B. T. A., 81) reversed.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

Commissioner of Internal Revenue, petitioner, v. *Ben Ginsburg Co., Inc., respondent.*

Petition to review an order of the Board of Tax Appeals which disallowed a claimed deduction. Petitioner appeals. Order reversed.

Before MANTON, AUGUSTUS N. HAND, and CHASE, Circuit Judges.

[November 2, 1931.]

OPINION.

MANTON, Circuit Judge: The respondent and Mendelson & Sussman Co., Inc., are New York corporations, both having offices in the city of New York. On January 2, 1927, the respondent's stockholders acquired all the capital stock of Mendelson & Sussman Co., Inc., in the proportions in which they owned shares of stock of the respondent, and thereby the corporations became affiliated for the taxable year 1927. In 1926, Mendelson & Sussman Co., Inc., sustained a net loss of $48,340.18, and for the year 1927, a net loss of $57,407.79. The net income of the respondent for 1927 was $101,934.11. The two affiliated corporations filed consolidated income tax returns for the year 1927. They determined the net income of the two affiliated corporations for 1927 by deducting the 1926 and 1927 losses of the Mendelson & Sussman Co., Inc. The Commissioner disallowed the deduction of the Mendelson & Sussman Co., Inc., 1926 loss, giving as his reason that the companies were not affiliated in 1926, and, therefore, that the loss was not that of the respondent. This action by the Commissioner left the consolidated net income to the affiliated companies of $44,526.32. This forms the basis for the deficiency. The Board of Tax Appeals sustained the taxpayer's contention, allowed the deduction and found that there was no deficiency.

The question, therefore, presented to us is whether the respondent is entitled to have $48,340.18, the net loss of the Mendelson & Sussman Co., Inc., in 1926, used as a deduction in determining the net income of the affiliated group in 1927. Even though both corporations were affiliated in 1927, they each remained taxpayers and their affiliation merely made them a tax computing unit. (*Swift* v. *United States*, 38 Fed. (2d), 365; *Sweets Co.* v. *Commissioner*, 40 Fed. (2d), 436 (C. C. A. 2).) Sections 234, 232, 206 of the Revenue Act of 1926 authorized the use of a net loss in the computation of net income of a taxpayer for the taxable year, but section 206(a) does not authorize the use of such net loss in the computation of a net loss for that year. Since each corporation of the affiliated group is a taxpayer, the net loss of each must be computed separately, and a net loss may not be carried forward and added to a net loss of the taxpayer unless the taxpayer has a net income for a succeeding year. Therefore, a net loss for a previous year, 1926, could not be availed of by the affiliated return since Mendelson & Sussman, Inc., had no net income in 1927. Affiliated returns are authorized by section 240(a) of the Revenue Act of 1926 as "a consolidated return of net income," under regulations prescribed by the Commissioner with the approval of the Secretary of the Treasury. Article 635 of Regulations 69, as promulgated, provides:

"Subject to the provisions covering the determination of taxable net income of separate corporations, * * * the consolidated taxable net income shall be the combined net income of the several corporations consolidated."

By this regulation, the affiliated group, filing a consolidated return, becomes a tax computing unit. It is not a taxable unit. Section 206(a) defines the term "net loss" as being the "excess of the deductions allowed by section * * * 234 over the gross income," and section 206(b) provides that if "any taxpayer has sustained a net loss, the amount thereof shall be allowed as a deduction in computing the net income of the taxpayer for the succeeding taxable year (hereinafter in this section called 'third year')."

The right of deduction of a net loss computed under section 206 is restricted to the computation of the net income of the taxpayer. But a corporation of the affiliated group remains a taxpayer and the deduction must be confined to the computation of the net income of the corporate entity. In *Swift Co.* v. *United States* (supra), the corporation, which was not a member of the affiliated group in 1918, sustained a net loss during the year 1919. Speaking of the right to take advantage of this loss in computing the 1918 taxes, the Court of

Claims said: "Of course this net loss will not be used in the consolidated computation for 1918 for the reason that this corporation was not a member of the 1918 group." And we said in *Sweets Co.* v. *Commissioner* (supra) that the statutory provisions for consolidated returns declared merely a method of computing the taxes of the corporation members of the group. It is section 240(a) which authorized the net income of the affiliated group to be made up while computing the net incomes and losses of the several corporations and then consolidating the results of the several computations, thereby adding net income to net income and net loss to net loss and arriving at the taxable income by subtracting the composite net loss from the total net income. Section 206(b) provides only that a net loss may be used in the computation of net income, but it may not be used in the computation of net loss. Under section 206(b) the right to carry the deduction forward is limited to the third year (counting the taxable year as the first year), but the statute does not contemplate carrying forward the net loss and its addition to a net loss for the succeeding year and thus indefinitely until the combined net losses are offset by net income. The deduction is limited to the computation of net income. (*Burnet* v. *Moore Cotton Mills Co.*, 49 Fed. (2d), 59 (C. C. A. 4).) It follows that when the net income is reduced to zero, the function of the net loss provision ceases. In article 1622 of the Treasury Regulations 69 it is said:

"It should be noticed, however, that a 'net loss' for a preceding year may not be considered in computing a 'net loss' for a succeeding year."

Since a net loss in the previous year may not be added to the net loss for a subsequent year, in the instant case, because of the lack of net income by Mendelson & Sussman Co. in 1927, it can not affect such taxpayer's net loss upon the computation of the consolidated net income. (*Woolford Realty Co.* v. *Rose*, 53 Fed. (2d), 821 [Ct. D. 442, page 145].) The income tax law has defined net income and provides the formula for its computation, and has defined net loss and prescribed the formula for its computation; these formulae are exclusive. (*Botany Worsted Mills* v. *United States*, 278 U. S., 282 [Ct. D. 39, C. B. VIII–1, 279].) The congressional intent is plain and it is the duty of the courts to give effect thereto. (*United States* v. *Goldenburg*, 168 U. S., 95.)

We are referred to *National Slag Co.* v. *Commissioner* (47 Fed. (2d), 846 (C. C. A. 3)), which seems to be in conflict with these views as well as with *Sweets Co.* v. *Commissioner*, supra. We think the purpose of Congress was to provide affiliation of corporations based upon the theory that common stockholders of two or more corporations whose holdings are substantially the same in each or all, bear the ultimate burden of tax equally and equitably, regardless of whether it rests primarily upon one or the other of the affiliated corporations. (*Commissioner* v. *Adolph Hirsch & Co.*, 30 Fed. (2d), 645 (C. C. A. 2) [Ct. D. 66, C. B. VIII–1, 267].) If the respondent were permitted to obtain credit for the losses sustained by Mendelson & Sussman Co. at a time when the two companies were not affiliated, the common stockholders of the corporation would not bear the ultimate burden of tax equally or equitably.

Order reversed.

ARTICLE 1622: Claim for allowance of net loss. XI–23–5502
Ct. D. 492

INCOME TAX—REVENUE ACT OF 1926—DECISION OF COURT.

DEDUCTION—NET LOSS—AFFILIATED CORPORATIONS—NET LOSS BEFORE AFFILIATION—STOCK OWNED BY ONE PERSON.

A net loss, as defined by section 206 of the Revenue Act of 1926, sustained by a corporation in a year when it is unaffiliated may not be deducted under that section in a subsequent year, in which it is affiliated with another corporation and in which without the application of the net loss it has no net income, in determining the consolidated net income of the corporations for the subsequent year, even though one person is the owner in the first year of substantially all the stock of the corporation sustaining the net loss and the owner in the subsequent year of substantially all the stock of the two corporations.

SUPREME COURT OF THE UNITED STATES. No. 672.—OCTOBER TERM, 1931.

Planters Cotton Oil Co., Inc., of Waxahachie, Tex., et al., petitioners, v. *George C. Hopkins, Collector of Internal Revenue.*

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

[May 16, 1932.]

OPINION.

Mr. Justice CARDOZO delivered the opinion of the court.

Three corporations, Planters Cotton Oil Co., Inc., Waxahachie, Planters Cotton Oil Co., Inc., Ennis, and Farmers Gins, Inc., were organized under the laws of Texas in August and September, 1924. Two joint stock associations, Planters Cotton Oil Co., Waxahachie, and Planters Cotton Oil Co., Ennis, which had been organized in earlier years, retained their separate existence. One man, H. N. Chapman, was the owner of 98 per cent of the shares of the unincorporated associations. He caused the assets of those associations, or substantially all of them, to be transferred to the newly organized corporations, and received in return substantially all the shares of stock.

For the fiscal year ending June 30, 1925, the three corporations and the two joint stock associations filed a consolidated income tax return wherein the corporations, which had earned a net income of $147,636.25, claimed a deduction of $78,399.25 for loss suffered by the associations during the year preceding the affiliation. The deduction was disallowed, and suit was brought by the corporation and the associations for the refund of the tax to the extent of the overpayment claimed. The district court dismissed the petition (47 F. (2d), 659); the court of appeals affirmed (53 F. (2d), 825); and by certiorari the case is here.

The controversy is ruled by our judgment in No. 582, *Woolford Realty Co., Inc.*, v. *Rose* [Ct. D. 493, below], unless the fact that in this case one shareholder, Chapman, was the owner of substantially all the shares of the five affiliated companies supplies an essential element of difference. We think it does not. Chapman was free, if he desired, to continue to do business in an unincorporated form. Preferring the privileges of corporate organization, he brought into being three corporations and did business through them. These corporations are not identical with the unincorporated associations to whose principal assets they have succeeded, and the losses of the associations suffered in an earlier year are not the losses of the corporations that came into existence afterwards.

The judgment is affirmed.

ARTICLE 1622: Claim for allowance of net loss. XI-23-5503
Ct. D. 493

INCOME TAX—REVENUE ACT OF 1926—DECISION OF COURT.

DEDUCTION—NET LOSS—AFFILIATED CORPORATIONS—NET LOSS BEFORE AFFILIATION.

A net loss, as defined by section 206 of the Revenue Act of 1926, sustained in 1925 and 1926 by a corporation without an affiliated status in those years, which without the application of any part of the net loss of either year had no net income in 1927 when it was affiliated with another corporation within the meaning of section 240 of that Act, may not be deducted in determining the consolidated net income of the corporations for the latter year.

SUPREME COURT OF THE UNITED STATES. No. 582.—OCTOBER TERM, 1931.

Woolford Realty Co., Inc., petitioner, v. *J. T. Rose, Collector of Internal Revenue.*

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

[May 16, 1932.]

OPINION.

Mr. Justice CARDOZO delivered the opinion of the court.

Petitioner and Piedmont Savings Co. are separate corporations organized in Georgia. They became affiliated in 1927 when the petitioner became the owner

of 96 per cent of the Piedmont stock. In March, 1928, the two corporations filed a consolidated income tax return for 1927 under section 240 of the Revenue Act of 1926. (Revenue Act of 1926, ch. 27, 44 Stat., 9, 46.) During 1927, the petitioner had a net taxable income of $36,587.62, and Piedmont had suffered during the same year a net loss of $453.80. Before its affiliation with the petitioner, it had suffered other and greater losses. Its net loss in 1925 was $43,478.25 and in 1926 $410.82, a total for the two years of $43,889.07. In the assessment of the tax for 1927, the Commissioner deducted from the petitioner's net income for that year the loss of $453.80 suffered by its affiliated corporation in the course of the same year. The consolidated net taxable income as thus adjusted was $36,133.82, on which a tax of $5,026.22 was assessed and paid. On the other hand, the Commissioner refused to deduct the Piedmont losses suffered in 1925 and 1926 before the year of affiliation. The deductions, if allowed, would have wiped out the tax. A refund having been refused, the petitioner brought this suit against the collector to recover the moneys paid. The district court sustained a demurrer to the petition (44 F. (2d), 856), and the court of appeals affirmed. (53 F. (2d), 821.) The case is here on certiorari.

Section 240(a) of the Revenue Act of 1926 provides that "corporations which are affiliated within the meaning of this section may, for any taxable year, make separate returns or, under regulations prescribed by the Commissioner with the approval of the Secretary, make a consolidated return of net income for the purpose of this title, in which case the taxes thereunder shall be computed and determined upon the basis of such return."

Section 240(b) provides that "in any case in which a tax is assessed upon the basis of a consolidated return, the total tax shall be computed in the first instance as a unit and shall then be assessed upon the respective affiliated corporations in such proportions as may be agreed upon among them, or, in the absence of any such agreement, then on the basis of the net income properly assignable to each. * * *"

The general principle underlying the income tax statutes ever since the adoption of the sixteenth amendment has been the computation of gains and losses on the basis of an annual accounting for the transactions of the year. (*Burnet v. Sanford & Brooks Co.*, 282 U. S., 359, 363 [Ct. D. 277, C. B. X-1, 363].) A taxpayer who seeks an allowance for losses suffered in an earlier year, must be able to point to a specific provision of the statute permitting the deduction, and must bring himself within its terms. Unless he can do this, the operations of the current year must be the measure of his burden.

The only section of the Revenue Act that made allowance in 1927 for the losses of earlier years was section 206(b), upon which this controversy hinges. Its provisions are as follows:

"If, for any taxable year, it appears upon the production of evidence satisfactory to the Commissioner that any taxpayer has sustained a net loss, the amount thereof shall be allowed as a deduction in computing the net income of the taxpayer for the succeeding taxable year (hereinafter in this section called 'second year'), and if such net loss is in excess of such net income (computed without such deduction), the amount of such excess shall be allowed as a deduction in computing the net income for the next succeeding taxable year (hereinafter in this section called 'third year'); the deduction in all cases to be made under regulations prescribed by the Commissioner with the approval of the Secretary."

Under that section of the statute, the losses suffered by the Piedmont company in 1925 might have been deducted from its net income in 1926, and might thereafter, if not extinguished, have been deducted to the extent of the excess from its net income in 1927, the year in which its shares were acquired by the petitioner. But the Piedmont company did not have any net income in 1927. Its operations for that year resulted in a loss. There was therefore nothing from which earlier losses could be deducted, for the net income without any such deductions was still a minus quantity. The tax for the year was nothing, and the losses of other years could not serve to make it less. The petitioner would have us hold that the minus quantities for all the years should be added together, and the total turned over by the company suffering the loss as an allowance to be made to the company realizing the gain. In that view of the statute, a net loss for a taxable year becomes for the purpose of determining the burdens of affiliated corporations, though not for any other, the equivalent of a net income, and deductions which the statute has said shall be made only

from net income, may, nonetheless, by some process of legerdemain, be subtracted from the loss.

There are two fundamental objections to this method of computation. In the first place, an interpretation of net income by which it is also a net loss involves the reading of the words of the statute in a strained and unnatural sense. The metamorphosis is too great to be viewed without a shock. Certainly the average man suffering a net loss from the operations of his business would learn with surprise that within the meaning of the Congress the amount of his net loss was also the amount of his net income. "The popular or received import of words furnishes the general rule for the interpretation of public laws." (*Maillard* v. *Lawrence*, 16 How., 251, 261; *Old Colony R. R.* v. *Commissioner*, 284 U. S., 552, 560 [Ct. D. 456 page 274].) In the second place, the statute has given notice to the taxpayer that the aggregate of minus quantities is not to be turned over as a credit to an affiliated company, but is to be used in another way. If the loss for the first year is more than the income for the second, the excess is to be carried over to a third year, and deducted from the net income, if any, returnable for that year, at which time the process of carrying over is to end. Cf. report of Senate committee in charge of the Revenue Act of 1924, Senate Report No. 398, Sixty-eighth Congress, first session, page 20. Obviously, the direction to apply the excess against the income of a later year is inconsistent with a purpose to allow it to an affiliated company as an immediate deduction from income of the current year. Adherence to the one practice excludes adherence to the other. Cf. Treasury Regulations 69, promulgated under the Act of 1926, articles 634, 635, 1622. The fact is not to be ignored that each of two or more corporations joining (under section 240) in a consolidated return is nonetheless a taxpayer. (*Commissioner* v. *Ginsburg Co.*, 54 F. (2d), 238, 239 [Ct. D. 479, page 151].) By the express terms of the statute (section 240(b)) the tax when computed is to be assessed, in the absence of agreement to the contrary, upon the respective affiliated corporations "on the basis of the net income properly assignable to each." "The term 'taxpayer' means any person subject to a tax imposed by this Act." (Revenue Act of 1922 [1924], section 2(a)9.) A corporation does not cease to be such a person by affiliating with another.

The petitioner insists that a construction of 206(b), excluding the allowance of past losses except as a set-off against the income of the company sustaining them is inconsistent with the accepted construction of section 234 of the same Act whereby the deductions there enumerated are made from the net income exhibited by the consolidated return without reference to their origin in the business of one company or another. Section 234 provides that in computing the net income of corporations subject to a tax there shall be allowed as deductions "(1) All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business * * *; (2) All interest paid or accrued within the taxable year on its indebtedness * * *; (3) Taxes paid or accrued within the taxable year * * *; (4) Losses sustained during the taxable year and not compensated for by insurance or otherwise * * *; (5) Debts ascertained to be worthless and charged off within the taxable year." The points of difference between the allowances under section 206(b) upon the one hand and those under section 234 upon the other are important and obvious. The deductions allowable under section 234 represent expenses paid or accrued or losses suffered during the same taxable year covered by the return. They are thus included in the net income according to the fundamental concept of such income reflected in the statute, instead of falling within an exception which, irrespective of its precise extension, is a departure from the general scheme. Even more decisive is the consideration that there is nothing in section 234 prohibiting the allowance by one unit of its current losses and expenses as a deduction for the benefit of the affiliated group, nor any statement that the use to be made of them shall follow other lines. On the other hand, section 206(b) provides, as we have seen, that the excess of loss remaining over the current net income of the taxpayer who has suffered it shall be carried over into the next year and if need be into a third, and thereafter disregarded. Subtle arguments have been addressed to us in support of the contention that the loss of one affiliated company suffered in earlier years may be allocated to the other without infraction of the rule that the loss shall be carried forward. They are not lacking in plausibility, but we can not hold that they comport with the direc-

tions of the statute "if we take words in their plain popular meaning as they should be taken here." (*United States* v. *Kirby Lumber Co.*, 284 U. S., 1, 3 [Ct. D. 420, C. B. X–2, 356].)

Doubt, if there can be any, is not likely to survive a consideration of the mischiefs certain to be engendered by any other ruling. A different ruling would mean that a prosperous corporation could buy the shares of one that had suffered heavy losses and wipe out thereby its own liability for taxes. The mind rebels against the notion that Congress in permitting a consolidated return was willing to foster an opportunity for juggling so facile and so obvious. Submission to such mischiefs would be necessary if the statute were so plain in permitting the deduction as to leave no room for choice between that construction and another. Expediency may tip the scales when arguments are nicely balanced. True, of course, it is that in a system of taxation so intricate and vast as ours there are many other loopholes unsuspected by the framers of the statute, many other devices whereby burdens can be lowered. This is no reason, however, for augmenting them needlessly by the addition of another. The petitioner was prosperous in 1927, and so far as the record shows for many years before. Piedmont was unfortunate in 1927, and unfortunate in the years preceding. The petitioner, affiliating in 1927, has been allowed the loss suffered by Piedmont through the business of that year as a permissible deduction from the consolidated balance. What it claims is a right to deduct the losses that were suffered in earlier years when the companies were separate. To such an attempt the reaction of an impartial mind is little short of instinctive that the deduction is unreasonable and can not have been intended by the framers of the statute. Analysis of the sections shows that there is no gap between what they wrote and what in reason they must have meant.

The petitioner refers us to the Revenue Act of 1928 (45 Stat., 791, 835) and to Treasury regulations adopted thereunder as supporting its position. These provisions were adopted after the liability for the tax of 1927 had accrued, and they can have little bearing upon the meaning to be given to statutes then in force. The Revenue Act of 1928 (section 141(b)) protects against unfair evasions in the making of consolidated returns by increasing the discretionary power of the Commissioner in prescribing regulations. "The Commissioner, with the approval of the Secretary, shall prescribe such regulations as he may deem necessary in order that the tax liability of an affiliated group of corporations making a consolidated return and of each corporation in the group, both during and after the period of affiliation, may be determined, computed, assessed, collected, and adjusted in such manner as clearly to reflect the income and to prevent avoidance of tax liability." Under the authority so conferred the Commissioner has adopted the following regulation (Treasury Regulations 75, article 41), applicable only to the taxable year 1929, and to taxable years thereafter:

"A net loss sustained by a corporation prior to the date upon which its income is included in the consolidated return of an affiliated group (including any net loss sustained prior to the taxable year 1929) shall be allowed as a deduction in computing the consolidated net income of such group in the same manner, to the same extent, and upon the same conditions as if the consolidated income were the income of such corporation; but in no case in which the affiliated status is created after January 1, 1929, will any such net loss be allowed as a deduction in excess of the cost or the aggregate basis of the stock of such corporation owned by the members of the group."

The provision in this regulation limiting the deductions to the cost or value of the stock will make it profitless hereafter to purchase stock for the purpose of gaining the benefit of deductions in excess of what is paid.

In holding that the Piedmont losses of 1925 and 1926 were properly excluded from the consolidated return, we are in accord with the preponderance of authority in the other Federal courts. (*Swift & Co.* v. *United States*, 38 F. (2d), 365; *Sweets & Co.* v. *Commissioner*, 40 F. (2d), 436; *Commissioner* v. *Ginsburg*, 54 F. (2d), 238.) Only one decision has been cited to us as favoring a different view. (*National Slag Co.* v. *Commissioner*, 47 F. (2d), 846.)

The judgment is affirmed.

PART II.—INDIVIDUALS.

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

ARTICLE 31: What included in gross income. XI-7-5387
G. C. M. 10198

REVENUE ACT OF 1926.

Oil and gas royalties received from leases on the separate land of the wife in the State of Texas, not being "rents and revenues" from the wife's separate property, as those terms are used in the laws of Texas relating to separate and community property, constitute the separate income of the wife.

An opinion is requested whether oil and gas royalties received in 1927 by a married woman constitute her separate property under the laws of Texas, a community property State.

With respect to the wife's separate property, section 15 of Article XVI of the constitution of the State of Texas provides as follows:

All property, both real and personal, of the wife, owned or claimed by her before marriage, and that acquired afterward by gift, devise or descent, shall be her separate property; and laws shall be passed more clearly defining the rights of the wife, in relation as well to her separate property as that held in common with her husband. Laws shall also be passed providing for the registration of the wife's separate property.

Articles 4621 and 4622, Vernon's Sayles' Texas Civil Statutes, 1914, relating to property rights of husband and wife in Texas, did not specifically state whether rents and revenues from the wife's property constituted separate property or community property. Chapter 194, Laws of Texas, 1917, and chapter 130, Laws of Texas, 1921, provide in part as follows:

* * * All property of the wife, both real and personal, owned or claimed by her before marriage, and that acquired afterwards by gift, devise or descent, as also the increase of all lands thus acquired, and the rents and revenues derived therefrom, shall be the separate property of the wife. * * *

In *Arnold* v. *Leonard* (114 Tex., 535, 273 S. W., 799) it was held, that the rents and revenues derived from the wife's separate lands not being a part of the wife's separate property under the constitution, and the legislature being without authority to enlarge or diminish such property, the portions of the acts of 1917 and 1921 enacted by the Texas Legislature, whereby it was attempted to make the rents and revenues of the wife's separate lands a part of her separate estate, were invalid. Prior to the enactment of the 1917 and 1921 acts of Texas, referred to above, it seems to be settled that the rents from the wife's separate lands constituted community property. (*Emerson-Brantingham Implement Co.* v. *Brothers*, 194 S. W., 608; *Texas Lumber & Loan Co.* v. *First National Bank of Rosebud*, 209 S. W., 811; *Armstrong* v. *Turbeville*, 216 S. W., 1101.)

The general theory of community property in Texas is that it is acquired during coverture through the efforts of one or the other spouse, or through the joint efforts of both, and that to some appreciable extent the skill, labor, or supervision of one or both the spouses

was expended in the production or acquisition of the property. It is also a general rule in Texas that property constituting the separate estate of the husband or wife may undergo mutations and changes without losing its character as the separate property of the particular spouse, so long as it can be clearly traced and identified. (*Arnold* v. *Leonard*, supra; *Rose* v. *Houston*, 11 Tex., 324, 62 Am. Dec., 478; *Schmidt* v. *Huppman*, 73 Tex., 112, 11 S. W., 175.)

But ordinary oil royalties from the wife's separate estate are not, under the laws of Texas, "rents and revenues" derived from land, but represent a mutation or change in the form of the separate property. In other words, there is a change in the form of the property from real estate to personalty. In *Stephens* v. *Stephens* (Tex. Civ. App., 292 S. W., 290) this theory was made clear in the following language:

> The land is separate property. The oil in place is realty capable of distinct ownership, severance, and sale. It is a part of the corpus of appellee's sole estate. He conveyed his oil and received, as the principal consideration therefor, one-eighth of the production. No skill, labor, or supervision of either of the spouses, and no community property was expended in the sale or production. The oil and the proceeds thereof received by appellee were neither rent nor profits, within the meaning of the law making such common property, but the consideration for separate realty. Extracting the oil from beneath the surface depletes and exhausts forever the corpus of his separate property; removing it to the top of the ground changes it from real to personal property; but such change or mutation, and the money received, are definitely traced, and, in our opinion, the fund in controversy belonged to appellee in his sole and separate right.

(In this connection see also G. C. M. 6351, C. B. VIII–2, 188; G. C. M. 8031, C. B. IX–1, 204; and G. C. M. 8209, C. B. IX–2, 326.)

It is well established that royalties derived from oil leases constitute ordinary income subject both to normal tax and surtax. (*Rosenberger* v. *McCaughn*, C. C. A., 25 Fed. (2d), 699, certiorari denied 278 U. S., 604; *John Hirschi* v. *United States*, 67 Ct. Cls., 637, certiorari denied 280 U. S., 576; *Appeal of Nelson Land & Oil Co.*, 3 B. T. A., 315; *Henry L. Berg et al.* v. *Commissioner*, 6 B. T. A., 1287; *R. H. Hazlett* v. *Commissioner*, 10 B. T. A., 332; *James R. Parkey et al.* v. *Commissioner*, 16 B. T. A., 441; *Ferguson* v. *Commissioner*, 45 Fed. (2d), 573; G. C. M. 4299, C. B. VII–2, 116.)

The Board of Tax Appeals has consistently followed the rule laid down in *Stephens* v. *Stephens*, supra, that oil extracted from separate property and the proceeds from the sale of such oil were the separate income of the spouse who owned the realty. (See *W. P. Ferguson*, 20 B. T. A., 130, affirmed on this point, 45 Fed. (2d), 573; *Oscar Chesson*, 22 B. T. A., 818, C. B. X–2, 13; *E. Michna*, 24 B. T. A., 715.)

In view of the foregoing, it is the opinion of this office that oil and gas royalties received from leases on the separate land of the wife in the State of Texas, not being "rents and revenues" from the wife's separate property, as those terms are used in the laws of Texas relating to separate and community property, constitute the separate income of the wife.

C. M. Charest,
General Counsel, Bureau of Internal Revenue.

ARTICLE 31: What included in gross income. XI–9–5400
Ct. D. 452

INCOME TAX—REVENUE ACT OF 1926—DECISION OF COURT.

INCOME—ASSIGNMENT.

Where a person agrees in a trust indenture to pay and transfer to the trustees named therein income paid to or received by her from a testamentary trust which is derived from certain stock, the instrument providing that as fast as any income from such stock is payable to her by the trustees under the will the latter may retain the same and pay it forthwith to the trustees mentioned in the indenture, there is no assignment or transfer of the property right which produces the income, the trustor merely transferring or agreeing to transfer by assignment or otherwise income as it is received, and such income is taxable to the trustor.

COURT OF CLAIMS OF THE UNITED STATES. No. L–69.

Edith R. Porter v. *The United States.*

[November 2, 1931.]

OPINION.

GREEN, Judge, delivered the opinion of the court.

The plaintiff, under her husband's will, was entitled to receive during her lifetime the income from certain stock, which, by the will, had been devised to trustees for that purpose. For reasons not material to the decision of the case, she made an agreement which applied to one-half of the income derived by the trustees from this stock which was payable to her under the will. In other trust indentures executed by her trustees were named to receive and dispose of the income to which the agreement applied. The question to be determined is whether by virtue of this agreement she parted entirely with the title to this income to which the agreement applied, or whether, on the other hand, she merely agreed to pay over this income to trustees when she acquired title thereto.

We think the latter construction is the one which should be adopted.

The fundamental agreement of plaintiff, as expressed in the instrument under consideration, was "to pay and transfer to the trustees therein named * * * one-half of any and all sums of money or other income, in whatever form paid to or received by me from the estate of William M. Wood, jr., which is in any way derived from said Edington & Co., Inc." Obviously, this provision standing by itself is merely to pay to the trustees the income whenever it was paid to or received by the plaintiff. It is contended, however, that a different construction should be placed thereon by reason of a further provision, as follows:

"The intent and meaning of this agreement is that as fast as any income is payable to me by the trustees under the will of William M. Wood, jr., which is derived from the investment of said Wood, jr., in Edington & Co., Inc., said trustees may retain one-half thereof and pay the same forthwith in equal shares to the trustees mentioned in said annexed indentures of trust, * * *."

We do not think this alters the situation. It gave the trustees under the will no right to make any disposition of the income until it became in the first instance payable to the plaintiff, or, as expressed in the agreement, "as fast as any income is payable to me by the trustees." In neither of these provisions, as we view them, is there any expression or statement which could be construed to be an assignment or a transfer by the plaintiff of the property right which produced the income.

Where the original owner merely transfers or agrees to transfer by assignment or otherwise, income as it is received, the authorities are uniform in holding that the person to whom the income was payable in the first instance is liable for taxes thereon. (See *Rosenwald* v. *Commissioner of Internal Revenue*, 33 Fed. (2d), 423, and *Bing* v. *Bowers*, 22 Fed. (2d), 450, affirmed 26 Fed. (2d), 1017 [T. D. 4124, C. B. VII–1, 210].)

What we have said above makes it unnecessary to pass upon the other objections that are made in the argument of counsel for defendant against the claim set up by plaintiff.

It follows that the petition of plaintiff must be dismissed and it is so ordered.

ARTICLE 31: What included in gross income. XI–9–5401
I. T. 2616

REVENUE ACTS OF 1921, 1924, AND 1926.

I. T. 2352 (C. B. VI–1, 32), holding in part that where, under the laws of California, there was an oral agreement between a husband and wife that their earnings should constitute their separate property and they have given effect to their intention by depositing their earnings in separate bank accounts, each retaining the control over his or her own earnings, the wife's earnings constitute her separate income and may be reported by her in her separate income tax returns, is modified in so far as same is inconsistent with General Counsel's Memorandum 9953 (page 13).

ARTICLE 32: Compensation for personal services.

REVENUE ACT OF 1926.

Commission allowed insurance agent on policy taken out on own life. (See G. C. M. 10486, page 14.)

ARTICLE 39: Sale of stock and rights. XI–10–5406
Ct. D. 454

INCOME TAX—REVENUE ACT OF 1926—DECISION OF COURT.

1. GAIN OR LOSS—SALES OF SHARES OF STOCK—LOTS PURCHASED ON MARGIN AT DIFFERENT TIMES—IDENTITY OF LOTS.

When shares of stock in a corporation are sold from lots purchased at different dates and at different prices and the identity of the lots can not be determined, stock sold should be charged against the earliest purchases of such stock in computing gain or loss on the sales under the Revenue Act of 1926. Where a taxpayer dealing on a margin and pyramiding his purchases under the requirement that he at all times maintain a margin of a specified per cent, unrealized profits being accepted by the brokers in reckoning the margin, the testimony of the broker that he thought that he was selling the shares of the last purchases, though in no way earmarked or allocated, because it was those shares that on a falling market had embarrassed the account, is not evidential identification of the shares last sold as the shares last purchased.

2. DECISION AFFIRMED.

The decision of the Board of Tax Appeals (20 B. T. A., 778) affirmed.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT. No. 4690.—OCTOBER TERM, 1931.

John A. Snyder, petitioner, v. *Commissioner of Internal Revenue, respondent.*

On petition to review an order of the United States Board of Tax Appeals.

Before BUFFINGTON, WOOLLEY, and DAVIS, Circuit Judges.

[December 11, 1931.]

OPINION.

WOOLLEY, Circuit Judge: The petitioner had been dealing in the stock of the United Gas Improvement Co. Operating through two brokerage houses he acquired during the year 1924 3,400 shares through 34 transactions of purchase and sold none. During the year 1925 he acquired 1,400 shares through 16

transactions of purchase and sold 2,100 shares through 11 transactions of sale. Thus the purchases were, approximately, in 100-share lots and the sales in 200-share lots.

He was dealing on margin and pyramiding his purchases under the requirement that he at all times maintain a 33⅓ per cent margin, unrealized profits being accepted by the brokers in reckoning the margin.

When, in the fluctuations of the market, the margin fell below this percentage, the brokers sold enough shares to bring it back. No such sales were required in 1924; many were required in 1925, thus showing gains or losses according as sales were set off against the early or late purchases. The petitioner in his 1925 tax return set off the 1925 sales against all of the 1925 purchases and the latest 1924 purchases, disclosing a loss of $10,284.38. The Commissioner of Internal Revenue set off the 1925 sales against the early 1924 purchases, disclosing a profit of $20,878, which so increased the petitioner's general income that the Commissioner determined a deficiency tax of $1,042.39. An order of the Board of Tax Appeals redetermining the deficiency in the same amount is here on the taxpayer's petition for review, assigning error to the Board for refusing to find from uncontradicted testimony that the shares last purchased were identified as the shares sold.

The case turns on article 39 of Regulations 69, promulgated by the Treasury Department under the Revenue Act of 1926, which provides that:

"When shares of stock in a corporation are sold from lots purchased at different dates and at different prices and *the identity of the lots can not be determined*, the stock sold shall be charged against the earliest purchases of such stock * * *," and gain or loss computed accordingly.

Evidently this rule was framed with especial reference to gains and losses in marginal transactions where, as in this case, shares purchased by a customer, while legally "owned" by him, are evidenced by a certificate not in his name but in the name of the broker until the transaction is closed out by sale or payment of the full purchase price. The evidence of the transaction and of the customer's ownership is merely a book entry of a debit of the shares purchased against a credit of the margin paid. The shares are commingled with perhaps many thousand held by the broker for other customers, subject always to be hypothecated by him in raising the difference in money between the customer's margin and the purchase price of the shares, which of course the broker must pay in order to get a certificate. The shares are not delivered or earmarked or allocated to the customer even on the books.

Where shares "are sold from lots purchased at different dates and at different prices" in a marginal account it is clear that, in the absence of something else, the identity of the lots sold can not be determined, hence the cited regulation, which is tersely called the "First in, first out" rule. The rule is an arbitrary one, as from the very nature of the case it must be; yet, again from the nature of the case, it is reasonable. Even so, the petitioner says it is not applicable to his situation, in which he reversed the "First in, first out" rule of the Treasury Department by applying one of his own, namely, "Last in, first out," on the contention that the shares he sold from time to time were identified by a witness as the "last in," that is, the last purchased, and that, as his testimony was not contradicted, the Board should have reversed the Commissioner.

True, the testimony was not contradicted, yet we can not find that it discloses the requisite identification. What happened in each account was that the broker, watching the petitioner's margin balance in relation to the minute to minute fluctuations of the market, gauged the account by keeping his eye on the most recent purchases and when a comparison of their figures with the tape showed the margin growing thin, he would sell enough shares to revive it. The broker thought, as he testified, he was selling the shares of the last purchases, though in no way earmarked or allocated. In other words, he conceived "from the technique of Mr. Snyder's operations"—overloading the account—he was in each instance selling the shares latest purchased because it was those shares that, on a falling market, had embarrassed the account. Stated differently: but for the last purchases the account would not be embarrassed, therefore the broker sold what he thought were the offending shares, although a sale of shares purchased earlier would have restored the account just the same. This was a purely mental operation of the broker, or, as he himself testified, "a mental condition entirely," which falls short of evidential "identification." As this was all the evidence of identification in the case, it left the regulation, "First in, first out," in force and justified the determination of a deficiency tax.

The order of the Board of Tax Appeals is affirmed.

ARTICLE 44: Sale of real property involving deferred payments. XI-8-5395 Ct. D. 450

INCOME TAX—REVENUE ACT OF 1926—DECISION OF COURT.

1. GAIN OR LOSS—SALE OF REAL ESTATE IN PENNSYLVANIA—RESERVATION OF GROUND RENT.

Where a taxpayer in 1925 sold real estate in Pennsylvania for a consideration in part cash and for the balance the grantor reserved a ground rent payable on or before a specified date which was always of the fair market value of the unpaid amount and was extinguished in 1927, there was a closed transaction in 1925, in which year the profit thereon was taxable.

2. DECISION AFFIRMED.

The decision of the Board of Tax Appeals (19 B. T. A., 699) affirmed.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT. No. 4534.—MARCH TERM, 1931.

Pennsylvania Co. for Insurances on Lives and Granting Annuities, petitioner, v. *Commissioner of Internal Revenue, respondent.*

Petition to review an order of the United States Board of Tax Appeals.

Before BUFFINGTON, WOOLLEY, and DAVIS, Circuit Judges.

[September 15, 1931.]

OPINION.

BUFFINGTON, J.: In this case the question involved is whether the profit made by the taxpayer on the sale of certain real estate was income for the fiscal year ending November 30, 1925.

The facts, which are not disputed, are that the taxpayer appellant, the Pennsylvania Co. for Insurances on Lives and Granting Annuities, hereafter called the company, owned, sold and conveyed by deed of December 22, 1924, to the First Penny Savings Bank of Philadelphia John Wanamaker Founder, hereafter called the bank, a lot of ground in Philadelphia. The consideration was $500,000 cash and a ground rent on the premises of $800,000 payable in 10 years, in addition to an annual ground rent of $40,000. This ground rent the bank had an option to pay at any time during said 10 years. This option the bank exercised, paying $200,000 during the fiscal year ending November 30, 1925; $200,000 during the fiscal year of 1926; and $400,000 during the fiscal year of 1927. On the transaction the company made a net profit of $376,108.58.

On these facts the Commissioner held there was a deficiency on the part of the company of $51,028.23 for the fiscal year ending November 30, 1925, on account of the company's failure to include its net profit of $376,108.58 in its gross income for that taxable year. On appeal therefrom the Tax Board upheld the Commissioner. Thereupon the company took this appeal.

In the presentation of the present appeal much stress is laid on the nature of a ground rent, which is a distinctively Pennsylvania instrument. This has received due consideration. There is no doubt the holder of such ground rent has certain real estate rights inherent therein and incident thereto until the ground rent is extinguished. But all this is, in our opinion, wholly apart from the income tax question here involved. In that regard we find ourselves in accord with the Tax Board, which said:

"We have no disposition to deny these authorities, but do not regard them as changing the method of Federal income taxation on realty sales made in Pennsylvania from what they ordinarily are in other States." (*Weiss* v. *Weiner*, 279 U. S., 333 [Ct. D. 60, C. B. VIII-1, 257].)

So far as profits were concerned, they were determined and the transaction closed in that regard when the deed was made. The property was in the heart of the business center of a metropolitan city. Half a million was paid in cash and the fair market value of the property was amply sufficient to secure the

ground rent. In fact $200,000 of it was paid that fiscal year. It is clear the ground rent, as a 5 per cent investment with 10 years to run, was a gilt-edged security of the highest type. Indeed, its advantage to the company and its burden to the bank were such that the bank preferred to use $800,000 of its cash and pay it off in toto within two years. Meanwhile its worth as a security was such that the company, on July 30, 1925, transferred it to the trustees of its reserve fund account and when the ground rent was paid, these three trustees were the holders thereof who extinguished it. As we have said, to all practical purposes the company made its profit when the deed passed and that profit had accrued to it and constituted and formed part of its assets. Accordingly, we affirm the action of the Tax Board.

ARTICLE 52: Examples of constructive receipt. XI-18-5469
Ct. D. 477

INCOME TAX—REVENUE ACTS OF 1921, 1924, AND 1926—DECISION OF COURT.

1. INCOME—RENEWAL COMMISSIONS ON INSURANCE—ASSIGNMENT.

Amounts received by B under an instrument executed by a taxpayer assigning to her one-third of certain renewal commissions on insurance due and to become due by virtue of a contract with an insurance company, which provides that the renewal commissions shall not in any event be payable to her unless and until they become due and payable to the assignor, are income to the assignor, under section 213 of the Revenue Acts of 1921, 1924, and 1926.

2. DECISION AFFIRMED.

The decision of the Board of Tax Appeals (19 B. T. A., 1108) is affirmed.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

L. Brackett Bishop, petitioner, v. *Commissioner of Internal Revenue, respondent.*

Petition for review of decision of United States Board of Tax Appeals.

Before ALSCHULER, EVANS, and SPARKS, Circuit Judges.

[December 9, 1931.]

OPINION.

This appeal is taken from the decision of the United States Board of Tax Appeals and involves taxes for the years 1923, 1924, and 1925, which decision required petitioner to pay additional income taxes for those years.

On February 26, 1915, petitioner executed and delivered to his wife the following instrument:

"Know all men by these presents, That I, L. Brackett Bishop, of Chicago, Cook County, Ill., in consideration of the sum of one dollar and in further consideration of the love and affection which I have for my wife hereinafter named, do hereby sell, assign, transfer, and set over unto my wife, Minnie R. Bishop, of said city, county and State, all my right, title and interest in and to one-third of any and all renewal commissions due or hereafter to become due to which I may be entitled by virtue of my general agency contract with the Massachusetts Mutual Life Insurance Co., of Springfield, Mass., dated September 6, 1906, and all amendments thereto, upon business secured thereunder on or before December 31, 1914.

"It is expressly understood and agreed, however, that this assignment is subject to all of the terms and conditions of said contract and amendments thereto, and that said renewal commissions shall not in any event be payable to said assignee unless and until they become due and payable to me under the terms and provisions of the aforesaid contract; and the said insurance company shall not be bound to pay the said assignee said renewal commissions in any other way or manner or at any other time as set forth in said contract and amendments thereto."

Thereafter similar assignments were executed by petitioner to his wife upon business secured by him in later years. Pursuant to such assignments the insurance company paid direct to petitioner's wife, in each of the taxable years in controversy, the sum of $7,500, which she included in her income tax returns for the respective years referred to.

In determining the deficiencies involved in this proceeding respondent added to petitioner's income for each of the years 1923, 1924, and 1925 the sum of $7,500, being the sums paid by the company to the wife during those years, which determination, upon review, was sustained by the Board.

SPARKS, Circuit Judge: The facts in this case are uncontroverted, and the sole question presented is whether the deficiencies added to petitioner's income were authorized by law.

The statutes involved are Revenue Act of 1921 (ch. 136, 42 Stat., 227):

"SEC. 210. That * * * there shall be levied, collected, and paid for each taxable year upon the net income of every individual a normal tax * * *.

"SEC. 211. (a) That * * * there shall be levied, collected, and paid for each taxable year upon the net income of every individual—

"(1) * * * a surtax * * *.

"SEC. 212. (a) That in the case of an individual the term 'net income' means the gross income as defined in section 213, less the deductions allowed by section 214. * * *

"SEC. 213. That for the purposes of this title * * * the term 'gross income'—

"(a) Includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * * of whatever kind and in whatever form paid, or from professions, * * *."

Sections 210, 211(a), 212(a), and 213 of the Revenue Act of 1924 (ch. 234, 43 Stat., 253) do not differ materially from the provisions of the Act of 1921 above referred to.

It is petitioner's contention (1) that his contractual right to receive renewal commissions constituted an existing property right; (2) that the instrument which he executed was an assignment, *in praesenti*, of that existing property right to his wife; and (3) that the renewal commissions received by the assignee after the assignment constituted income to her from property then owned by her, and hence they were taxable to her.

With petitioner's first contention we are in accord, but to the others we can not assent. In support of the last two contentions he has cited many cases, typical of which are *Leydig* v. *Commissioner* (15 B. T. A., 124); *O'Malley-Keyes* v. *Eaton* (24 F. (2d), 436); *Commissioner* v. *Field* (42 F. (2d), 820); *In re Wright* (157 Fed., 544). With these decisions we are not at variance, but we think they do not support petitioner's contentions.

In the first case cited Leydig had leased a part of his farm for mining and operating for oil and gas, for which he was to receive, as royalties, free gas and one-eighth of the oil produced. He was contemplating executing a similar lease on another part of his farm, but had not done so. He assigned to his wife an undivided one-half interest in and to any and all oil and gas royalty interests which may have been heretofore, or should be in the future, received or retained by him. The Board held that the lease was ineffective as to the royalty interests subsequently to be acquired by Leydig. As to the existing lease, the Board held that Leydig, having assigned to his wife one-half of the property in the right to receive royalties, the royalties which she later received were her income on the property which had been assigned to her and, of course, should not be charged as income to Leydig. The Board in its decision uses the following language, which we regard as quite apt:

"The cases collected above are singularly free from conflict as to the principle governing the issue raised. From them we conceive the rule to be that income *per se* can not be assigned to relieve the assignor of the tax levy, but, where the thing assigned was a property right, real or personal, productive of income, income thereafter arising from such property is income to the assignee by virtue of his ownership."

It will be observed that Leydig did not in words assign to his wife one-half of the royalties, but he assigned to her a one-half interest in all oil and gas *interests* which he then held. It was an interest in the thing that produced the royalties which was assigned. This was the property right which afterwards produced the royalties or income which the Board held was her income and not that of her husband.

In *O'Malley-Keyes* v. *Eaton*, supra, appellant irrevocably sold, assigned, and transferred all right, title, and interest in and to all moneys, funds, income, property, and choses in action which she then had, or to which thereafter she might be entitled, in a certain trust fund. She thereby disposed of all of her interest in the trust estate, which included not only the future income, but the interest in the trust fund which subsequently produced the income.

In re Wright, supra, held that the right to renewal commissions of bankrupt inured to the trustee in bankruptcy because it was a right which bankrupt could have transferred, and that this fact brought it squarely within the statute which designates what property of the bankrupt shall pass to his trustee. In this case, however, no question of income tax was involved. In cases of bankruptcy each and every asset, either contingent or vested, which is subject to transfer by bankrupt passes to the trustee, and this is true whether the value be definite or problematical. (11 U. S. C. A., par. 110, subd. (5).) The trustee's title to the *right* to renewal commissions, if and when paid, was a present property right, and this is the property right which the statute transfers to the trustee at the time of the adjudication. The statute conveyed no title to the commissions at the time of the bankruptcy adjudication. They were not then in existence and might never be. Trustee's title to them was not perfected until the premiums were paid, and when they were paid he acquired the commissions by virtue of the property right which the statute gave him at the date of the adjudication.

The decision in *Commissioner* v. *Field*, supra, turned upon whether, under a decision of the Supreme Court of Illinois relative to the matter under discussion, Marshall Field had a present interest in the income of Henry Field's share of a trust fund assignable under the law of Illinois. The court held that under the Illinois decree Henry's share, after his death, was not limited, but went to Marshall upon Henry's death merely as a trust fund until Marshall became 50 years of age, at which time Marshall got the principal, and that the trust was terminable at any time at Marshall's will. Accepting this decree as binding, the Circuit Court of Appeals held that Marshall was absolutely entitled to the income and that it was a present right, and that upon assignment to his wife the income should be charged to his wife and not to Marshall. In that case the income on the trust fund was not contingent—it was a present right and fixed in all respects except as to amount.

In the instant case there are two elements to consider: (1) The contract between petitioner and the insurance company, which gave the right, if any, to the renewal commissions. This was a property right. (2) The renewal commissions, which might or might not come into existence. The first element was never assigned to petitioner's wife. The second element was assigned to her, and we think it was not a property right *in praesenti*.

It is the law that insurance renewal commissions, for the purposes of taxation, shall not be charged as income to petitioner until the premiums have been paid. The reason for this is that it would be inequitable to charge him with income which he had not received and which he might never receive. It is true that he has earned them in the sense that he has labored for them; but as a matter of contractual right he has not earned them, in the sense of meriting or deserving them, until the premiums have been paid.

We are convinced that the subject matter of petitioner's assignment to his wife was income *per se*, and that it was not in any sense a present property right which was itself productive of income. Petitioner's third contention illustrates the distinction. He says the renewal commissions received by his wife were income to her from *property then owned by her*, and hence were taxable to her. But what property did she then own which produced these commissions? Certainly none, for petitioner had assigned her nothing but the commissions.

The distinction is very clearly recognized in *Hall* v. *Burnet, Commissioner*, No. 5173, decided by the Court of Appeals of the District of Columbia, November 16, 1931, but not yet published. In that case appellant, a life insurance agent, entered into a contract with his second wife, in which her rights in his property were defined for the protection of his children by a former marriage, in consideration of which she renounced her dower. Among other considerations moving from him he sold, assigned, and transferred to her an undivided interest in his *contract* with the insurance company. The court held that one-half of the subsequent renewal commissions should be taxed not to appellant but to the wife, as income accruing to her from the property right which appellant had assigned to her. The court said:

"* * * it is obvious that if what was here sought to be conveyed from the husband to the wife was salary, or personal earnings, the same would still be taxable to him though he never actually received it, but in the view we take of this case, what was assigned was neither income nor earnings, but property. It was not an assignment of future earnings but the transfer of a property right, and though this property right gave rise to future income, uncertain and contingent though it might be as to amount, that fact does not destroy the distinction."

In the instant case, however, we think it quite clear, even after the assignment, that the commissions became income to petitioner before they passed to his wife. This is manifest by the language of the assignment, which says "that said renewal commissions shall not in any event be payable to said assignee unless and until they become due and payable to me under the terms and provisions of the aforesaid contract." It is perfectly obvious from this language that petitioner had no intention of conveying a property right *in praesenti*, but only in future income as it might become due to him. This brings the case squarely within the rule that instruments intended to deflect income subsequently falling due serially are unavailing for tax purposes. (*Lucas* v. *Earl*, 281 U. S., 111.)

Another reason which must preclude petitioner's recovery is that the burden of establishing error in the Board's finding is upon him. It will be observed that the assignment is made subject to the conditions of the contract existing between the company and petitioner. That contract is not in the record, and hence we have no way of knowing what sort of title to the commissions was given to the wife. For aught we know that contract may prevent an absolute assignment. Anything less than this would be sufficient to defeat petitioner's claim. (*Mitchell* v. *Boicers*, 15 F. (2d), 287 [T. D. 3982, C. B. VI–1, 244].)

The order of the Board of Tax Appeals is affirmed.

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

ARTICLE 88: Compensation of State officers and employees. XI–7–5388 Ct. D. 448

INCOME TAX—REVENUE ACTS OF 1924 AND 1926—DECISION OF COURT.

1. INCOME—EXEMPTION—EMPLOYEE OF STATE—INDEPENDENT CONTRACTOR—GOVERNMENTAL FUNCTION.

Income received by a taxpayer as a member of a partnership employed under a contract with the prothonotary of a county with the approval of the court of common pleas and the county commissioners by which it agrees to install and under the supervision of the prothonotary and the index committee of the local bar association carry out the Russell system of indexing is not exempt from income tax under section 213(b)7 of the Revenue Acts of 1924 and 1926, the status of the partnership being that of an independent contractor and the taxpayer is not an employee of a political subdivision of a State. Nor is such tax imposed upon an agency of a State government and therefore prohibited.

2. EVIDENCE—ADMISSIBILITY.

In a suit by a taxpayer in which the issue is whether income is exempt from tax as received by him as an employee of a county or whether the tax thereon is imposed upon an agency of a State government and the taxpayer grounds his case on his relation to the county established by the contract which he made a part of the statement of claim, which is certain and unambiguous in its terms and which the parties stipulated was fully carried out, testimony is properly rejected which is offered by the taxpayer to show the nature of the services rendered and under whose control and supervision they were performed.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

R. C. Russell, appellant, v. *D. B. Heiner, Collector of Internal Revenue for the Twenty-third District of Pennsylvania, appellee.*

Appeal from the District Court of the United States for the Western District of Pennsylvania.

Before BUFFINGTON, WOOLLEY, AND DAVIS, Circuit Judges.

[December 14, 1931.]

OPINION.

WOOLLEY, Circuit Judge: With the approval of the Court of Common Pleas and the County Commissioners of Allegheny County in the State of Pennsylvania, the Russell Index Co., a copartnership of which the appellant taxpayer was a member, entered into a contract with the prothonotary of that county to install and, under the supervision of the prothonotary and the index committee of the local bar association, carry out the Russell system of indexing in return for $1,000 per month for a stated term. The Russell Index Co. had like contracts with 20 or more counties in 3 States.

The appellant first included the compensation so received in his tax returns for the tax years in question, later filed amended returns excluding it; made a claim for refund and on its rejection brought this suit to recover taxes unlawfully assessed and collected, he says, because of his position as an employee of the county government, or, failing that, because the compensation paid him was for services so intimately connected with the sovereign powers of the State or a political subdivision thereof that taxation of his compensation constitutes direct interference by the Federal Government with a State government. On both of these issues the district court ruled against him, finding that he and his copartners were independent contractors whose compensation for services rendered under the contract was taxable. With these conclusions we agree upon the reasoning of the learned trial judge in his opinion reported in 45 Fed. (2d), 872 [Ct. D. 273, C. B. X–1, 233].

The remaining assignments charge error to the court for rejecting testimony offered by the appellant to show the nature of the services rendered and under whose control and supervision they were performed as bearing on the issues of county employment and Federal interference.

The court ruled against the appellant's tender of this evidence on the ground that the contract spoke for itself. The error of law which the appellant now says the court committed was in applying to this case the rule forbidding parol evidence to vary the terms of a written contract when, in fact, the suit is not on a contract and, therefore, is not between the parties but is between one of the parties and a stranger, a tax collector. With the cited law as to the inapplicability of the parol evidence rule in cases not between parties which prevails in some jurisdictions (*Roberts* v. *Cauffield*, 283 Pa., 64; *Gills' Estate*, 268 Pa., 500; *Simon & Sons* v. *Emery*, 254 Pa., 569), we are not concerned for, as we read the record, the learned trial court did not apply the parol evidence rule—indeed, it was not mentioned in the colloquies—but regarded the contract as the best, and therefore sufficient, evidence of the relation of the appellant to the county. On that relation turns the question whether he was an employee or an independent contractor and the question of Federal interference with a State government.

The contract between the partnership and the prothonotary showed official authority for its execution, called for bond covering faithful performance, disclosed the character of work to be undertaken, stated under whose supervision it should be done and provided payment therefor by the county. The duties of the prothonotary are fixed by statute, of which the court took judicial notice. The contract and the statute told all that was intended to be done and definitely established the relation of the actors. Finally, the parties stipulated that the contract was "fully carried out by the respective parties."

Had the contract been uncertain or ambiguous in showing the relation of the parties, the character of their undertakings or the work done for the taxed compensation, the evidence tendered might have been admissible. But having grounded his case on his relation to the county established by the contract, which he made a part of his statement of claim, the plaintiff could not have been permitted to prove any other or different relation than that which by his contract he himself had disclosed. If, on the other hand, he sought by parol

evidence to prove the same relation as that proved by the contract, such evidence was redundant and therefore not admissible to fortify the uncontested evidence of the contract. We think the tender of evidence, however viewed, was properly denied.

The judgment is affirmed.

SECTION 214(a)9.—DEDUCTIONS ALLOWED INDIVIDUALS: DEPLETION.

ARTICLE 223: Charges to capital and to expense in the case of oil and gas wells.

REVENUE ACT OF 1926.

Restatement of article 223, Regulations 69. (See T. D. 4333, page 31.)

SECTION 215.—ITEMS NOT DEDUCTIBLE.

ARTICLE 291: Personal and family expenses.

REVENUE ACT OF 1926.

Payments from trust provided in consideration of release of all claims for alimony, dower, maintenance, and support. (See I. T. 2638, page 34.)

SECTION 216.—CREDITS ALLOWED INDIVIDUALS.

ARTICLE 302: Personal exemption of head of family.

REVENUE ACT OF 1926.

Child adopted without legal proceedings. (See I. T. 2611, page 36.)

ARTICLE 305: Date determining exemption.

REVENUE ACT OF 1926.

Computation of personal exemption where status changes during taxable year. (See G. C. M. 10129, page 38.)

SECTION 219.—ESTATES AND TRUSTS.

ARTICLE 342: Method of computation of net income and tax. XI-11-5411 G. C. M. 10273

REVENUE ACTS OF 1924 AND 1926.

Where a trustee holding the fee to mineral lands subject to a mining lease distributes to beneficiaries having an interest in the corpus the entire amount of net royalties received, each such beneficiary is entitled to a reasonable allowance for depletion.

General Counsel's Memorandum 7101 (C. B. VIII-2, 202) is revoked in so far as it is inconsistent with the decision of the Circuit Court of Appeals in the case of *Merle-Smith* v. *Commissioner* (42 Fed. (2d), 837, certiorari denied, 282 U. S., 897).

An opinion is requested relative to certain claims for refund for the years 1924 and 1925, which are based on the ground that the Bureau improperly refused to allow a deduction for depletion claimed by the taxpayer who was a beneficiary of a trust.

The action of the Bureau in refusing to allow the deduction claimed was based on General Counsel's Memorandum 7101, and it is now requested that the conclusion reached in that memorandum be reconsidered in view of the decision of the Circuit Court of Appeals, Second Circuit, in the case of *Merle-Smith* v. *Commissioner* (42 Fed. (2d), 837, certiorari denied by the Supreme Court, 282 U. S., 897).

The taxpayer, A, is the daughter of the late C, who (with his wife, N) conveyed by deed to his two sons, H and K, as joint tenants with right of survivorship, all his right, title, and interest to certain lands and mineral rights in lands. Contemporaneously therewith the two sons executed a declaration of trust in favor of C (their father), N (their mother), and the four children of C, H, K, A (the instant taxpayer), and B. By the terms of this declaration of trust the trustees were to receive the rents, royalties, issues, profits, income, and proceeds of the property so conveyed to them by their father, and out of such receipts were to pay the expenses incidental to the administration of the trust.

During the lifetime of the father the trustees were to make certain payments out of such receipts to the father, the mother, and two daughters, and were to retain the surplus of the receipts as their share.

Upon the death of C the trustees were to pay the net receipts to the widow and the four children in the following proportions, namely, one-third to the widow during her life and one-sixth to each of the four children.

Article 5 of the declaration of trust reads as follows:

> 5. Upon the death of both the said trustees, H and K, the trust hereby declared shall cease and terminate, and the property then embraced in said trust shall vest, share and share alike, in the children of said C, to wit—said H, K, A, and B, or in the survivors or survivor of them, the issue of any of said children who may have died prior to the termination of said trust to represent and take such deceased child's share; and said property and estate shall so vest without any further or other conveyance, assignment, or transfer, the same to all intents and purposes as if such vesting had, in terms legally apt and effective therefor, been prescribed and provided for in the deed by the said C and wife to the said H and K hereinabove recited.

Article 6(b) of the declaration of trust reads as follows:

> (b) In case of the death of any said children of said C during the existence of the trust hereby created, leaving issue, then and in that case any distributive payment accruing under the terms of this trust to such child so dying, shall belong to, and be paid to, such issue.

C died about January 1, 1916. One trustee, H, died on December 30, 1913. The other trustee, K, died on April 15, 1925, whereupon the trust terminated and the trust estate became vested in the two daughters and the children of the two deceased sons.

The income received by the trustees and distributed to the various beneficiaries, including the instant taxpayer, under and by virtue of the declaration of trust, was derived principally from royalties paid by various lessees to the trust in the operation and development of the mineral lands referred to in the declaration of trust.

As of April 29, 1925, the two daughters and the children of the two deceased sons formed a new trust for the purpose of continuing the annual payments to the widow of C. The corpus of this trust was the property which vested in them when the first trust terminated.

In General Counsel's Memorandum 7101, referred to above, this office reached the conclusion that the beneficiaries under the second trust were not entitled to deduct from their distributive shares of income from the trust a proportionate amount of depletion sustained by the trust. This conclusion was supported by a number of Board of Tax Appeals decisions, one of which was *Arthur H. Fleming et al.* v. *Commissioner* (6 B. T. A., 900). It was also supported by *Kate Fowler Merle-Smith* v. *Commissioner* (11 B. T. A., 254) and *Margaret B. Fowler* v. *Commissioner* (11 B. T. A., 265).

These three cases arose under similar trusts, the Fowler Trust and the Fleming Trust, created by one E. M. Fowler. In the Fowler Trust, E. M. Fowler, by will, devised, inter alia, to his daughter Kate Fowler (Kate Fowler Merle-Smith) one-half of his realty and one-half of his interest in certain mineral rights, rights in minerals, ores, mineral reservations, and surface rights, all in Minnesota, when she arrived at the age of 45, with power in her to dispose of the property and interests by will. Should she die intestate before reaching that age, her interest was to go to her issue, if any, and if not, then to designated relatives, including the widow, Margaret B. Fowler, under certain contingencies. This devise was subject, however, to a trust created in the will, by virtue of which certain named trustees were to have full charge, possession, and control of the properties until the daughter Kate reached the age of 45, or, if she died before she reached that age, then until his granddaughter, Marjorie Fleming, reached the age of 40. The trustees were to collect all dividends, royalties, rents, and income, and after the deduction of expenses of administration were to pay the net annual income to the widow, to a son-in-law (A. H. Fleming), and to Kate Fowler, in certain designated proportions. With respect to a claim for deduction on account of depletion of the corpus of the trust, the Board held that Kate Fowler Merle-Smith was not entitled to such a deduction. The two cases, Kate Fowler Merle-Smith and Margaret B. Fowler (the widow), were consolidated and appealed to the Circuit Court of Appeals, Second Circuit. The court (42 Fed. (2d), 837) reversed the Board in both cases and held that both petitioners had property rights in the corpus of the trust, and that as they had received their proportionate part of the royalties without deduction for depletion they were entitled to such deduction. As indicated above, a petition for writ of certiorari was denied by the Supreme Court.

Prior to the decision by the Board in the Merle-Smith case this office, in General Counsel's Memorandum 1673 (C. B. VI–1, 252), had reached the conclusion that beneficiaries of a trust, even though they are at the same time remaindermen, are not entitled to a deduction for depletion. When the petition for writ of certiorari was denied in the Merle-Smith case, this office, in General Counsel's Memorandum 9804 (C. B. X–2, 353), revoked General Counsel's Memorandum 1673 in so far as it was inconsistent with the decision in the Merle-Smith case.

Subsequent to the decision by the Circuit Court of Appeals in the Merle-Smith case, the Board considered the cases of *Mary Alphin et al.* v. *Commissioner* (21 B. T. A., 1101) and *Ida L. Kuhn et al.* v. *Commissioner* (24 B. T. A., 216), and in each case held that beneficiaries of a trust having also an interest in the residual corpus *were entitled to a deduction for depletion.* These two cases, however, differ somewhat from the Merle-Smith case, supra.

In the Merle-Smith case the property was devised directly to the daughter, the devise to take effect when she reached a certain age, and the devise was made subject to a trust of which she was a beneficiary. In the cases of Mary Alphin and Ida L. Kuhn, property was conveyed to trustees in trust for the beneficiaries, who were also ultimately to share as remaindermen in the corpus. The Board, apparently, did not lay stress on the difference between these latter cases and the Merle-Smith case, but decided them on the broad principle that a beneficiary of a trust having an interest in the corpus was entitled to a reasonable allowance for depletion. The Mary Alphin case was acquiesced in by the Commissioner (C. B. X–2, 2). The Alphin case involved royalties from oil leases, and the Kuhn case involved royalties from mining leases. In each case the trustees paid over to the beneficiaries the full net royalties received and made no deduction or reserve for depletion. Under the decision in the Merle-Smith case and the Alphin and Kuhn cases, it is clear that where a trustee holding the fee to mineral lands subject to a mining lease distributes to beneficiaries having an interest in the corpus the entire amount of net royalties received, each such beneficiary is entitled to a reasonable allowance for depletion.

In the instant case it is apparent that the taxpayer, A, during the year 1924 and up to the time when the trust terminated in April, 1925, had an interest in the corpus of the C Trust. Such an interest, under the decisions cited above, entitled her, as beneficiary of the C Trust, to a reasonable allowance for depletion of that interest during the year 1924 and in 1925 up to the time the trust terminated. For that reason this office is of the opinion that the claims now under consideration should be allowed as their merits may indicate.

For the reasons set forth above, General Counsel's Memorandum 7101, above referred to, is hereby revoked in so far as it is inconsistent with the decision of the Circuit Court of Appeals in the Merle-Smith case, supra.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

PART III.—CORPORATIONS.

SECTION 231.—CONDITIONAL AND OTHER EXEMPTIONS OF CORPORATIONS.

ARTICLE 523: Farmers' cooperative marketing and purchasing associations.

REVENUE ACT OF 1926.

Operating in its own behalf as creamery; distributing proceeds to stockholders; and making no distribution to nonstock-holding producers from whom it derives 30 per cent of its profits. (See Ct. D. 506, page 223.)

SECTION 238.—CREDIT FOR TAXES IN CASE OF CORPORATIONS.

ARTICLE 611: Credit for foreign taxes. XI-24-5513
G. C. M. 10613

REVENUE ACTS OF 1924 AND 1926.

British income taxes assessable for the British year of assessment, April 6–April 5, regardless of whether such taxes are based on the average income of a 3-year period or on the income of the preceding year, accrue on the first day of the British tax year of assessment, for it appears that liability for the payment of the British taxes is dependent upon whether the taxpayer continues in business during the year of assessment.

General Counsel's Memorandum 5971 (C. B. VIII-1, 182) revoked in so far as inconsistent herewith.

This office has previously held in General Counsel's Memorandum 5971 that British income tax assessable for the British year of assessment, April 6–April 5, on the average income of "three years ending on that day of the year immediately preceding the year of assessment on which the accounts of the said trade have been usually made up," is properly accruable as at the end of the third year in the average, and where the tax for the British year of assessment is based on the income of the preceding year, the tax accrues as at the end of such preceding year.

The question raised in that memorandum was whether the taxpayer in claiming a credit under section 238 of the Revenue Acts of 1924 and 1926 for income taxes paid to the British Government could accrue such taxes as at the end of the taxpayer's taxable year, namely, the calendar year, or whether such taxes were accruable at the end of the British taxable year, namely, April 6–April 5. The Board of Tax Appeals, in the case of the *Columbian Carbon Co.* v. *Commissioner* (25 B. T. A., 456), took the position that although under the British Income Tax Act, 1918, the British tax was computed and assessed on the average gains and profits of the 3-year period preceding the year of assessment, and that on the last day of such preceding 3-year period all the events had occurred which fixed the amount of the tax, this alone was not sufficient to constitute an accrual of liability.

The Board cited *United States* v. *Anderson* (269 U. S., 422, T. D. 3839, C. B. V-1, 179) and stated that in addition to the occurrence of the events which fixed the amount of the tax there must also have occurred the event which determined the liability of the taxpayer to pay it. The Board cited numerous American decisions which followed the rule laid down in *United States* v. *Anderson*, supra, and held that the event which determined the liability of the taxpayer to pay the tax for the year of assessment (namely, the year following the 3-year period) was the taxpayer's continuance in business during that year. It was pointed out that at the end of the prior 3-year period the year of assessment for which the tax was imposed had not yet arrived, hence prior to the first day of the year of assessment the event had not occurred which determined the liability of the taxpayer to pay the tax. The Board stated that if a taxpayer discontinued business prior to the beginning of the year of assessment, no tax liability for that year would or could have been incurred. It concluded that not until the first day of the British year of assessment (April 6–April 5) had all the events occurred which fixed the amount of the tax and determined the liability of the taxpayer to pay

it. Consequently, the liability for the taxes accrued as of the first day of the year of assessment rather than the last day of the year immediately preceding the year of assessment. The Board in its opinion, after discussing the British cases of *Brown* v. *National Provident Institution* (2 Appeal Cases, 222; 8 Tax Cases, 57, 100, House of Lords, 1921) and *Whelan* v. *Henning* (Appeal Cases, House of Lords, 1926, page 293), which held that if a British corporation had no income in the year of assessment no tax could be levied, stated:

* * * These [British] decisions gave rise to the enactment of those provisions of the British Finance Act of 1926, to the effect that notwithstanding no profits or gains arose for or within the year of assessment, income tax computed by reference to the amount of profits or gains of the period preceding the year of assessment should nevertheless be charged for that year. *However, the 1926 Finance Act did not change the rule that where the taxpayer discontinued business prior to the beginning of the year of assessment no liability to tax for such year was incurred.*

Applying the principles of accrual hereinabove discussed, in the light of the English statutes and decisions mentioned, leads us to the conclusion that liability under the British Income Tax Act of 1918 was incurred on the first day of each year of assessment, and not prior or subsequent thereto. Prior to such date it could not be known that the taxpayer would be in operation of the business on the first day of the year of assessment, and if the business had been discontinued prior thereto, no liability would have been incurred. (Italics supplied.)

In view of the decision of the Board of Tax Appeals in *Columbian Carbon Co.* v. *Commissioner*, which was supported by the British and American authorities cited, this office has accepted the Board's decision as a precedent. Accordingly, British income taxes, regardless of whether such taxes are based on the average income of a 3-year period or on the income of the preceding year, will be held to have accrued on the first day of the British tax year of assessment, for it appears that liability for the payment of the British taxes is dependent upon whether the taxpayer continues in business during the year of assessment.

For the foregoing reasons General Counsel's Memorandum 5971 is revoked in so far as it is inconsistent herewith, and cases involving this question will be disposed of in accordance with the Board's decision in *Columbian Carbon Co.* v. *Commissioner*, acquiescence notice of which appears in this Bulletin (page 2).

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

SECTION 240.—CONSOLIDATED RETURNS OF CORPORATIONS.

ARTICLE 631: Affiliated corporations. XI–17–5461
Ct. D. 474

INCOME TAX—REVENUE ACT OF 1926—DECISION OF COURT.

1. AFFILIATION.

Where in the taxable years 1925 and 1926 a group of persons owns 95 per cent of the stock of corporation A and owns only 94.64 per cent of the stock of corporation B, the two corporations are not affiliated within the meaning of section 240 (c) and (d) of the Revenue Act of 1926. Control by the dominant group in both corporations, without ownership, of the remainder of the stock of corporation B does not satisfy the requirement of ownership of 95 per cent of the stock of corporation B which is essential to affiliation under those subdivisions.

2. DECISION AFFIRMED.

The decision of the Board of Tax Appeals (18 B. T. A., 1055) is affirmed.

UNITED STATES CIRCUIT COURT OF APPEALS, SIXTH CIRCUIT.

The John B. Morris Foundry Co., petitioner, v. *Commissioner of Internal Revenue, respondent.*

Petition to review an order of the United States Board of Tax Appeals.

Before DENISON, HICKS, and HICKENLOOPER, Circuit Judges.

[October 9, 1931.]

OPINION.

HICKS, Circuit Judge: Petition by the John B. Morris Foundry Co. to review a decision of the Board of Tax Appeals affirming the action of the Commissioner of Internal Revenue in assessing, on redetermination, a deficiency in income taxes against it in the sum of $1,992.25 and $7,119.85 for the years 1925 and 1926, respectively.

Petitioner, a corporation, organized in 1890, manufactured castings until 1905. In 1905 it began the manufacture of machine tools. After about five years' experience it concluded that the manufacture of such tools by a foundry company adversely affected their sale. Therefore the John B. Morris Machine Tool Co., a corporation, was organized with an authorized capital of $125,000, all of which was issued to petitioner's stockholders in proportion to their holdings. Thereafter and before January 1, 1925, the name of the tool company was changed to the Morris Machine Tool Co. Its capital stock was reduced to $25,000 and the par value thereof was reduced from $100 to $20 per share. Both companies have at all times occupied the same building and the same offices and have retained the same bookkeeper. The officers of the two companies have always been the same with the exception of the secretary of the tool company. Petitioner manufactures all the castings used by the tool company.

During the progress of the business the majority stockholders as a matter of policy made sales or gifts of a small number of their shares to employees. The stock ownership of both companies during the calendar years 1925 and 1926 is set forth in the table.[1]

[1]

		The John B. Morris Foundry Co.	The Morris Machine Tool Co.
		Number of shares.	*Number of shares.*
1. Geo. McG. Morris, president		1,260	685
2. S. M. Blackburn, vice president		330	213
3. Alfred K. Nippert		20	11
4. Mathias Boehm		12	5
5. A. M. Rittenhouse, secretary		10	5
6. Mrs. Emma Niehaus		85	62
7. Chas. Kobmann		20	9
8. Chas. Kobmann and Fred Guckenberger, trustees		10	3
9. Fred Guckenberger		5	----------
10. Kate Guckenberger, wife of No. 9		10	3
11. Chas. J. Miner		93	12
12. Grace M. Miner, sister of No. 11		92	13
13. Mrs. Mabel S. Stonehill	One family	79	44
14. Geo. M. Stearns		79	43
15. Mrs. Geo. M. Stearns		2	2
16. Mrs. Miriam N. Nason		----------	29
17. Mrs. Miriam N. Nason, guardian for daughter		79	14
18. Mrs. E. R. Morris, wife of No. 1		----------	25
19. Mrs. Minnie Minebrecker		----------	5
20. Charlotte Minebrecker, daughter of No. 19		10	----------
21. Anna C. Wessel		30	----------
22. W. J. Buvinger		30	----------
23. Mrs. Minnie D. Douglass		25	----------
24. C. S. Blackburn, nephew of No. 2		12	----------
25. B. F. Lewis		2	----------
26. A. C. Pletz, secretary		----------	52
27. J. H. Holtbrink, was an employee		----------	5
28. Mrs. Flora Berkmeyer, widow of employee		----------	5
29. E. G. Mechstroth, an employee		----------	5
		2,295	1,250

The issue before the Board of Tax Appeals was whether the petitioner and the tool company were affiliated during the calendar years 1925 and 1926 within the meaning of section 240 (c) and (d) of the Revenue Act of 1926 (ch. 27, 44 Stat., 9), i. e., whether at least 95 per cent of the stock of both corporations was "owned by the same interests."

Petitioner's point is that the business and family relationship shown to exist between certain stockholders of both corporations constitute ownership by the same interests and from this viewpoint the same interests own at least as much as 95 per cent of the stock of both corporations. We can not assent. The evidence to support petitioner's claim consists of the relationships reflected in the subjoined tabulation.

The material portion of section 240(c) is as follows:

"For the purpose of this section two or more domestic corporations shall be deemed to be affiliated * * * (2) *if at least 95 per centum of the voting stock of two or more corporations is owned by the same interests.* This subdivision shall be applicable to the determination of affiliation for the taxable year of 1925.

"(d) For the purpose of this section two or more domestic corporations shall be deemed to be affiliated * * * (2) *if at least 95 per centum of the stock of two or more corporations is owned by the same interests* * * *. This subdivision shall be applicable to the determination of affiliation for the taxable year 1926 * * *." [Italics ours.]

Treasury Department Regulations 69, article 633, in force at the time of the passage of the Act, defined the phrase "the same interests" as follows:

"The words 'the same interests' shall be deemed to mean the same individual, partnership, or corporation, or the same individuals, partnerships, or corporations, but when the stock of two or more corporations is owned by two or more individuals, by two or more partnerships, or by two or more corporations, the corporations will not be held to be affiliated unless the percentage of the stock of such corporations held by each individual, each partnership, or each corporation is substantially the same in each of the corporations."

However, on November 12, 1927, this definition was dropped and thereafter the regulation followed the statute. We may assume, therefore, without deciding, that in a given case the shares of a class of stockholders common to two corporations (herein 15 in number) are for the purposes of affiliation owned by the same group interests. We may further assume that under given circumstances shares owned by relatives of any of the first mentioned group of stockholders may, for affiliation, be justly said to be owned by the group interests and that such related stockholders may be classified as belonging to such group. (See *Kyle & Morgan Co.* v. *Commissioner*, 41 Fed. (2d), 925 (C. C. A. 1).)

We do not mean to intimate that such an assumption would be warranted in this case because of the meagerness of its evidential facts. The assessment by the Commissioner was prima facie right and the burden was upon petitioner to make it clear to the Board at least by a preponderance of the evidence that it was wrong. (*United States* v. *Anderson*, 269 U. S., 422, 443 [T. D. 3839, C. B. V–1, 179]; *Wickwire* v. *Reinecke*, 275 U. S., 101, 105 [T. D. 4126, C. B. VII–1, 316]; *Austin Co.* v. *Commissioner*, 35 Fed. (2d), 910, 912 (C. C. A. 6) [Ct. D. 189, C. B. IX–1, 332]; *Portage Silica Co.* v. *Commissioner*, 49 Fed. (2d), 985, 986 (C. C. A. 6).) There was substantially no evidence before the Board except such as has been recited herein and found in the footnote hereto. (See *Oriental Real Estate Co.* v. *Commissioner*, 17 B. T. A., 1220, 1221.) But, taking it for granted that the situation is as it appears in the tabulation, we are not warranted in disturbing the action of the Board, for, after classifying the stockholders as above indicated, we have a group which, although owning more than 95 per cent of the stock of petitioner, does not own 95 per cent of the stock of the tool company. It owns only 1,183 shares thereof, or 94.64 per cent. The remaining 67 shares, or 5.36 per cent, are owned as follows: Pletz, secretary, 52 shares; Heitbrink, 5 shares; Flora Berkmeyer, widow of an employee, 5 shares; and E. G. Mechstroth, an employee, 5 shares. Upon such showing alone affiliation must fail because the Act is plain and the requirement of "at least 95 per cent of the stock" of both corporations is lacking.

But it is urged that stockholders Pletz and/or Heitbrink, Berkmeyer and Mechstroth should be associated with the original group and that if this is

allowed the lack will be supplied. The foundation for such insistence is that the group, dominant in the control of both corporations, really owned the 67 shares of Pletz, Heitbrink, Berkmeyer and Mechstroth. The basis for such claim is, (1) that Pletz, being secretary, was under moral or economic coercion to ally himself with the dominant influence in both companies if he would retain his position; (2) that the same was true as to Mechstroth, an employee; and (3) that the shares of Heitbrink and Mrs. Berkmeyer were so insignificant as to be naturally dominated by the majority allied interests.

We think the proposition strained and untenable. Whatever might be said as to whether under the circumstances the allied majority interests *controlled* the 67 shares of Pletz and others (a point upon which there is a divergence of judicial opinion) we have no hesitancy in concluding that they did not *own* them and we are dealing with *ownership* and not *control*. That feature was present in the Revenue Act of 1918, section 240(b), and of the Revenue Act of 1921, section 240(c), but was entirely eliminated from the Revenue Acts of 1924 and 1926. Even when they were used in prior Acts it was never thought that the terms "owns" and "controls" were used synonymously. (*United States* v. *Cleveland P. & E. R. Co.*, 42 Fed. (2d), 413, 418 (C. C. A. 6) [Ct. D. 252, C. B. IX–2, 387]; *Great Lakes Hotel Co.* v. *Commissioner*, 30 Fed. (2d), 1, 4 (C. C. A. 7).) The Revenue Act of 1926, supra, following the Act of 1924, not only abandoned the word "control" used in the prior Acts of 1918 (section 240(b)) and 1921 (section 240(c)), but also the phrase "substantially all" and substituted therefor the phrase "at least 95 per centum." The evident purpose of the Congress was not only the more clearly to identify but also to narrow the group for whose benefit affiliation would be available.

The decision of the Board of Tax Appeals is affirmed.

Article 632: Consolidated returns.

XI–12–5419
Ct. D. 458

INCOME TAX—REVENUE ACT OF 1926—DECISION OF COURT.

1. Consolidated Returns—Insurance Company and Ordinary Corporation.

An insurance company subject to the tax imposed by section 246 of the Revenue Act of 1926 can not be affiliated within the meaning of section 240 of that Act with an ordinary corporation subject to the tax imposed by section 230 of the Revenue Act of 1926.

2. Decision Affirmed.

The decision of the Board of Tax Appeals (23 B. T. A., 550) is affirmed.

United States Circuit Court of Appeals for the Second Circuit.

Fire Companies Building Corporation, petitioner, v. *Commissioner of Internal Revenue, respondent.*

Appeal by a taxpayer from a decision of the Board of Tax Appeals fixing a deficiency upon its income tax return for the year 1926.

Before Manton, L. Hand, and Swan, JJ.

L. Hand, Circuit Judge: The only question raised by this appeal is whether the Commissioner should have accepted a consolidated return of the appellant for the year 1926, which included not only its own income, but that of two subsidiaries. He refused to do so and assessed the appellant on its separate income; the Board affirmed the ruling on the taxpayer's appeal and this appeal is from the Board's decision. The appellant's business is to manage its real estate and to invest and dispose of the income arising from its assets, among which are all the shares of the American Eagle Investment Co., which in turn owns all but a few shares of the American Eagle Fire Insurance Co., a corporation doing a fire insurance business, as its name implies. If an insurance

company may become affiliated with a holding company under section 240(a) of the Act of 1926, all conditions of affiliation existed, and the Commissioner and the Board were wrong. The appellant had filed a consolidated return for each year from 1917 to 1925, inclusive, which the Commissioner had accepted. In 1930 he changed his interpretation of the statute and assessed a deficiency for the year 1926. It is agreed that the income of the appellant and the American Eagle Investment Co. should be consolidated; the question is only whether that of the fire insurance company may be included.

The regulations under the Act of 1926 did not make any distinction between insurance companies and others as to affiliation, and in May, 1927, the Solicitor of the Tax Bureau ruled that the consolidated income should be taxed at the higher rate, 13½ per cent, in 1926, instead of 12½ per cent, which was applicable to insurance companies. This ruling presupposed that there might be a consolidation, but in January, 1929, it was overruled, and the tax at bar assessed accordingly. By the Act of 1928, Congress had meanwhile provided that insurance companies should not so affiliate (section 141(e)), but that section went into effect only on January 1, 1929, and section 142 substantially reenacted section 240(a) of 1926 for the year 1928.

There appear to us insuperable obstacles to construing section 240(a) as permitting the consolidation of the incomes of an insurance company and any other, certainly after the Act of 1926 went into effect. Affiliation does not merge the taxpayers; they remain as before, and their incomes are consolidated only for purposes of appraisal; the tax is levied upon the affiliates individually. (*Swift* v. *U. S.*, 38 Fed. (2d), 365, 374 (Ct. Cls.); *Sweets Co.* v. *Commissioner*, 40 Fed. (2d), 436, 438 (C. C. A. 2).) Before the Act of 1926, and while the rates for insurance companies were the same as for other corporations, such affiliation was perhaps possible, though even then the deductions allowable to each affiliate were different and the result really perverted the purpose of the statute. (*First National Bank* v. *U. S.*, 283 U. S., 142.) But we are dealing with 1926, after which the rates were different, and it is impossible at once to consolidate the incomes and to find any rate at which to tax the resultant, which is neither the income of an insurance company, nor of an ordinary corporation, but a hotch-pot of the items and cross items of each. To tax it at the ordinary rate is to apply that rate to insurance income which ought not to bear it; to adopt the insurance rate is to exempt ordinary income from what it should bear. Thus if the taxing sections and section 240(a) are read together and literally, no tax can be collected at all. Obviously logic must not stifle understanding, and some modus vivendi must be found. In such cases courts choose that alternative which most nearly conforms to the general purpose, so far as they can glean it. (*U. S.* v. *Katz*, 271 U. S., 354; *Hellmich* v. *Hellman*, 276 U. S., 233 [T. D. 4217, C. B. VII–2, 238].) It appears to us rather that the general language of section 240(a) was subject to an exception in this case, than that the amorphous consolidated income should be taxed at either rate. It is idle to protest against such liberties; courts have taken them from time immemorial, and must do so if the business at hand is to go on.

We can put little weight on the departmental practice; at least after 1926, even if it were right before. Thereafter it is not unfair to say that the officials were groping their way, at first accepting one horn of the dilemma and later the other. That was not the kind of uniformity which should embarrass us in reading the language as we think right. Nor do we think that the Act of 1928 stands in our path. Section 141(e) was to "clarify" the law; certainly not the Act of 1928 itself, as the appellant supposes, but the law as it had theretofore stood. Section 142 did indeed continue for the current year the old provision in substantially the old words; and, while at first blush it may seem plausible to argue that the contrast between it and section 141(e) indicated a change in intent, the evidence is too fragile. Congress may no doubt indicate its understanding as to the scope of its former words, and when this can be treated as a command, it will control, subject to constitutional limits (*Merle-Smith* v. *Commissioner*, 42 Fed. (2d), 837, 842 (C. C. A. 2)); but its interpretation as such is immaterial. It is as likely to be wrong as anyone else, and in the end the courts must decide. At any rate there is here no reason to suppose that it meant to declare that the law before 1928 should permit such affiliations. It is as just to argue that its failure to omit any

reference to earlier years indicated a purpose to leave them unaffected, as to say that the contrast between the sections declared that the earlier law was different. So far as we can gather—and we can gather very little—Congress intended to leave the situation as it had been; but to make it clear that for the future, at any rate, affiliation should be limited to corporations of the same sort. Certainly we should require more indication of a positive purpose, before we held that either rate should be applied where it clearly was not intended.

Decision affirmed.

PART V.—PAYMENT, COLLECTION, AND REFUND OF TAX AND PENALTIES.

SECTIONS 273 AND 274.—DEFICIENCY IN TAX.

ARTICLE 1232: Assessment of a deficiency. XI-26-5527
Ct. D. 505

INCOME TAX—REVENUE ACT OF 1926—DECISION OF COURT.

NOTICE OF DEFICIENCY—DEFECT—AMBIGUITY.

Where a deficiency for the year 1917 is erroneously assessed on March 12, 1927, because of the omission of that year in a waiver executed by the taxpayer of its right to file a petition with the Board of Tax Appeals, and on April 4, 1927, the Commissioner sends to the taxpayer a 60-day letter in accordance with section 274(a) of the Revenue Act of 1926 stating in part that an audit of the taxpayer's return for the year 1917 resulted in the determination of a deficiency in tax in an amount stated "which has been assessed" and requesting a waiver of its right to appeal to the Board of Tax Appeals "if you acquiesce in this determination," and sends another letter two days later calling attention to the fact that an erroneous assessment had been made on March 12, 1927, and to the 60-day period within which to file a petition with the Board "against the determination of your income tax liability for the year 1917," the two letters when construed together clearly show that the Commissioner was notifying the taxpayer in accordance with said subdivision that he had determined a deficiency in tax for the year 1917 in the amount stated in the letters, dispelled any ambiguity and cured any defect in the notice arising from the use of the phrase "which has been assessed" in the letter of April 4 and the reference therein to section 283(k) of the Revenue Act of 1926 concerning jeopardy assessments which the taxpayer claims left him in doubt as to whether or not the letter was intended to give notice of a jeopardy assessment already made or was a notice of a determination of a deficiency subject to appeal and subsequent assessment.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

B. S. Noyes, William S. Noyes, L. M. Doherty, F. M. Parcells, and A. L. Coombes, Trustees for the Creditors and Stockholders of Presidio Mining Co. (a Dissolved Corporation), appellants, v. *United States of America, appellee.*

[February 1, 1932.]

OPINION.

WILBUR, Circuit Judge: This is an action to recover the sum of $10,294.76, being a portion of the excess tax paid by the Presidio Mining Co. for the taxable year 1918, said amount having been determined by the collector of internal revenue to be an overpayment. This overpayment was applied to a deficiency of that amount for the taxable year 1917. The balance of the excess for the

year 1918 ($8,764.02) has been repaid to the Presidio Mining Co. Judgment went for the defendant and the plaintiffs appeal.

The main question in the case is whether or not valid assessment was made for the tax year 1917. The appellants claim that no valid assessment having been made of a deficiency for the year 1917 the attempt of the Commissioner to apply the tax to a purported assessment for that year was unauthorized and that the amount of $10,294.76 with interest is due the taxpayer and collectible by the appellants as its representatives.

It appears that on January 31, 1927, the Commissioner notified the taxpayer that he had determined a deficiency of $19,611.03 for the years 1917, 1919, 1920, and 1921, and overpayments of almost the same amount ($19,252.08) for the years 1914, 1916, and 1918. The taxpayer was notified by this letter of January 31, 1927, that he had 30 days in which to protest against the proposed deficiency and to submit additional evidence and argument to the Commissioner, and that—

"if the Commissioner finally determines that there is a deficiency, you will be advised thereof by registered mail in accordance with the provisions of section 274 of the Revenue Act of 1926. Should you not agree to the deficiency as finally determined by the Commissioner, you will be allowed 60 days from the date of mailing of the registered letter (not counting Sunday as the sixtieth day) in which to file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

"If you acquiesce in the proposed deficiency as shown in this letter and the accompanying statement, you are requested to execute a waiver of your right to file a petition with the United States Board of Tax Appeals on the inclosed Form A, and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT-E-SM W H H-30305 A-30306-B-30307-C-30308 CD-30309. In the event that you acquiesce in a part of such deficiency the waiver should be executed with respect to the items to which you agree."

Attached to this letter was a computation of the tax for each year; that for the year 1917 showed a net income of $72,709.08, tax liability of $21,674.22, of which $10,665.61 had been assessed March, 1918; $710.81, April, 1918; discount allowed $3.04; total, $11,379.46, deficiency in tax, $10,294.76 (being the balance of $21,674.22 less $11,379.46). In 1919 the computation showed an overassessment of $19,058.78. The letter also showed that the taxpayer's claim for refund for $50,000 for the year 1918 had been granted for the amount of this overassessment, $19,058.78. The letter states:

"The overassessments shown above will be made the subject of certificates of overassessment which will reach you in due course through the office of the collector of internal revenue for your district, who thus will be officially notified of the rejection of the claims above mentioned."

This letter was accompanied by a blank form of waiver of right to file a petition to the United States Board of Tax Appeals as to the deficiency tax for the years 1917, 1919, 1920, and 1921, aggregating $19,611.03. This waiver was modified before signing by striking out the year 1917 and decreasing the aggregate amount from $19,611.03 to $9,316.27. Apparently the fact that the waiver had been changed so as to exclude the year 1917 was not observed by the Commissioner of Internal Revenue when it was returned and on March 12 an assessment was made for all the years involved, including 1917, in accordance with the letter of January 31, 1927. The Commissioner evidently received a telegram from the taxpayer dated March 10, 1927, in regard to the additional tax of $10,294.76 plus $639.68 assessed against the taxpayer for the year 1917 in the Commissioner's assessment list for March, 1927. This telegram was answered by a letter dated April 6, 1927. A letter dated April 4, 1927, was sent by the Commissioner which was evidently intended as a determination of the deficiency of tax for the year 1917 amounting to $10,294.76 with a notice to the taxpayer that it had 60 days in which to appeal to the Board of Tax Appeals. On July 1, 1927, a deficiency tax for the year 1917 was assessed to the Presidio Mining Co. for the above deficiency of $10,294.76 with $833.73 interest. If we ignore the assessment of March 12, 1927, of the deficiency for the year 1917, as both parties contend we should, and if we treat the letter of April 4, 1927, as a determination of a deficiency tax for 1917 with the right of appeal from that determination to the Board of Tax Appeals, then the assessment of July 1, more than 60 days thereafter, is a valid assessment. The appellants claim, however, that the letter of April 4, 1927, is so ambiguous that it can not be determined therefrom whether there was

a jeopardy assessment and the letter was intended as notice thereof, or whether the letter was intended merely as a determination of a deficiency in tax subject to an appeal and a subsequent assessment. The point made can not well be discussed without quoting the letter of April 4, 1927, above referred to, and the letter of April 6, 1927:

Address reply to Commissioner of Internal Revenue and refer to
IT:E:SM WHH–30305.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, April 4, 1927.

PRESIDIO MINING CO.,
814 Mills Building,
San Francisco, Calif.

SIRS: An audit of your income and excess profits tax return for the calendar year 1917, has resulted in the determination of a deficiency in tax of $10,294.76 as shown in Bureau letter dated January 31, 1927, which has been assessed.

In accordance with the provisions of section 283(e) or section 283(k) of the Revenue Act of 1926, you are allowed 60 days (not counting Sunday as the sixtieth day) from the date of mailing of this letter within which to file a petition with the United States Board of Tax Appeals, Earle Building, Washington, D. C., contesting in whole or in part the correctness of this determination.

If you acquiesce in this determination and do not desire to file such petition, you are requested to execute waiver of your right to file a petition with the United States Board of Tax Appeals on the inclosed Form A, and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:E: SM–WHH–30305.

In the event that you acquiesce in a part of the determination, the waiver should be executed with respect to the items to which you agree.

A copy of this letter has been furnished your duly authorized representative, Mr W. E. Hayes, 730 Munsey Building, Washington, D. C.

Respectfully,

D. H. BLAIR,
Commissioner.
(Signed) By C. R. NASH,
Assistant to the Commissioner.

Address reply to Commissioner of Internal Revenue and refer to
IT:C:P–4–LCT.

TREASURY DEPARTMENT,
OFFICE OF THE COMMISSIONER OF INTERNAL REVENUE,
Washington, April 6, 1927.

PRESIDIO MINING CO.,
814 Mills Building,
San Francisco, Calif.

SIRS: Receipt is acknowledged of your telegram dated March 10, 1927, in regard to the additional tax of $10,294.76 plus interest of $639.68 assessed against you for the year 1917 and appearing on the Commissioner's list for March, 1927, No. 2, page 2, line 3. It is noted you request this office to forward a 60-day letter and authorize the collector to cancel the above-mentioned assessment, since the waiver signed on February 3, 1927, did not include the year 1917.

In reply, you are advised that the records of this office show that a Form A was duly executed under date of February 3, 1927, waiving the right to file a petition with the United States Board of Tax Appeals and consenting to the assessment and collection of a deficiency in tax in the amount of $9,316.27 for the years 1919, 1920, and 1921. The additional tax for the year 1917, in the amount of $10,294.76, was erroneously assessed under date of March 12, 1927. This assessment will be eliminated by the issuance of a certificate of allowance, which will be scheduled to the collector of internal revenue for your district in due course, for abatement.

Under date of April 4, 1927, a letter was addressed to you in accordance with the provisions of section 283(e) or section 283(k) of the Revenue Act of 1926, granting 60 days within which to file a petition with the United States Board of Tax Appeals against the determination of your income tax liability for the year 1917.

Respectfully,

(Signed) C. R. NASH,
Assistant to the Commissioner.

It is claimed that the use of the phrase "which has been assessed" in the first paragraph of the letter of April 4, and the reference therein to section 283(e) of the Revenue Act of 1926, concerning jeopardy assessments, left the taxpayer in doubt as to whether or not the letter was intended to give notice of a jeopardy assessment already made, or was a notice of a determination of a deficiency to be assessed 60 days later. The letter of April 4, 1927, informed the taxpayer that the Commissioner of Internal Revenue had determined a deficiency in tax for the year 1917 in the amount of $10,294.76. Waivers were requested "if you acquiesce in this determination," not assessment. If there were any doubt created in the mind of the taxpayer by the phrase "which has been assessed" used in the letter of April 4, 1927, it was dispelled by the letter of April 6 calling attention to the fact that an erroneous assessment of that amount had been made on March 12, 1927. The letter of April 4 also called attention of the taxpayer to the 60-day period within which an appeal might be taken "against the determination of your income tax liability for the year 1917." These two letters, when construed together, clearly show that the Commissioner of Internal Revenue was notifying the taxpayer that he had determined a deficiency in tax for the year 1917 in the amount stated in the various letters ($10,294.76).

The assessment of the deficiency for that amount was properly made in July, 1927.

Appellants contend that the Commissioner had no authority to apply the amount of overpayment for the year 1918 to the tax for the year 1917 for the reason that the deficiency tax for the year 1917 was not "then due" within the meaning of section 284(a) of the Revenue Act of 1926, and that for that reason he should recover the amount prayed for, notwithstanding the fact that the taxpayer owes the Government a like amount. There is no merit in this proposition. (*Tull & Gibbs* v. *United States*, 48 F. (2d), 148; *Edgar Percy Lewis et al.* v. *Reynolds*, No. 115, decided January 4, 1932 [Ct. D. 443, page 130].)

Judgment affirmed.

SECTIONS 277 AND 278.—PERIOD OF LIMITATION UPON ASSESSMENT AND COLLECTION OF TAX.

ARTICLE 1272: Period of limitation upon collection of tax. XI-21-5488 Ct. D. 486

CORPORATION EXCISE TAX—REVENUE ACT OF 1926—DECISION OF COURT.

COLLECTION—LIMITATION—UNLIMITED WAIVER.

A consent in writing by a taxpayer to the assessment of a tax, pursuant to section 250(d) of the Revenue Act of 1921, which is unlimited as to time, expires, if limited at all, only after the taxpayer gives notice to the Commissioner that he will regard the waiver as at an end after a reasonable time, and where no such notice is given a tax due under a return made under section 38 of the Act of August 5, 1909, which was assessed in March, 1924, by virtue of such consent executed in 1923 and after the expiration of the statutory period for assessment, is lawfully collected by distraint by virtue of the consent in November, 1928.

If the rule be applied that the consent requires collection within a reasonable time after the assessment, the collection is likewise lawful, since a delay was occasioned on account of the consideration of the taxpayer's claim for a credit filed shortly after the assessment and rejected in 1927. Moreover, the period from the date of the assessment to February 26, 1926, the date of the enactment of the Revenue Act of 1926, is not unreasonable in the circumstances and the collection was made within six years from the date of the assessment as allowed by section 278(d) of that Act.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

Big Four Oil & Gas Co., a Corporation, appellant, v. *D. B. Heiner, Collector of Internal Revenue for the Twenty-third District of Pennsylvania, appellee.*

Appeal from the District Court of the United States for the Western District of Pennsylvania.

[March 1, 1932.]

OPINION.

DAVIS, Circuit Judge: This is an appeal from a judgment of the district court in an action to recover income taxes for the year 1909, and interest, alleged to have been collected illegally from the appellant, the Big Four Oil & Gas Co.

The appellant paid its income tax for 1909 as shown on its return. Nothing further happened until March 2, 1923, when the appellant signed and filed, at the request of the Commissioner of Internal Revenue, the following waiver, which is unlimited in time, consenting to the assessment of any additional tax for 1909:

"The Big Four Oil & Gas Co., Pittsburgh, Pa., a corporation organized under the laws of the State of Delaware; hereby consents to the assessment of any and all taxes imposed by the Act of Congress approved August 5, 1909, and shown or found to be due on the basis of its net income received from all sources during the year 1909, and said corporation hereby waives any statutory limitation as to the time in which such taxes and penalties should have been assessed."

Thereupon, the Commissioner, on March 15, 1924, assessed an additional tax for 1909. On July 7, 1924, the collector of internal revenue gave the appellant notice of the assessment and demanded payment. This it refused for the reason that the tax was barred by the statute of limitations.

A second notice and demand were issued in June, 1927, and the final notice and demand on July 6, 1927. These were followed in the same month by a warrant for distraint. The warrant was returned in November, 1927, to the Commissioner as uncollectible, but it was executed a year later, on November 23, 1928, by distraint on a bank deposit of the appellant.

Thereupon, the appellant filed a claim for refund which was duly considered and rejected, and this suit followed.

The Supreme Court has decided that an unlimited waiver, executed after the expiration of the period of limitation, is operative. But this case does not decide how long it remains operative after its execution. (*Stange* v. *United States*, 282 U. S., 270, 273 [Ct. D. 274, C. B. X–1, 414].) The appellant insists that an unlimited waiver permits assessment and collection only within a reasonable time after its execution, and that the period in this case between assessment and collection is entirely unreasonable. (*Warner Sugar Refining Co.*, 4 B. T. A., 5; *Wirt Franklin*, 7 B. T. A., 636; *Cunningham Sheep & Land Co.*, 7 B. T. A., 652; *William S. Doig, Inc.*, 13 B. T. A., 256.)

The present case is like the Stange case, save that here a longer period of time elapsed between the deficiency assessment and the collection of the tax. The only question, therefore, to be decided is whether or not the unlimited waiver filed March 2, 1923, authorized the collection by distraint in November, 1928, of the tax assessed on March 15, 1924.

If such a waiver does require the Commissioner to act within a reasonable time, the evidence was sufficient to allow the court below to say that the period between the assessment (March 15, 1924) and the collection of the deficiency (November 8, 1928) was not unreasonable, because shortly after the assessment, the appellant filed a claim for credit which was duly considered and rejected prior to June 24, 1927, when the second notice and demand were issued. These were followed by the other notices, demands and warrants as above stated. The warrant was returned as uncollectible and the appellant, by its attorney, again denied liability on the ground that the statute of limitations had run. Collection was made a year later in November, 1928. No question is raised as to the reasonableness of the period between the filing of the waiver and the date of the deficiency assessment, but it appears that four and a half years elapsed between the assessment and collection of the item. In that time the appellant filed a claim for credit which was evidently rejected in 1927. The

delay in collecting the tax must have been caused by the time required to consider the appellant's claim for credit. It can not object to a delay that it caused.

The interval of three years, during which the appellant's claim for credit was being considered, is long, but not unreasonable, when caused by the taxpayer, in view of the mass of other claims and returns demanding the attention of the Commissioner.

At any rate, the period from March, 1924, to February 26, 1926, the effective date of the Revenue Act of 1926, is not unfair, under the circumstances. Section 278(d) of the Revenue Act of 1926 provides that where the assessment of income tax "has been made (whether before or after the enactment of this Act) within the statutory period of limitation properly applicable thereto," such tax may be collected by distraint if begun within six years after the assessment of the tax. So here, the collection made in 1928, was well within the 6-year period for collection, allowed after assessment.

The Supreme Court has pointed out that "a waiver is not a contract, * * * (but) is essentially a voluntary, unilateral waiver of a defense by the taxpayer." (*Stange* v. *United States*, supra.) Again, the court said that "the instruments were nothing more than they were termed on their face—waivers." (*Florsheim Bros. Drygoods Co.* v. *United States*, 280 U. S., 453, 466 [Ct. D. 167, C. B. IX–1, 260].)

In *Greylock Mills* v. *Commissioner of Internal Revenue* (31 Fed. (2d), 655, 658, certiorari denied 280 U. S., 560 [Ct. D. 98, C. B. VIII–2, 253]), the Circuit Court of Appeals, for the Second Circuit said:

"But there is also another ground equally fatal to appellant's contention. If waivers which are in terms unlimited are to be limited at all, we think they should expire only after the taxpayer gives notice to the Commissioner that he will regard the waiver as at an end after a reasonable time, say three or four months, from the date of such notice. In such a rule there is no harshness to either party; on the contrary, it seems to us the most reasonable one. An analogy may perhaps be found in the case of contracts for the sale of land, where time does not ordinarily become of the essence, unless expressly so stated, until notice is given by one party and an opportunity afforded to the other to act. In the instant case, no such notice was given to the Commissioner, and we think the waiver remained outstanding, so that he was entitled to act at his leisure."

This rule seems reasonable and the present case falls within its scope.

The judgment of the district court is affirmed.

ARTICLE 1272: Period of limitation upon collection of tax.

XI–26–5528
Ct. D. 507

FEDERAL TAXES—BOND AS A DEFENSE—DECISION OF COURT.

1. SUIT—DEFENSE—BOND.

Where a taxpayer files a claim for abatement of an assessment, made within the period of limitation properly applicable thereto, accompanied by a bond conditioned for the payment of any part of such assessment found to be due and after the Commissioner rejects the claim the surety makes a payment to discharge the obligation of the bond, the bond is an independent valid promise to pay the tax found due and is a defense to a suit based upon the ground that the collection of the amount paid was barred by the statute of limitation applicable to the collection of taxes.

2. PAYMENT—ERRONEOUS APPLICATION.

Where a surety makes a payment with the intent and purpose to discharge the obligation of a bond conditioned for the payment of any part of an additional assessment, which the collector receives for that purpose but, the additional assessment being transferred to another collection district, by error credits to a second additional assessment, not covered by the bond, against the collection of which the statutory period of limitation for collection of the tax had run at the time of the payment, and where, after the payment was

made, the first additional assessment is by error abated as uncollectible on a claim filed by the collector to whose district it was transferred, the errors of the collectors are not irrevocable and, being corrected without prejudice to creditors or the parties to the bond, the United States is not bound thereby in a suit to recover the amount paid.

COURT OF CLAIMS OF THE UNITED STATES. No. L–93.

John M. Kroyer, for the use of himself and of Fidelity & Casualty Co. of New York, a Corporation, as the interest of each may appear, v. *The United States.*

[January 18, 1932.]

OPINION.

GREEN, Judge, delivered the opinion of the court.

Since the beginning of this case, the plaintiff has asked leave to amend his petition by changing the title of the plaintiff from simply "John M. Kroyer" to "John M. Kroyer, for the use of himself and of Fidelity & Casualty Co. of New York, a corporation, as the interest of each may appear." This motion has been granted, but for reasons that will hereinafter appear we have concluded that this change does not affect the decision in the case. For convenience in the opinion, when the word "plaintiff" is used, it will refer to John M. Kroyer only.

This case presents a situation where the plaintiff, a taxpayer, had filed a return of income and profits taxes in due time and paid the tax shown by his return, but the Commissioner of Internal Revenue assessed an additional tax in the sum of $75,243.58. About a month later the plaintiff filed a claim for abatement thereof together with a bond with himself as principal and the Fidelity & Casualty Co. of New York as surety, the penalty of the bond being $75,000 and conditioned on the payment of any part of such additional assessment found to be due by the Commissioner of Internal Revenue. Later the Commissioner rejected plaintiff's claim and assessed a further additional tax in the sum of $66,503.76. Thereafter certain complications arose which have resulted in the bringing of this suit.

The plaintiff moved to Los Angeles, Calif., and the additional assessment first made and which was secured by the bond was transferred from the first collection district in San Francisco to the sixth collection district in Los Angeles where the plaintiff then resided. The second additional assessment of $66,503.76 remained on the books of the collector of the first district at San Francisco, and on January 27, 1925, the collector of the first district at San Francisco collected from the Fidelity & Casualty Co. surety on the bond given to secure the payment of the first additional assessment, the sum of $75,000, which was paid by the surety with the purpose and intent to discharge the obligations of the bond and received for that purpose. But instead of transmitting this sum of $75,000 so collected to the collector at Los Angeles, where the same should have been applied under the terms of the bond as a credit on the tax account referred to in and secured by said bond, that is, the first assessment, the collector at San Francisco posted the same on his books to the credit of the second additional assessment appearing against the plaintiff in the amount of $66,503.76 principal and $8,496.24 interest. On January 13, 1925, the collector for the sixth district of Los Angeles filed a collector's claim for abatement of the outstanding tax account against plaintiff then appearing on his books in the amount of $75,243.58, being the amount of the first additional assessment made. This claim on the part of the collector was allowed by the Commissioner of Internal Revenue and the first additional assessment was abated on September 24, 1925, as uncollectible. On January 7, 1929, the plaintiff filed two claims for refund, the basis of the claim being in each case that the additional tax of $66,503.76 and interest thereon in the amount of $8,496.24 were illegally collected from the plaintiff after the expiration of the statutory period within which said collection could legally be made. These claims for refund were rejected.

After the claim for refund had been filed by the taxpayer and the Commissioner of Internal Revenue become apprised of the action of the collector of the first district of California in so applying the $75,000 collected from the surety company to the credit of the second additional assessment, the account

against the taxpayer in the sum of $75,243.58, which had been transferred to the sixth district of California was by the Commissioner's instructions reinstated upon the books of the collector and transferred back to the first district at San Francisco, and the collector of the first district was instructed to adjust his books by posting the payment made by the surety on the bond to the credit of the first additional assessment made, amounting to $75,243.58. The collector made such adjustments accordingly and canceled the credit which had erroneously been made to the second additional assessment.

The issue raised by plaintiff may be stated in a simple form, but it presents a novel and somewhat subtle question. The money collected from the surety company was in the first instance applied on the second additional assessment against the collection of which the statute of limitations had run at the time the payment was made. Such being the facts, it is contended on the part of the plaintiff that the action of the collector in making the collection and crediting the amount collected to the second additional assessment was in both instances contrary to law, and that by reason thereof the plaintiff is entitled to file a claim for refund and recover the amount so paid. Under the circumstances of the case, we do not think this contention can be sustained. The facts are that the bonding company made the payment in compliance with its bond which was conditioned on the payment of the first additional assessment. Manifestly, it was intended to have the money so paid applied on the first additional assessment and not on the second. By error and mistake the collector at San Francisco applied the payment on the second additional assessment, which the bond did not cover, and subsequently by a further error the collector at Los Angeles filed a collector's claim in abatement of the first additional assessment and had it abated, although the payment should have been applied thereon and no abatement of any kind made. Later when the Commissioner discovered, through the filing of the claim for refund by the plaintiff, that these errors had been made, he had the books corrected. The abatement of the first additional assessment was set aside and the payment applied thereon, as was intended when it was made. The account against the taxpayer for the second additional assessment was reinstated and corrections upon the books of the respective collectors were made accordingly. It is now urged on behalf of plaintiff that the original action taken by the collectors with reference to the application of the money paid by the bonding company and the abatement of the first additional assessment is irrevocable, and that the Commissioner had no right to have proceedings taken to the end that the payment should be applied as had been intended, and the collectors' books corrected to make the record show what ought to have been done in the first instance. Several authorities are cited in support of the position taken by the plaintiff, but we do not think any of them have any application. There are some instances where a change in the application of a payment by a debtor would operate to the prejudice of other creditors such as is shown by the case of *The Sophia Johnson* (237 Fed., 406), in which it was held that the party to whom the payment was made would not be permitted to change the application thereof, but in this case no other creditors are involved. Moreover, the money was not applied in the manner in which the bonding company intended and had the right to expect when the payment was made. The payment was made by the bonding company to extinguish its indebtedness on the bond, and defendant could not properly use it for any other purpose.

It is true the collector obtained an entry abating the additional tax first assessed for the payment of which the bond was given, but this was after the payment had been made, and in any event we do not think the Government can be bound by the bookkeeping errors of its agents when such errors in no way affect the real equities of the case or result to the prejudice of a party making a payment. In *Wisconsin Central R. R. Co.* v. *United States* (164 U. S., 190, 210), the court held in effect, that the Government was not bound by the action of one of its officers resulting from an "erroneous conclusion * * * as to the legal effect of the particular statutory law under or in reference to which he is proceeding."

A fortiori we think it would follow that the Government was not bound by some action of one of its officers resulting from a mistake of fact which, when such action was corrected, left the whole matter in such a situation that the party complaining had received no injury and been done no injustice. It should also be noted in this connection that while the word "abatement" usually refers to a cancellation or an annulment of a tax or assessment which has been changed on application of the taxpayer, the particular abatement in this case

was an altogether different matter. It was a claim filed by the collector on Form 53 to abate an uncollectible tax, so far as the collector was concerned. This form of abatement of claim is used by collectors for the purpose of clearing their books of a tax which they have determined to be uncollectible, and for the purpose of advising the Bureau of this condition. It does not cancel or annul the tax, but, on the contrary, the Treasury regulations provide in substance that the obligation to pay the tax still remains upon the person assessed, and it is the collector's duty to use diligence to collect it if opportunity arises.

Another, and, as we think, valid defense, is presented on behalf of the Government. The case on the merits is similar to and controlled by the case of *United States* v. *John Barth Co.* (279 U. S., 370 [Ct. D. 65, C. B. VIII–1, 189]) and *Mascot Oil Co.* v. *United States* (70 C. Cls., 246, affirmed 282 U. S., 434 [Ct. D. 286, C. B. X–1, 190]). In both of these cases the taxpayer filed a claim in abatement. In the Barth Co. case, the taxpayer gave a bond to secure the payment of the tax; in the Mascot Oil Co. case, a certain sum was deposited in a bank in escrow to insure the payment of the tax. It was held in each case that a contractual liability was created whereby the Government obtained an additional remedy. In the Barth Co. case the action was directly on the bond but commenced after the statute of limitations had run against the collection of the tax; in the Mascot Oil Co. case the plaintiff and taxpayer deposited with the bank in escrow a sufficient sum to secure payment of the tax finally determined to be due, thus creating a liability on the part of the bank for the amount of the tax. Subsequently, the plaintiff itself paid over the amount of the tax instead of the bank making payment, as had been agreed. In both of these cases it was held that the fact that the statute of limitations had run against the collection of the tax was immaterial. In our opinion, mistakes of the agents of the Government do not prevent the application of the rule laid down in the two cases last cited, and if that rule is followed it is clear that the plaintiff can not recover herein.

The Government sets up the further defense that the payment in controversy having been made by the bonding company for the purpose of discharging its liability upon the bond, the plaintiff can in no event rightfully set up a claim to the money so paid, and that the statute with reference to refunds has no application to such a case, but the views above expressed make it unnecessary to give further consideration to the case.

Our conclusion is that the petition should be dismissed, and it is so ordered.

SECTION 283.—TAXES UNDER PRIOR ACTS.

SECTION 283. XI–15–5443
Ct. D. 469

INCOME TAX—REVENUE ACTS OF 1918, 1921, AND 1926—DECISION OF COURT.

1. RES JUDICATA—ACTION IN DISTRICT COURT—APPEAL FROM BOARD TO CIRCUIT COURT OF APPEALS.

Where at the time of the enactment of the Revenue Act of 1926 an appeal under subdivision (a) of section 274 of the Revenue Act of 1924 is pending before the Board of Tax Appeals from a deficiency determined by the Commissioner and the Circuit Court of Appeals on review of the Board's decision affirmed the order of the Board sustaining the deficiency, in an action thereafter brought in the district court to recover a part of the original assessment, all questions raised in the proceedings before the Board are res judicata.

2. ASSESSMENT—LIMITATION—WAIVER.

Where the Commissioner and the taxpayer pursuant to section 250(d) of the Revenue Act of 1921 consent in writing to a later determination, assessment, and collection of a tax, the waiver extends the statutory period for the collection of a tax assessed before the filing of the waiver.

DISTRICT COURT OF THE UNITED STATES, DISTRICT OF MASSACHUSETTS.

The Greylock Mills v. *Thomas W. White, Collector.*

[January 13, 1932.]

OPINION.

BREWSTER, J.: This is an action brought against the collector of internal revenue for this district, to recover income, war-profits and excess-profits taxes, assessed for the period January 1 to June 30, 1918. The issues were presented upon an agreed statement of facts and documentary and other evidence offered at the hearing, from which the following facts appear:

The petitioner, a Massachusetts corporation, on March 15, 1919, acting in the belief that it should return on a calendar-year basis, filed a tentative return for the calendar year of 1918, and on March 19, 1919, paid $100,000 on account of the estimated tax. The petitioner had kept its books on the basis of a fiscal year ending June 30, and later it was required to file a return for its fiscal year. On June 14, 1919, it filed a complete income and profit tax return for the fiscal year ending June 30, 1918. This return showed the income from July 1, 1917, to June 30, 1918. According to this return, the tax for the full fiscal year thereon, computed under the 1918 Revenue Act, amounted to $156,011.96. The amount of this tax attributable to the period falling within the calendar year 1918 was one-half of the total tax of $78,005.98. (Revenue Act of 1918, section 335(a); Regulations 45, article 1622.)

In August, 1919, the Commissioner, without an audit of the petitioner's books or records, and without making any change in the amount of income reported, or in the computation of the tax liability, made an assessment upon this return for this six months' period in the amount of $156,011.96. No explanation is offered for an assessment in excess of the amount shown on the return. On September 17, 1919, the petitioner filed a claim for a refund of the difference between $78,005.98 and the $100,000 already paid, and on December 30, 1919, filed a claim for an abatement in the amount of $56,011.96.

On January 12, 1923, the Commissioner advised the plaintiff that his tax liability was about $57,000 in excess of the original assessment. He then suggested that if the plaintiff desired to question this determination it execute the form of waiver accompanying his letter. On February 6, 1923, the waiver, duly executed, was received by the Commissioner and later signed by him. The waiver was unlimited as to time and waived all limitations relating to the "determination, assessment and collection" of the tax "due under any return made by" said corporation under the Revenue Act of 1918 "for the years 1917–1920 * * *."

On August 27 the Commissioner sent the usual 30-day letter advising the plaintiff of an additional assessment for the first six months of 1918 of $14,568.67. The accompanying statement showed a total tax liability with respect to that period of $170,580.63 and an original assessment of $158,011.96. This was followed by the usual 60-day letter under date of December 18, 1925. Plaintiff filed an appeal to the Board of Tax Appeals on February 12, 1926. In the proceedings before the Board the parties entered into a stipulation that the correct amount of the deficiency was $9,878.13 added to an original assessment of $156,011.96. So far as the 1918 tax is concerned, the whole controversy before the Board of Tax Appeals related to the validity and effectiveness of the waiver to extend the time for an additional assessment beyond the statutory period. The Board of Tax Appeals (9 B. T. A., 1281) held the waiver to be valid and that it authorized the assessment and collection of the deficiency. Accordingly, the deficiency was assessed on May 5, 1928, and paid May 22, 1928. Thereafter, the petitioner on or about June 5, 1928, pursuant to the provisions of the Revenue Act of 1926, sought a review in the Circuit Court of Appeals for the Second Circuit. That court, on April 1, 1929, affirmed the order of the Board of Tax Appeals. (31 F. (2d), 655.) On June 20, 1929, the plaintiff filed a petition for writ of certiorari with the Supreme Court which was denied October 21, 1929. (280 U. S., 566.)

Since the appeal to the Board of Tax Appeals was taken before the enactment of the Revenue Act of 1926 and was pending when the Act was passed, the plaintiff did not lose its rights by its appeal to invoke the jurisdiction of this court. (Revenue Act of 1926, section 283(b).) But all questions raised in

the proceedings before the Board are res adjudicata. (Revenue Act of 1926, section 283(b); *Old Colony Trust Co.* v. *Commissioner of Internal Revenue*, 279 U. S., 716, 728 [Ct. D. 80, C. B. VIII–2, 222].) The following matters, therefore, must fall within the doctrine of res adjudicata:

(1) That the plaintiff's total tax liability for the period in 1918 ending June 30 was $165,890.09;

(2) That of this amount $156,011.96 was assessed as an original assessment and $9,878.13 was assessed as a deficiency;

(3) That the waiver of February 6, 1923, was a valid waiver and was effective to extend the time for assessing said deficiency to the dates when it was, in fact, assessed;

(4) That no adequate notice was given by the plaintiff to the Commissioner to the effect that after the lapse of a reasonable time the waiver would be regarded as at an end.

If the original assessment was erroneous, as it seems to have been, the error has been completely cured, and it is now too late to revise the assessment. (*Greylock Mills* v. *Commissioner of Internal Revenue*, 18 B. T. A., 75.)

The only question open to the petitioner at this time is whether the waiver can be extended to cover a collection in 1929 of the balance of an assessment made in 1919.

That a waiver extending the time for assessment also extends the time for collecting the tax so assessed must be conceded on the authorities. (*Stange* v. *United States*, 282 U. S., 270 [Ct. D. 138, C. B. VIII–2, 268]; *Aiken, Admx.*, v. *Burnet, Com'r.*, 282 U. S., 277 [Ct. D. 275, C. B. X–1, 417]; *Brown & Sons Lumber Co.* v. *Burnet, Com'r.*, 282 U. S., 283 [Ct. D. 279, C. B. X–1, 274].)

I am inclined to agree with the Circuit Court of Appeals for the Second Circuit that plaintiff's waiver was broad enough to authorize the collection of taxes already assessed as well as those subsequently assessed. (*Greylock Mills* v. *Commissioner of Internal Revenue*, supra; *Roy & Titcomb, Inc.*, v. *United States*, 39 F. (2d), 753 [Ct. D. 201, C. B. IX–2. 244], affirmed without opinion 282 U. S., 811.)

It is the plaintiff's first contention that the circumstances disclosed by the evidence require the conclusion that the parties intended that the waiver should be limited in its application to taxes thereafter assessed. While it is true that when the waiver was given the case of *Bowers* v. *New York & Albany Lighterage Co.* (273 U. S., 346 [T. D. 4009, C. B. VI–1, 268]) had not been decided and the Commissioner was proceeding on the assumption that the limitations of the statute did not apply to collection by distraint, I am unable to adopt the limited construction which plaintiff would give to the language of the waiver. I am satisfied that the waiver was intended to embrace all liability under the 1918 return then pending, whether then or thereafter determined. (Compare *Aiken, Admx.*, v. *Burnet, Com'r.*, supra.) When the waiver was given, a claim for refund and a claim for abatement of a portion of the original assessment were pending. Until the tax liability for the period had been accurately determined by the Commissioner, he would not know whether the plaintiff owed the tax assessed, and until these claims were passed upon he could very properly refrain from collecting the tax. It must have been contemplated by both the taxpayer and the Commissioner that the period of limitation would expire before such determination was reached. In fact, it had expired before the claims were rejected. There is nothing in the situation that shows that the parties did not intend what was clearly expressed in the terms of the waiver.

Secondly, the plaintiff contends that, if the waiver covered taxes already assessed, since it was not limited in time it operated to extend the time for a reasonable period only, and that such reasonable period had expired before any steps were taken to collect the balance of the original assessment.

The pertinent facts bearing on this contention not already stated were that on August 13, 1925, a warrant of distraint was issued for the collection of this balance. A deputy collector undertook to serve the warrant on September 3, 1925, and again on December 18, 1925. Both attempts consisted of nothing more than a demand which was refused on the ground that the statute of limitations had run against the collection of this tax. On January 29, 1926, this balance was included in a report of uncollectible corporation taxes for the year 1918 forwarded to the Commissioner of Internal Revenue who, on June 30, 1926, included the balance on a schedule of assessments abated as uncollectible. On September 13, 1929, this action was reversed and the balance restored to its original status.

According to the agreed statement of facts, the plaintiff received notice by letter, dated August 31, 1926, that its claim for refund of a portion of the tax originally assessed would be rejected and that the claim for an abatement was rejected in a schedule dated December 20, 1929, but it appears, in the 30-day letter dated August 27, 1925, that the petitioner was then advised that, since the audit of 1918 income and profits tax return resulted in a deficiency of the tax for that year, its claim for abatement of $56,011.96 would be rejected in full.

The unpaid assessment against the plaintiff in the amount of $56,011.96 for the period in question, together with interest in the amount of $22,677.69, was satisfied in part by credits and in part by cash payments. The credits, amounting in all to $58,518.84, were applied between June 28 and October 16, 1929. Substantially all of the credits were applied on or before August 27, 1929. In two instances refunds had been allowed and checks issued therefor which were subsequently canceled on March 28, 1927, and July 8, 1929, respectively. The balance of $20,170.81 was paid in cash on December 9, 1929. On July 5, 1929, the plaintiff received a communication from the defendant collector advising him that after applying certain of the credits there was a balance of $69,432.84 due on the taxes for the fiscal year ending June 30, 1918. Thereupon the plaintiff on the 21st day of September, 1929, filed a second appeal with the Board of Tax Appeals alleging that the communication amounted to a notice of further deficiency. The Board, however, declined to take jurisdiction and dismissed the appeal on November 9, 1929. (18 B. T. A., 75.)

Judge Swan, in dealing with the plaintiff's waiver in the case of *Greylock Mills* v. *Commissioner of Internal Revenue* (31 F. (2d), 655 [Ct. D. 98, C. B. VIII–2, 253]) strongly intimated that the proper rule to apply in cases of unlimited waiver was to treat the waiver as continuing in force until the taxpayer had given the Commissioner notice that he would regard the waiver as at an end unless the assessment, or collection, was made within a reasonable time after the notice. (See also *Wirt Franklin* v. *Commissioner*, 7 B. T. A., 636.)

It has already been determined that no such notice was given by the taxpayer and, if we adopt this rule, it is unnecessary to canvass the above facts in order to ascertain whether they supply an excuse for the Commissioner's delay in collecting the tax. The plaintiff, however, argues that although the Commissioner received an unlimited waiver it is his duty to act by assessing and collecting within a reasonable time. (*Cunningham Sheep & Land Co.*, 7 B. T. A., 652; *A. Cellers et al.* v. *Commissioner*, 16 B. T. A., 411; *William S. Doig, Inc.*, v. *Commissioner*, 13 B. T. A., 256.)

What is a reasonable time, of course, depends in each case upon the particular facts of that case.

In the case at bar I find we reach the same end whichever rule is adopted: for it must be noted that when the waiver was given claims for refund and claims for abatement were pending. Until such claims were disposed of, the Commissioner was justified in refraining from taking steps to collect. (*Graham & Foster* v. *Goodcell*, 282 U. S., 409 [Ct. D. 287, C. B. X–1, 191].)

That the deficiency assessment was made within a reasonable time has already been adjudicated. Immediately upon the receipt of the 60-day notice of this deficiency an appeal was taken which was not determined until April 1, 1928. Following this was a petition for review in the Circuit Court of Appeals which was not determined until April 1, 1929, and on June 20, 1929, the plaintiff had petitioned the Supreme Court for a writ of certiorari which was not denied until October 1, 1929. In all of these proceedings the plaintiff had vigorously attacked the validity and effectiveness of the waiver and, if it had prevailed, the result would have been that the Government was without right to collect not only the deficiency but the original tax as well.

Although the claims in abatement and the proceedings before the Board of Tax Appeals and the Circuit Court of Appeals did not operate to stay the hands of the collector, yet, since the whole controversy centered around the question whether the statute of limitations had been extended by the waiver, the plaintiff can not complain if the Bureau of Internal Revenue saw fit to await the outcome of the litigation before renewing any efforts to collect the tax.

The order of the Board of Tax Appeals was not affirmed until April 1, 1929, and the delay which ensued subsequent to that time would not seem to me to be unreasonable. It is an important consideration that the total amount of taxes assessed was admittedly the correct amount due for the six months' period, and the burden rests upon the taxpayer to show that the delay of the

Commissioner was unreasonable and arbitrary. (*Niles Bement Pond Co.* v. *United States*, 281 U. S., 357 [Ct. D. 185, C. B. IX–1, 295]; see also *Lucas, Com'r.*, v. *Kansas City Structural Steel Co.*, 281 U. S., 264 [Ct. D. 223, C. B. IX–2, 299].)

It is said in *Graham & Foster* v. *Goodcell* (282 U. S., 409, at 421), that "In the case of a taxpayer, believed to be solvent, who had filed a claim in abatement, the postponement of collection would normally take place without agreement."

I think the same observation could be made respecting the case of a taxpayer, believed to be insolvent, who was contesting the right of the Government to collect in administrative boards and the courts.

I see no merit in the plaintiff's claim that the interdepartmental steps taken in 1926, relative to the collection of this tax, operate to terminate the waiver. That the Commissioner did not accept the views of the plaintiff as to the effect of it on the statute of limitations is evidenced not only by the litigation but also by the fact that in 1927 he was canceling refund checks already issued, apparently with the object of using these refunds as credits if the litigation should terminate favorably to the Government.

My conclusion is that the defendant was entirely within his rights in collecting the balance of the tax originally assessed.

Judgment for the defendant to be entered.

SECTION 283. XI–24–5511
Ct. D. 497

INCOME TAX—REVENUE ACT OF 1926—DECISION OF COURT.

ASSESSMENT—DEFICIENCY—LIMITATION—WAIVER—APPEAL TO BOARD.

Where the right to assess a tax for the year 1919 is extended by a consent in writing to December 31, 1925, the agreement providing that if an appeal is filed with the Board of Tax Appeals then said date shall be extended by the number of days between the date of mailing a notice of a deficiency and the date of final decision by the Board and the taxpayer before the enactment of the Revenue Act of 1926 appeals to the Board from a determination of a deficiency for that year under subdivision (a) of section 274 of the Revenue Act of 1924, which appeal is pending before the Board without a hearing thereon having been had at the time of the enactment of the Revenue Act of 1926, the time within which the Commissioner may assess the deficiency redetermined by the Board is governed not by the provisions of the waiver but, by virtue of section 283(b) of the Revenue Act of 1926, by the same provisions and limitations of that Act as are applicable in a case where the Commissioner determines that there is a deficiency imposed by the Revenue Act of 1926, notice of which the Commissioner sends to the taxpayer by registered mail, and the taxpayer files a petition with the Board.

COURT OF CLAIMS OF THE UNITED STATES. No. L–217.

Manz Corporation (Formerly J. Manz Engraving Co.) v. *The United States.*

[December 7, 1931.]

OPINION.

BOOTH, Chief Justice, delivered the opinion of the court.

The plaintiff is an Illinois corporation and brings this suit to recover an alleged illegal exaction of income and profits taxes for the calendar year 1919. The facts are stipulated and disclose the following situation:

May 12, 1920, plaintiff filed its income and profits-tax return for the year 1919 and paid the tax shown thereon. January 5, 1925, plaintiff executed and filed with the Commissioner a waiver of the statute of limitations with respect to assessment of income and profits taxes for 1919. This waiver extended the time for the assessment of said taxes to December 31, 1925, containing a provision, however, "that if a notice of a deficiency in tax is sent to said taxpayer by registered mail before said date and (1) no appeal is filed therefrom with

the United States Board of Tax Appeals then said date shall be extended 60 days, or (2) if an appeal is filed with said Board then said date shall be extended by the number of days between the date of mailing of said notice of deficiency and the date of final decision by said Board."

On November 4, 1925, the Commissioner mailed the plaintiff a deficiency letter notifying plaintiff of a deficiency in tax for the year 1919 of $11,701.46. December 31, 1925, the plaintiff filed with the Board of Tax Appeals a petition asking for a redetermination of its tax liability for 1919. On June 24, 1926, the Commissioner moved the Board of Tax Appeals to issue an order of redetermination showing a deficiency in plaintiff's taxes of $11,701.46 for 1919. Plaintiff by letter dated July 9, 1926, requested permission of the Board to withdraw its appeal. However, on July 28, 1926, the Board entered its decision redetermining plaintiff's tax liability for 1919 and decided against the plaintiff, sustaining the Commissioner, in the amount of $11,701.46.

Plaintiff took no appeal under section 1001 of the Revenue Act of 1926.

February 19, 1927, the Commissioner assessed a deficiency tax in the above amount against the plaintiff, which was subsequently, on March 4, 1927, paid by the plaintiff, i. e., $11,701.46 additional taxes and $689.74 interest thereon. January 13, 1930, the plaintiff filed with the Commissioner a claim for refund of the total amount of additional taxes paid as aforesaid, and interest thereon, predicating its right to a refund upon an allegation that the assessment of said amounts was made after the bar of the statute of limitations had run. May 23, 1930, the Commissioner denied the claim.

It is to be noted in the first instance that the waiver executed by the parties on January 5, 1925, had the effect, irrespective of any statutory provision, as conceded in the briefs, of extending the time within which the Commissioner might assess a deficiency of tax to 57 days after "the date of final decision by said Board." The plaintiff, insisting that the deficiency tax was not assessed until after the expiration of 57 days from the date of the final decision by the Board, rests its case upon three propositions:

First. That the date of final decision by said Board was July 28, 1926, i. e., the date stated in finding 6; and since this proceeding was instituted before the Board under the Revenue Act of 1924, the limitation provided in the waiver controlled the right of the Commissioner to assess, and the provision of section 1005(a) of the Revenue Act of 1926 that the decision of the Board should become final upon the expiration of six months after the entry thereof, being the time allowed for filing a petition for review, does not apply to this case.

Second. If the date of the final decision by the Board was not July 28, 1926, then the date on which it became final was August 27, 1926, i. e., 30 days after the decision under sections 900(f) of the Revenue Act of 1924 and 906 (b) and (d) of the Revenue Act of 1926—the 1924 Act providing that the decision of a division, unless reviewed by the Board within 30 days, should become the final decision and findings of the Board, and the 1926 Act providing that the report of a division, unless reviewed by the Board within 30 days, should become the report of the Board.

Third. That in any event the decision by the Board was not reviewable.

The waiver is conceded to have had this effect: It would have expired by its terms on December 31, 1925, if the Commissioner had not mailed to the plaintiff a deficiency notice. However, the notice of deficiency having been given on November 4, 1925, and an appeal to the Board of Tax Appeals having been taken by the plaintiff, the time limit of expiration was extended beyond December 31, 1925, 57 days, with the added period of time represented by the number of days between the date of the mailing of the deficiency notice and the date of final decision by the Board. Therefore it is clear that the vital issue in the case is the date when the decision of the Board of Tax Appeals became *final*. Although an appeal was taken to the Board of Tax Appeals under the Revenue Act of 1924, nevertheless the proceeding was pending before the Board and no hearing had been had thereon prior to the passage of the Revenue Act of 1926, approved February 26, 1926; therefore, the pertinent sections of the Revenue Act of 1926 are applicable to the proceedings and actions taken by the Board after its passage. Section 283 (a) and (b) of the Revenue Act of 1926 (44 Stat., 63) is as follows:

"(a) If after the enactment of this Act the Commissioner determines that any assessment should be made in respect of any income, war-profits, or excess-profits tax imposed by the Revenue Act of 1916, the Revenue Act of 1917, the Revenue Act of 1918, the Revenue Act of 1921, or the Revenue Act of 1924, or

by any such Act as amended, the Commissioner is authorized to send by registered mail to the person liable for such tax notice of the amount proposed to be assessed, which notice shall, for the purposes of this Act, be considered a notice under subdivision (a) of section 274 of this Act. In the case of any such determination the amount which should be assessed (whether as deficiency or as interest, penalty, or other addition to the tax) shall, except as provided in subdivision (d) of this section, be computed as if this Act had not been enacted, but the amount so computed shall be assessed, collected, and paid in the same manner and subject to the same provisions and limitations (including the provisions in case of delinquency in payment after notice and demand and the provisions prohibiting claims and suits for refund) as in the case of a deficiency in the tax imposed by this title, except as otherwise provided in section 277 of this Act.

"(b) If before the enactment of this Act any person has appealed to the Board of Tax Appeals under subdivision (a) of section 274 of the Revenue Act of 1924 (if such appeal relates to a tax imposed by Title II of such Act or to so much of an income, war-profits, or excess-profits tax imposed by any of the prior Acts enumerated in subdivision (a) of this section as was not assessed before June 3, 1924), and the appeal is pending before the Board at the time of the enactment of this Act, the Board shall have jurisdiction of the appeal. In all such cases the powers, duties, rights, and privileges of the Commissioner and of the person who has brought the appeal, and the jurisdiction of the Board and of the courts, shall be determined, and the computation of the tax shall be made, in the same manner as provided in subdivision (a) of this section, except as provided in subdivision (j) of this section and except that the person liable for the tax shall not be subject to the provisions of subdivision (d) of section 284."

Subdivision (b) of the foregoing section continues the jurisdiction of the Board of Tax Appeals over proceedings pending when the Act of 1926 became effective, and provides that in all such cases the powers, duties, rights, and privileges of the Commissioner and of the person who has brought the appeal, and the jurisdiction of the Board and of the courts, shall be determined, and the computation of the tax shall be made in the same manner as provided in subdivision (a) quoted above. In other words, in so far as the right of the Commissioner to assess and collect a deficiency is concerned, all cases pending before the Board which had not been heard and decided upon the passage of the Revenue Act of 1926 were to be governed by the same provisions and limitations as cases arising by the mailing by the Commissioner of a deficiency notice after the enactment of the Revenue Act of 1926, and were also to be governed by the same provisions and limitations as in the case of a deficiency in tax imposed by the Revenue Act of 1926. Therefore the deficiency in the plaintiff's tax for 1919 determined by the Board was to be assessed and collected precisely as if the proceeding now challenged by it had originated under the Revenue Act of 1926.

Section 274(a) of the Revenue Act of 1926 (44 Stat., 55), dealing with deficiency assessments, reads as follows:

"(a) If in the case of any taxpayer, the Commissioner determines that there is a deficiency in respect of the tax imposed by this title, the Commissioner is authorized to send notice of such deficiency to the taxpayer by registered mail. Within 60 days after such notice is mailed (not counting Sunday as the sixtieth day), the taxpayer may file a petition with the Board of Tax Appeals for a redetermination of the deficiency. Except as otherwise provided in subdivision (d) or (f) of this section or in section 279, 282, or 1001, no assessment of a deficiency in respect of the tax imposed by this title and no distraint or proceeding in court for its collection shall be made, begun, or prosecuted until such notice has been mailed to the taxpayer, nor until the expiration of such 60-day period, nor, if a petition has been filed with the Board, until the decision of the Board has become final. Notwithstanding the provisions of section 3224 of the Revised Statutes the making of such assessment or the beginning of such proceeding or distraint during the time such prohibition is in force may be enjoined by a proceeding in the proper court."

Obviously, under the above provision, the facts in this case, and the provision of section 1005(a) of the Revenue Act of 1926 providing that the decision of the Board shall become final upon the expiration of the time allowed for filing a petition for review, if no such petition is filed, the Commissioner was prohibited from proceeding to assess a deficiency tax until the expiration of 60 days from the date of the deficiency notice and until the decision of the Board became final. Section 1001, stated as an exception in the above-quoted section with reference to the right of the Commissioner to assess, provides in sub-

division (c) thereof that the right of review shall not operate as a stay of assessment or collection of any portion of the deficiency determined by the Board until a petition for review in respect of such portion is filed by the taxpayer, and then only if the taxpayer on or before the time his petition for review is filed has executed a bond in such sum as the Board may fix. Further, section 277 relating to the limitation for assessment and collection of taxes provides, in subdivision (b) thereof, that the running of the statute of limitations provided in this section or section 278 on the making of assessments and the beginning of distraint or a proceeding in court for collection, in respect of any deficiency, shall after the mailing of a notice under subdivision (a) of section 274 be suspended for the period during which the Commissioner is prohibited from making the assessment or beginning distraint or a proceeding in court, and for 60 days thereafter. The provisions of the 1926 Act with reference to the time for assessment and collection are applicable to this case. But the plaintiff contends that when it and the Commissioner consented in writing to a limited waiver of the time within which a deficiency tax might be assessed and collected, decisions of the Board of Tax Appeals were not reviewable by any other agency and such decisions were not final, and that it is apparent therefore that the word "final" as employed in the waiver, and in the understanding of both parties thereto, was employed wholly in an adjective sense. That is, it was intended to be used and it was used as being synonymous with last, ultimate, closed, etc. In *Florsheim Bros. Drygoods Co.* v. *United States* (280 U. S., 453, 465–468 [Ct. D. 167, C. B. IX–1, 260]), the court held that the limitation provisions of the Revenue Acts of 1924 and 1926 were applicable, notwithstanding a waiver had been executed prior to their passage fixing a definite date for the expiration of the time for assessment and collection; and upon a contention similar to that here made, the court said that "obviously, the Commissioner did not undertake to limit the power of Congress to extend the period of limitations as consideration for the waivers." See also *Brown & Sons Lumber Co.* v. *Commissioner* (282 U. S., 283 [Ct. D. 279, C. B. X–1, 274]).

Plaintiff further contends that the Commissioner could have made a jeopardy assessment; that a final decision by the Board, as provided in the waiver, is not the same as a final decision of the Board; and, in any event, the decision of the Board was not reviewable because it was equivalent to a consent decree and, therefore, the statutory provision that the decision of the Board should become final upon the expiration of the time allowed for filing a petition for review did not apply. The record in this case affords no justification for a jeopardy assessment and, even if it did, this court would not inquire into the matter. (*Williamsport Wire Rope Co.* v. *United States*, 277 U. S., 551 [T. D. 4172, C. B. VII–2, 323].) As stated above, the provisions of the 1926 Act, and not the waiver, govern the right of the Commissioner to assess and collect. We need not decide whether the judgment of the Board in this case was reviewable. The date on which it became final and the time within which the Commissioner might assess and collect were fixed by the statute, and he acted within that time. There is no provision in the statute that requires the Commissioner to assess and collect earlier in a case where the Board renders a judgment upon a motion by the Commissioner for judgment upon the pleadings raising a question of law, or where the parties may stipulate the amount of judgment without trial. The petition must be dismissed, and it is so ordered.

SECTION 284.—CREDITS AND REFUNDS.

ARTICLE 1301: Authority for abatement, credit, and refund of tax.

REVENUE ACT OF 1926.

Overpayment and refund as affected by tax due but barred from assessment. (See Ct. D. 443, page 130.)

ARTICLE 1301: Authority for abatement, credit, and refund of tax. XI-16-5451 Ct. D. 472

INCOME TAX—REVENUE ACT OF 1926—DECISION OF COURT.

CREDITS—ADJUSTMENT—APPLICATION OF OVERPAYMENTS TO A TAX DUE—AUTHORITY OF COMMISSIONER.

Where, before the Commissioner sends a 60-day letter under section 274(a) of the Revenue Act of 1926, he mails notice of overpayments for the years 1917, 1918, and 1919 and of a proposed deficiency for the year 1920 in an amount in excess of the overpayments, the tender of a part of the proposed deficiency on the day the notice was mailed but before its actual receipt is properly refused, there being a tax "then due from the taxpayer" for the year 1920 within the meaning of section 281(a) of the Revenue Act of 1926 which requires the Commissioner to credit the overpayments determined by him against the deficiency.

UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF CALIFORNIA, SOUTHERN DIVISION. AT LAW.—No. 18306K.

The United States, plaintiff, v. *Pacific Midway Oil Co., a Corporation, defendant.*

[December 31, 1931.]

OPINION.

KERRIGAN, Judge: Two of the matters disputed in this case have been eliminated from consideration by concessions of the Government: It has abandoned its contention that there was an illegal refund on the overassessment of the defendant's tax for 1921; it has conceded that a credit of $85.26 should be allowed defendant upon the computation of interest upon its 1920 deficiency.

The sole question then is, Should the collector of internal revenue have credited the overpayments of the defendant's taxes for 1917, 1918 and 1919 against its deficiency of $86,557.19 for the year 1920 which would have necessitated a refusal to refund the overpayments with interest? The Government's contention that he should have done so appears to be supported by the authorities construing the sections of the law on set-off of overpayments against deficiencies and on the allowance of interest upon deficiencies and overpayments.

The only difficulty in this case arises from the fact that the sum of $85,000 was paid by the defendant to the collector upon November 10, 1926, to be applied upon its 1920 deficiency. This was the same day that notice was mailed from Washington to defendant advising it of the respective overpayments and the deficiency. Subsequently this sum was applied to the deficiency leaving a balance of $1,577.19 with interest on the deficiency from February 26, 1926, amounting to $3,676.56. The total of these amounts was considered by the collector to be the amount of tax "then due" under the terms of the section on set-off (Revenue Act of 1926, section 284(a)) and was the only sum deducted from the overpayments to be refunded. As a result the balance of the overpayments with interest thereon from the respective dates of overpayment was paid to the taxpayer; the payment of this interest was improper. Had the collector not applied the payment of $85,000 to the deficiency, he would have set off the full amount of the overpayments against the deficiency, leaving a balance of $64,531.26 with interest payable from February 26, 1926, under the terms of section 283(d) of the Revenue Act of 1926.

The authorities hold that there shall be no refund of overpayments to the taxpayers unless there is a net balance in favor of the taxpayer on the theory that "any other interpretation would permit the taxpayer * * * to exact from the Government interest when the net balance was against him." (*McCarl* v. *Leland*, 42 Fed. (2d), 346; *Tull and Gibbs* v. *U. S.* (C. C. A. 9), 48 Fed. (2d), 148.) This rule was applied in the McCarl case where the determination of the deficiency was pending on appeal and in the Tull and Gibbs case where the amounts of the deficiencies had not been ascertained but where

it was known that there were deficiencies. The courts have given weight to the fact that the statutes require the Government to pay interest on overpayments from the date they were made while it can only collect interest on deficiencies from February, 1926. Two cases consider the effect of a tender of the deficiency. In *Lucas* v. *Blackstone* (45 Fed. (2d), 291 [Ct. D. 356, C. B. X–2, 270]) it was held that a tender was properly refused by the Commissioner when there had been overpayments by the taxpayer even though the overpayments had not been scheduled until after the tender. The case of *York Safe & Lock Co.* v. *U. S.* (40 Fed. (2d), 148) expressly leaves open the situation where, as in this case, the payment was made after notice of the determination of the deficiency but before the determination became final. It is immaterial that the notice was not actually received until after the tender. Evidently the taxpayer had a representative in Washington who was keeping it advised of the progress of its matters pending before the Commissioner and who did advise the taxpayer of the fact of the determination the day the notice was sent out. It seems to be the rule that if the payment of the deficiency is made under such circumstances that the court believes it was made to defeat the Government's right to set-off overpayments against deficiencies and thus require the payment of interest upon overpayments, such payment should be applied only to the *net balance of the deficiency.* The Government is therefore entitled to the interest improperly paid. Since this money is now in the hands of the Government, having been withheld upon a subsequent adjustment of an overassessment, the Government is only entitled to interest from the date of its payment to the taxpayer to the date of such subsequent adjustment.

According to the suggestion in *Parker* v. *St. Sure*, decided by the Circuit Court of Appeals for the Ninth Circuit on October 26, 1931 (see Supplement to Manual of Federal Appellate Procedure by Paul P. O'Brien, pages 5 and 6), this opinion is adopted by me as my findings of fact and conclusions of law. In order that the defendant's record on appeal may be further protected, defendant's motion for special findings is denied; exception noted.

Let judgment be entered in accordance with the principles stated in this opinion in favor of the United States with costs.

ARTICLE 1305: Limitations upon the crediting and refunding of taxes paid.

XI–13–5426
Ct. D. 461

INCOME TAX—REVENUE ACT OF 1926—DECISION OF COURT.

1. REFUND—LIMITATION—OVERPAYMENT FOUND BY BOARD OF TAX APPEALS.

Where a taxpayer appeals to the Board of Tax Appeals under section 284(d) of the Revenue Act of 1926 from a deficiency determined for the taxable year 1919 and the Board, in accordance with the provisions of section 284(e) of the Revenue Act of 1926 as amended by section 507 of the Revenue Act of 1928, finds, after the enactment of the latter Act, that the taxpayer has made an overpayment in respect of the tax for that year, the right to sue for the overpayment is given by section 284(e) and as provided in that subdivision as amended, unless a claim for refund or the petition to the Board is filed within the time prescribed for filing claims in section 284(g) of the Revenue Act of 1926, no refund can be made of any portion of the tax paid more than four years before the filing of the claim or the filing of the petition, whichever is earlier.

2. SAME—FINDINGS OF BOARD OF TAX APPEALS—RES JUDICATA.

The findings of the Board of Tax Appeals that there has been an overpayment of tax in respect of the taxable year in respect of which the Commissioner determines a deficiency is not res judicata and binding on the Court of Claims with respect to the question whether a refund of the overpayment is barred because of the taxpayer's failure to file a sufficient claim therefor within the prescribed statutory time.

8. SAME—ACCOUNT STATED.

Where the Board of Tax Appeals in accordance with section 284(e) of the Revenue Act of 1926 as amended by section 507 of the Revenue Act of 1928 determines that there has been an overpayment of tax at a time when a refund of the overpayment is barred by the statute of limitations, the decision of the Board does not give rise to an account stated upon which the taxpayer may bring suit and the time within which a suit for the overpayment can be instituted is governed by the provisions of section 3226, Revised Statutes, as amended, and not by the provisions of section 156 of the Judicial Code as for suits upon claims against the United States, and the right to recover is dependent upon whether a timely and sufficient claim for refund is filed. Section 284(d)2 of the Revenue Act of 1926 is inapplicable to such overpayment.

4. SUIT—LIMITATION—CLAIM FOR REFUND—AMENDED CLAIM.

Where a claim for refund is filed which does not mention any of the items giving rise to an overpayment determined by the Board of Tax Appeals in accordance with section 284(e) of the Revenue Act of 1926 and the overpayment does not relate to any of the grounds specified in the claim, the claim does not constitute a claim for refund under section 3226 of the Revised Statutes, as amended, which will support a suit for such overpayment and a claim for refund filed after the expiration of the period of limitation for filing the same which does not relate to any of the matters specified in the earlier claim is not an amendment of the first claim so as to give the taxpayer any greater right than existed under the first claim.

COURT OF CLAIMS OF THE UNITED STATES. No. L–49.

National Fire Insurance Co. v. *The United States.*

[October 20, 1931.]

OPINION.

LITTLETON, Judge, delivered the opinion of the court.

Plaintiff contends, first, that the jurisdiction of this court to entertain this action is not governed by the provisions of sections 3226 and 3228 of the Revised Statutes requiring a claim for refund to be filed and suit to be instituted within a certain time thereafter but is governed by the general limitation provision of section 156 of the Judicial Code giving six years within which to sue upon claims against the United States; secondly, that the final decision of the United States Board of Tax Appeals entered July 29, 1929, finding an overpayment of $33,349.76, is *res adjudicata* and, as such, binding upon this court for the total amount sued for; thirdly, that plaintiff may also in this action recover interest upon the overpayment determined by the Board of Tax Appeals; and, fourthly, that, notwithstanding issues (1) and (2), its claim for refund of March 12, 1925, is sufficient in law to entitle it to maintain this suit and recover the overpayment in question.

On the other hand, the defendant insists that under the provisions of section 284 of the Revenue Act of 1926 and section 507 of the Revenue Act of 1928, the latter Act being in effect at the time of the entry of the decision by the Board of Tax Appeals, the plaintiff can not recover the overpayment determined by the Board for the reason that it failed to file a claim for refund therefor within the time allowed by subdivision (g) of section 284, supra.

We are of opinion, first, that under section 284 of the Revenue Act of 1926 plaintiff was required to file a proper claim for refund on or before April 1, 1927, which it did not do; secondly, the United States Board of Tax Appeals has held that its jurisdiction extends only to the determination of the fact of overpayment and the amount thereof (*Dickerman & Englis, Inc.*, 5 B. T. A., 633; *W. H. Hill Co.*, 23 B. T. A., 605), and we find no reason to question the correctness of these decisions. The decision of the Board of Tax Appeals is not therefore *res adjudicata* and binding on this court with respect to the question here involved. Thirdly, that the right to sue for the overpayment is given by

section 284(e) of the Act of 1926; that in the circumstances of this case the time within which this suit could be instituted is governed by the provisions of section 3226 of the Revised Statutes, as amended, and not by the provision of section 156 of the Judicial Code as for suits upon claims against the United States, and that the right to recover is dependent upon whether a timely and sufficient claim for refund was filed.

In *Ohio Steel Foundry Co.* v. *United States* (69 C. Cls., 158, 38 Fed. (2d), 144) and *Arthur Curtiss James* v. *United States* (69 C. Cls., 215, 38 Fed. (2d), 140 [Ct. D. 175, C. B. IX–1, 241]) this court pointed out that in cases where the Board of Tax Appeals determines an overpayment and no question of credits is involved, and the refund of the overpayment was not barred by the statute of limitation at the time of the decision by the Board, suit might be brought within six years from the date the right to the overpayment accrued as for a claim against the United States in the event the Commissioner refused to refund the overpayment determined by the Board. (See *Bowcit Teller & Co.* v. *United States*, 283 U. S., 258 [Ct. D. 334, C. B. X–1, 328].) But that rule does not apply here inasmuch as the refund was not allowed within the time during which the overpayment could be refunded without the filing of a claim therefor. Plaintiff did not comply with the statutory requirement that a claim for refund be filed on or before April 1, 1927, so as to authorize the refund of the overpayment or the institution of suit therefor at a later date. The decision of the Board of Tax Appeals finding the overpayment in question did not therefore give rise to an account stated upon which the plaintiff might bring suit within six years. Section 284(e) specifically prohibits the refund or credit of any overpayment determined by the Board unless a timely and sufficient claim for refund is filed.

The claim for refund filed by plaintiff March 12, 1925, was allowed in part and rejected in part by the Commissioner and no suit was brought thereon. None of the items giving rise to the overpayment finally determined by the Board upon stipulation filed by the parties, and upon which this is based, was mentioned in this claim; nor did the overpayment in question directly relate to any of the grounds specified in the claim of March 12, 1925. The claim of December 23, 1927, was not an amendment of the first claim in that the grounds thereof did not relate to any of the matters specified in the earlier claim. It was filed more than eight months after the time allowed by section 284(g) of the Revenue Act of 1926 for filing of a claim for 1919. Plaintiff seems to place some reliance upon the provisions of section 284(d)2 of the Revenue Act of 1926, but that subdivision has no bearing upon the question here involved. It authorizes the Commissioner of Internal Revenue to make a credit or refund, and authorizes the institution of suit to recover an amount which the Commissioner may collect, after the decision of the Board has become final, in excess of the tax computed in accordance with the final decision of the Board.

The petition must be dismissed, and it is so ordered.

ARTICLE 1305: Limitations upon the crediting and refunding of taxes paid.

XI–13–5427
Ct. D. 462

INCOME AND EXCESS PROFITS TAXES—REVENUE ACT OF 1926—DECISION OF COURT.

1. REFUND—LIMITATION—DECREASE OF INVESTED CAPITAL.

The tax imposed upon a corporation for each of the years 1910, 1911, and 1912 not being an income, war-profits, or excess-profits tax, the taxpayer is not entitled to a refund of overpayments for those years pursuant to section 284(c) of the Revenue Act of 1926, which provides for the refund only of "an overpayment of income, war-profits, or excess-profits tax."

2. SAME.

Whether the invested capital of a taxpayer is decreased by the Commissioner within the meaning of section 284(c) of the Revenue Act of 1926 must be ascertained by comparing the amount determined by the Commissioner to be correct with the amount returned by the taxpayer and where there is an increase by the Commissioner in the amount of invested capital over that returned by the taxpayer that subdivision has no application.

DISTRICT COURT OF THE UNITED STATES FOR THE WESTERN DISTRICT OF MISSOURI IN THE WESTERN DIVISION.

First National Bank of Kansas City, Mo., plaintiff, v. United States of America, defendant.

[October 27, 1931.]

OPINION.

The petition here is bottomed on section 284 of the Revenue Act of 1926 which, so far as pertinent, is as follows:

"Where there has been an overpayment of any income, war-profits, or excess-profits tax * * * the amount of such overpayment shall * * * be refunded. * * * No such * * * refund shall be * * * made * * * unless * * * a claim therefor is filed * * * (except that)—If the invested capital of a taxpayer is decreased by the Commissioner, and such decrease is due to the fact that the taxpayer failed to take adequate deductions in previous years, with the result that there has been an overpayment of income, war-profits, or excess-profits taxes in any previous year or years, then the amount of such overpayment shall be * * * refunded, without the filing of a claim therefor * * *."

In the first count of the petition it is alleged that for the year 1910 (and succeeding years to and including 1918) the plaintiff did make an overpayment of income and excess-profits tax and that that overpayment was the result of a decrease by the Commissioner of the plaintiff's invested capital as for the year 1910 (and other years) and that that decrease was made because the plaintiff had failed to take adequate deductions in previous years.

Defendant's answer denies the allegations of the petition.

To be entitled to a refund under the section here relied on the plaintiff must prove, first, that there has been an overpayment of income, war-profits, or excess-profits tax, and, second (to obviate the effect of failing timely to file claim of refund and of the statute of limitations), that the overpayment resulted from a subsequent determination by the Commissioner that in previous years there was a failure to take adequate deductions from invested capital and a consequent decrease by the Commissioner in invested capital.

1. Since the sixteenth amendment was not proclaimed as a part of the Constitution until February 25, 1913, it would scarcely be contended that the plaintiff made any overpayment of "income, war-profits, or excess-profits tax" for the years 1910, 1911, and 1912. The tax paid for those years was none of these but a corporation excise tax. (*Flint* v. *Stone Tracy Co.*, 220 U. S., 107.) So far as those years are concerned the plaintiff has failed to prove the first essential of its cause of action.

2. The second essential of the cause of action involves proof that there has been a decrease by the Commissioner in the taxpayer's invested capital. Has this been proved here?

It has been stipulated by the parties that for 1919 the Commissioner determined plaintiff's invested capital to be $3,740,699.22 instead of $3,658,404.07, the amount returned; that for 1920 the Commissioner determined plaintiff's invested capital to be $3,965,924.17 instead of $3,946,962.85, the amount returned; that for 1921 the Commissioner determined plaintiff's invested capital to be $3,965,-924.17 instead of $3,946,962.85, the amount returned. In each of these years, in other words, the whole amount of invested capital, as returned by the plaintiff, was not decreased, but increased by the Commissioner.

But the plaintiff contends that whether within the meaning of section 284 there has been a decrease or increase in invested capital is to be ascertained by comparing the amount determined by the Commissioner to be correct not with the amount returned by the plaintiff but with the amount which should have been returned if the words "invested capital" had been given their statutory meaning. "Invested capital," plaintiff says, so far as this case is concerned, is the total amount of actual cash paid in for stock or shares plus the total amount of paid in or earned surplus and undivided profits. The several Revenue Acts do so define the words "invested capital." (Section 207, Revenue Act of 1917; section 326, Revenue Act of 1918.)

I can not think plaintiff's is a sound contention. The amount of the invested capital of a corporation at a given time certainly can not be increased or decreased by the Commissioner. He can only increase or decrease the

amount given by the taxpayer as invested capital. Obviously section 284 refers to such an increase or decrease as that.

Now what was done here was (*inter alia*) this:

The plaintiff invested in its banking building in 1905 $450,000. In 1905 and 1906 it charged off of this amount $125,000 as anticipated depreciation and thereafter carried on its books and returned as its invested capital, so far as its building was concerned, the sum of $325,000. This item was included in its return for 1919. The Commissioner first restored to invested capital the amount of $125,000 and then decreased the invested capital so increased by an amount less than $125,000 which decrease was for accumulated depreciation. The net result of this increase and decrease was an increase in the amount of invested capital over that returned. So that subdivision (c) of section 284 has no application. Unless the subdivision does apply the plaintiff, which did not file timely claims for refund, can not recover.

I make the following

FINDINGS OF FACTS.

1. The plaintiff was, during the time involved in this suit, and now is, a banking corporation organized, located, and doing business in Kansas City, Mo.

2. In the year 1905 the plaintiff erected a banking building in the city of Kansas City, Mo., at a total cost of $450,000, which included the cost of the land, the cost of erecting the building, and the cost of furniture and fixtures.

3. In 1905 and 1906 the plaintiff charged off against its undivided profits account sums aggregating $125,000, and thereafter the banking building and equipment was carried on the plaintiff's books at the sum of $325,000, and so remained through all of the years involved until the year 1919, when an adjoining property was purchased for $80,000 thereby increasing the building account to $405,000, which was reduced by depreciation in the amount of $1,500 on December 31, 1920, and $1,500 on December 31, 1921, thus reducing the amount at which the said building account was carried on the plaintiff's books to $402,000 at the end of 1921.

4. Beginning with the year 1910 the plaintiff each year purchased furniture and fixtures and in its returns of income deducted the amount of such purchases during the year of furniture and fixtures from its gross income as items of expense.

5. During all of the years involved the plaintiff, in stating its income, took no deduction for depreciation of the assets carried in its building and equipment account or of the furniture and fixtures purchased in 1910 and subsequent years.

6. The plaintiff filed no claims for refund of any taxes alleged to have been overpaid for the years 1909 to 1918, inclusive, due to failure on its part to take adequate deductions. The Commissioner of Internal Revenue, based upon an audit of the plaintiff's books and returns, in the year 1926 determined the correct tax liability of the plaintiff for all of the years, and in reaching his conclusion the Commissioner determined the depreciation which should have been taken on the depreciable assets of the plaintiff and disallowed the deduction for expense on account of purchases of furniture and fixtures in 1910 and subsequent years, and added to the invested capital of the plaintiff the amount of such purchases, together with the sum of $125,000, which had been written off by the plaintiff in 1905 and 1906.

7. The Commissioner of Internal Revenue, in making his adjustments for the year 1919, increased the amount of invested capital of the plaintiff from $3,658,404.07, as returned by the plaintiff (which included the building and equipment account carried on the books of the plaintiff at $325,000), to the sum of $3,740,699.22.

8. In making the adjustments for the year 1920 the Commissioner of Internal Revenue increased the invested capital of the plaintiff from the sum of $3,946,962.85, as returned by the plaintiff (which included the building and equipment account carried on the books of the plaintiff at $325,000), to the sum of $3,966,924.17.

9. For the year 1921 the Commissioner of Internal Revenue, in making his adjustment, increased the invested capital of the plaintiff to the sum of $4,290,586.36 from the sum of $4,274,103.60, as returned by the plaintiff (which included the building and equipment account carried on its books at $325,000).

10. In making his determinations of depreciation the Commissioner of Internal Revenue treated the building and equipment account and furniture and fixtures purchased in 1910 and subsequent years as a composite fund. The segregated

amounts of sustained depreciation on these two funds are stipulated, from which it appears that on January 1, 1919, the accumulated sustained depreciation on building and equipment amounted to $117,258.62 and on furniture and fixtures purchased in 1910 and subsequent years $12,577.88. Thus on January 1, 1919, the sum of $125,000 anticipated depreciation written off by the plaintiff in 1905 and 1906 had not been exhausted by the adjustments determined by the Commissioner.

11. In making his adjustments the Commissioner as of January 1, 1919, added to invested capital the sum of $125,000 written off by the plaintiff in 1905 and 1906 and the sum of $28,245.04, being the cost of the furniture and fixtures purchased in 1910 and subsequent years, making a total addition by him to the invested capital of $153,245.04. He deducted therefrom the sustained depreciation on the depreciable assets in the sum of $129,836.50, making a net increase made to invested capital by the Commissioner of Internal Revenue as of January 1, 1919, of $23,408.54, all of which had relation to the depreciable assets of the plaintiff.

12. In making his adjustments for the year 1919 the Commissioner of Internal Revenue allowed annual depreciation on the depreciable assets of the plaintiff in the sum of $12,693.24, as claimed by the plaintiff, and as a result determined an overassessment for the year 1919 of $6,483.50, which was refunded to the plaintiff. For the year 1920 the Commissioner allowed annual depreciation on the depreciable assets of the plaintiff of $13,426.55, as claimed by the plaintiff, and determined an overassessment for the year 1920 of $994.35, which amount was refunded to the plaintiff. In the adjustment for the year 1921 the Commissioner of Internal Revenue allowed annual depreciation on the depreciable assets of the plaintiff in the sum of $13,851.03 as claimed by the plaintiff, and determined an overassessment in the amount of $3,472.64, which amount was refunded to the plaintiff. No part of the deductions from invested capital represented by the allowance of annual depreciation for the years 1919, 1920, and 1921 was due to failure on the part of the plaintiff to take adequate deductions in previous years.

13. The net result of the adjustments of invested capital made by the Commissioner of Internal Revenue attributable to depreciation of depreciable assets was to increase the invested capital of the plaintiff in each of the years 1919, 1920, and 1921. Thus the Commissioner restored to invested capital the sum of $125,000 written off by the plaintiff in 1905 and 1906 and the sum of $42,606.63 representing the cost of furniture and fixtures purchased in 1910 and subsequent years and deducted as expense by the plaintiff, making a total restoration of $167,606.63 on account of the depreciable assets. From this the Commissioner deducted $155,956.29, the sustained depreciation on the depreciable assets, making a net increase in invested capital made by him on account of the depreciable assets of $11,650.34 as of January 1, 1921, which entered into his determination of the total invested capital of the plaintiff for the year 1921.

I make the following

CONCLUSION OF LAW.

Upon the findings of facts herein the plaintiff is not entitled to recover, and judgment for the defendant must be given on the first count of the amended petition, with costs.

Counsel for the defendant will submit an appropriate judgment entry for approval and filing.

ARTICLE 1306: Credits or refunds under prior Acts. XI-5-5374 Ct. D. 444

INCOME TAX—REVENUE ACTS OF 1918 AND 1926—DECISION OF SUPREME COURT.

1. OVERPAYMENTS—ALLOCATION—RETURNS REQUIRED FOR FISCAL YEARS FILED ON CALENDAR-YEAR BASIS.

Where a taxpayer files returns for the years 1918, 1919, and 1920 on the basis of a calendar year but is required by section 212(b) and section 226 of the Revenue Act of 1918 to file a return for the six months ended June 30, 1918, and for the fiscal years ended June 30, 1919 and 1920, and the payments made for the calendar years 1918 and 1919 exceeded the tax due computed on the basis of the fiscal year, the object of each payment is defined by the intention of the taxpayer which is ascertained by a consideration of

the returns which it filed. Accordingly, the overpayment of the tax for the six months ended June 30, 1918, must be treated as a payment on account of the tax accruing for the fiscal year 1919, and the payments for the calendar year 1919, exclusive of an amount refunded, when added to this overpayment exceeding the tax assessed for the fiscal year 1919, the excess of the tax due and payable for the fiscal year 1919 was in fact and in law a payment in advance on account of the tax on income for the fiscal year 1920.

2. REFUND—LIMITATION.

The words "date the return was due" in section 284(h) of the Revenue Act of 1926 do not refer to the return which the taxpayer in fact filed for the calendar year 1920 but the due date of the return required of the taxpayer for its fiscal year 1920. A claim for a refund "of a tax for the taxable year 1920," therefore, filed September 15, 1925, is not barred from allowance as provided in that paragraph, where the taxpayer is required to file a return for the fiscal year ended June 30, 1920, the due date of which was September 15, 1920.

SUPREME COURT OF THE UNITED STATES. No. 62.—OCTOBER TERM, 1931.

American Hide & Leather Co., petitioner, v. *The United States.*

On writ of certiorari to the Court of Claims.

[January 4, 1932.]

OPINION.

Mr. Justice STONE delivered the opinion of the court.

The case is here on certiorari (284 U. S., 599) to review a judgment of the Court of Claims, denying recovery of an overpayment of income taxes because barred by the statute of limitations. (48 F. (2d), 430, 434.) Claim for refund was filed September 15, 1925, and the questions presented are whether the court below correctly held that the admitted overpayment was of the tax due and payable for petitioner's fiscal year ending June 30, 1918, so that the bar of the statute had fallen at the time of the claim for refund, or was of taxes on income for the fiscal period ending June 30, 1920, and, if the latter, whether recovery was barred by the statute of limitations.

Petitioner filed income tax returns for the calendar years 1918, 1919, and 1920, although in each of those years it had kept its books on the basis of a fiscal year ending June 30. By section 212(b) of the Revenue Act of 1918 (ch. 18, 40 Stat., 1057, 1064), returns were required to be made on the basis of the fiscal year, as shown by the taxpayer's books of account, and under the applicable section and regulation petitioner was required to file a return for the six months ending June 30, 1918, and for the years ending on June 30, 1919 and 1920. (Section 226, 40 Stat., 1057, 1075; Treasury Regulations 45, article 431.) Pursuant to its returns for the calendar years in question, petitioner paid taxes as follows:

For the calendar year—		
1918		$1,246,271.24
1919		1,113,509.41
1920		None.
		2,359,780.65
Refunds of the taxes paid were made in the following amounts, to which interest was added:		
May 17, 1928	$217,194.58	
Aug. 17, 1928	94,835.16	
		312,029.74
Net taxes paid for the calendar years 1918, 1919, 1920		2,047,750.91
The correct tax for the period in question as computed by the Commissioner on the basis of amended returns for petitioner's fiscal years:		
For the 6 months ending June 30, 1918	$708,068.47	
For the fiscal year ending June 30, 1919	896,314.83	
For the fiscal year ending June 30, 1920	None.	
		1,604,383.30
Total overpayment for the period in question		443,367.61

The Government contends that as the only return petitioner was authorized by the statute to make for the year 1918 was for the six months January 1 to June 30, petitioner's return for the calendar year can be given effect only as a return for that six months and payments of the tax as returned must be deemed, as the Court of Claims held, to be on account of the tax due for the six months, with a consequent overpayment for that period in the sum of $538,202.77. Of this overpayment, $94,835.16 has been refunded, and, as petitioner concedes, recovery of the $443,367.61 balance is barred by the statute of limitations if it be treated as an overpayment attributable to that period.

The petitioner insists that the amount paid as tax for each of the calendar years 1918 and 1919 should be divided and one-half applied to payment of the tax due for the fiscal period ending June 30 and one-half to payment of the tax due for the following fiscal year, the first six months of which were the last six months of the calendar year for which the tax was paid. This would result in an underpayment for the six months ending June 30, 1918, of $84,932.85, collection of which is barred by the statute; in an overpayment for the year ending June 30, 1919, of $66,380.91, reclaim of which is also barred by the statute; and in an overpayment for the year ending June 30, 1920, of $556,754.70, for which claim for refund was filed September 15, 1925, and for recovery of which the present suit was brought.

We think that neither the Government nor the petitioner has chosen the correct method of restating the account. At the outset it is to be observed that throughout the taxable periods in question the total payments made by the taxpayer always exceeded the total taxes due, computed, as the statute required, on the basis of the taxpayer's fiscal years, and the right to recover the excess payment turns on whether it was paid for a period bringing it within or without the applicable period of limitation. The periods for which the several payments by petitioner were made are not necessarily the same as petitioner's fiscal years, for which the statute required returns. The object of the payment is in each instance defined by the intention of the taxpayer, to be ascertained from all the relevant facts and circumstances. To determine petitioner's intention, we may look at the returns which it filed, even though they mistakenly embraced a period which did not coincide with the fiscal period for which a return was prescribed.

The return made for the calendar year 1918, and the payments of tax made in accordance with it, disclose unmistakably petitioner's intention to pay the tax on all income received during the calendar year 1918.

Of the total income thus received, only that of the first six months was, under the statute, taxable in that year. Hence, the payment of taxes on the income for the entire year resulted in an overpayment of the tax accrued in the first six months in the sum of $538,202.77. But this is not, as the Government contends, to be regarded as an overpayment only of tax due for the first six months of 1918. True, the taxpayer was required to make a return and pay taxes for that six months, and was not authorized to make any other return, but it did in fact make a return of its income and pay taxes for the entire calendar year and thus evidenced its intention to include in the return and pay taxes upon income accruing in the last, as well as the first six months of the calendar year. Thus, when the taxpayer had completed its payments of taxes for the entire year, they were enough to pay in full the tax due and payable for the six months ending June 30, 1918, and in addition to pay the sum of $538,202.77 on account of the tax on income accrued in the remaining six months of the year for which the payment was made. But as those six months were embraced in the fiscal period ending June 30, 1919, which for purposes of assessing and paying the tax the statute treats as a unit, the overpayment must necessarily be treated as a payment on account of the tax accruing for that period.

For the calendar year 1919 the same considerations govern. The overpayment last referred to, applicable on account of taxes due for the fiscal year ending June 30, 1919, was not sufficient to pay the entire tax, aggregating $896,314.83, which the Commissioner assessed for that period. But the payments for the calendar year 1919 when added to this overpayment, exceeded the tax assessed for the fiscal year ending in June by a sum amounting, after deduction of refunds since made, to $443,367.61. As in the case of the tax paid for 1918, that paid by petitioner for 1919 was not for the fiscal, but for the calendar year. Consequently, the payment in excess of the tax due and payable for the period ending June 30, 1919, was in fact and in law a payment in advance on account of the tax upon income for the ensuing taxable period, the

fiscal year ending June 30, 1920. As upon recomputation of the tax none was found due for that fiscal year, this payment in advance became an overpayment, when the tax for that period was assessable, which the petitioner is entitled to recover unless barred by the statute of limitations.

Section 284(b)1 of the Revenue Act of 1926 (ch. 27, 44 Stat., 9, 66) provides that no refund shall be made after four years from the time the tax is paid unless within that period a claim for refund is filed by the taxpayer. But by section 284(h) it is provided that that section shall not "bar from allowance a claim in respect of a tax for the taxable year 1919 or 1920, if such claim is filed before the expiration of five years after the date the return was due." As the petitioner's tax payments for the entire period under consideration were completed in December, 1920, its claim for refund, filed September 15, 1925, was not within the 4-year period, and its right to recover is barred unless September 15, 1925, the date the claim was filed, was before the expiration of "five years after the date the return was due," as provided by paragraph (h). The claim was in time only if, as petitioner contends, the return was due September 15, 1920, which is the date fixed by section 227 of the 1918 Act for filing petitioner's return for the fiscal year ending June 30. See *Burnet* v. *Willingham Loan & Trust Co.* (282 U. S., 437 [Ct. D. 292, C. B. X–1, 258]).

On its face, section 284(h), which specifically refers to a claim for a refund "of a tax for the taxable year * * * 1920," and bars it if not filed within five years after the return was due, would seem to refer to the time fixed by the statute for return of income for the taxable year for which the tax was paid, which, in this case, was September 15, 1920. But the Government, notwithstanding its argument that the return for petitioner's fiscal year is the only one referred to or authorized by section 212 of the 1918 Act, insists that the words "date the return was due" in section 284(h) of the 1926 Act refer to the return which the taxpayer in fact filed for the calendar year 1919, which, under the applicable section, section 227 of the 1918 Act, was due on March 15, 1920. In support of this contention it points to the language of section 252 of the 1918 Act, in which the quoted words first occurred. In that section they were preceded by a provision requiring credit or refund "if, upon examination of any return," an overpayment appeared. From this it is argued that the proviso in the same section that refund should not be allowed unless claim was made within five years from the "date the return was due" refers to the due date of the return actually filed and not the due date of the return required by the statute.

But it is to be noted that the reference, in section 252 of the 1918 Act, to an examination of the return, which was continued in section 252 of the 1921 Act (ch. 136, 42 Stat., 227, 268), was dropped from the corresponding section 281 of the Act of 1924 and the applicable section 284 of the Act of 1926. Both of these sections provide for refund or credit of any overpayment of the tax, and specific reference to the taxable year 1920 was inserted in the proviso that the section should not bar claims for overpayment of "a tax for the taxable year 1919 or 1920" if "filed before expiration of five years after the date the return was due." Whatever the meaning of "return" as used in the earlier sections, we think it reasonably clear that the omission by the later ones of all reference to the return actually filed and the insertion of a reference to the taxable year, in juxtaposition to the phrase "five years after the date the return was due," evidenced an intention that the date from which the statute is to run should be the due date of the return required by the statute for the taxable year.

There is no basis for the contention of petitioner that the taxes paid for each calendar year should be divided and one-half applied to tax due for the first six months and one-half for tax accruing in the last six months of the year.[1] We think neither the circumstances nor the applicable statute permits such an allocation. Section 226 of the 1918 Act authorizes the calculation of the tax for that part of a fiscal year falling between the beginning of the calendar year and the end of the fiscal year by the apportionment of gross income and deductions for the calendar year, pro rata to the taxable fiscal period, in order to arrive at net income for the latter. (See *Appeal of Weed*, 2 B. T. A., 84.) But the section does not authorize a like apportionment of the tax paid

[1] Such a prorating of tax payments in order to allocate taxes, erroneously paid for a calendar year, to the portions of the two fiscal years which make up the calendar year was allowed by the Board of Tax Appeals in *Paso Robles Mercantile Co.* v. *Commissioner* (12 B. T. A., 750; affirmed 33 F. (2d), 653). Certiorari was denied (280 U. S., 595) upon a petition which did not present for review the method of allocation thus adopted.

for the calendar year, and none was made by the returns which petitioner filed. The tax paid was for the income of the entire year and was obviously intended to be applied to the payment of any tax due or payable in that year, which would include all the tax accruing for the fiscal period ending June 30. Under section 252 of the Revenue Act of 1918, petitioner could not at any time have claimed a refund of any overpayment of tax except such amount as was "in excess of that properly due" for the first six months, and since the excess, as already indicated, was, in each year, paid on account of the calendar year, a part of which fell within the fiscal period following June 30, a correct statement of the account requires the overpayment to be credited to that rather than the preceding fiscal period.

It follows that recovery should be allowed of the amount of the overpayment not already refunded, which, as stated, is $443,367.61, with interest computed in accordance with the applicable statutes, and that the judgment should be reversed and the cause remanded for further proceedings in accordance with this opinion.

Reversed.

NOTE.—On January 25, 1932, the United States Supreme Court took the following action:

The opinion in No. 62, *American Hide & Leather Co.* v. *United States*, was amended by adding at the conclusion thereof the following paragraph:

"The amounts of the tax computed by the Commissioner and the amount of the overpayment as stated in this opinion are those shown by the findings of the Court of Claims, but the mandate of this court will be without prejudice to any restatement of the amount of overpayment based on a recomputation of the tax."

TITLE X.—BOARD OF TAX APPEALS.

SECTIONS 1003 AND 1004.—JURISDICTION.

SECTIONS 1003 AND 1004. XI–15–5444
Ct. D. 468

INCOME TAX—REVENUE ACT OF 1926—DECISION OF COURT.

1. BOARD OF TAX APPEALS—CONCLUSIVENESS OF FINDING OF FACT—REVIEW BY CIRCUIT COURT OF APPEALS.

Where there is evidence of record legally sufficient to support a finding of fact by the Board of Tax Appeals, such finding must be accepted as conclusive by the Circuit Court of Appeals on review of the Board's decision.

2. DECISION AFFIRMED.

The decision of the Board of Tax Appeals (15 B. T. A., 1107) affirmed.

UNITED STATES CIRCUIT COURT OF APPEALS, SIXTH CIRCUIT.

No. 5688. *Thomas H. Tracy, appellant*, v. *Commissioner of Internal Revenue, appellee.*

No. 5689. *The Huron Building Co., appellant*, v. *Commissioner of Internal Revenue, appellee.*

Petitions to review orders of the United States Board of Tax Appeals.

Before MOORMAN, HICKS, and HICKENLOOPER, Circuit Judges.

[November 3, 1931.]

HICKENLOOPER, Circuit Judge: In January, 1902, the petitioner, The Huron Building Co., acquired lot No. 251 in Port Lawrence Division in the city of Toledo, Ohio, being a lot of land fronting 60 feet on Jefferson Avenue, and

having a depth of 120 feet. The purchase price was $45,000. In 1904 a retail store and commercial loft building was constructed on the lot at a cost of $90,940.71. On December 1, 1921, the petitioner sold these premises for the net sum of $213,340. The principal question for decision before the Commissioner and the Board of Tax Appeals related to the March 1, 1913, value to be used in computing the profit derived from the sale. The Commissioner fixed this value at $132,310.64. The Board of Tax Appeals increased it to $176,000, and, since much of the evidence was directed to the valuation of land and buildings separately, apportioned $96,000 of this sum to the land and $80,000 to the building. The Board also held that the value of the building on March 1, 1913, should be reduced by 2 per cent depreciation, from March 1, 1913, to January 1, 1921, in computing the profit on the sale in 1921. The petitioner contends that the March 1, 1913, value should not be less than $211,000 and that the Board acted arbitrarily in fixing it at $176,000; that the conclusion of the Board was not supported by any evidence, was contrary to the evidence, and was not based upon the independent knowledge of the Board. It also contended that the Board erred in deducting depreciation, in refusing to allow, as a proper charge to depreciation reserve, certain sums said to represent capital expenditures, and in rejecting and excluding certain evidence tendered by petitioner.

The case of Thomas H. Tracy is related to that of the Huron Building Co. in that it concerns the effect to be given a dividend of $15,000 paid to him by the Huron Building Co. in 1921. Determination of the portion of such dividend which constituted a return of capital and nontaxable surplus depends upon the decision in the case of the Huron Building Co. If the decision in the case of that petitioner be affirmed, the decision of the Board of Tax Appeals in the Tracy case must likewise be affirmed.

The evidence introduced by the petitioners consisted largely of the testimony of experts, all of whom attempted to place a separate value upon the land and to arrive at the reconstruction cost of the building, less depreciation, as of March 1, 1913. This separate valuation of land and building was necessary and proper in determining the amount of annual depreciation, but is not particularly helpful in arriving at the market or sound value of a parcel of improved real estate. In such case building and land constitute a unit, the market value of which has been frequently said to be the price which one, who is under no compulsion to sell, is willing to take for the property, and which another, who is under no compulsion to buy, but is able and desires to buy, is willing to pay for the property. This price may or may not be largely influenced by reproduction costs. The type of the building, its suitability to the neighborhood in which it is located, whether construction expenditures were needlessly lavish and extravagant on the one hand, or wise and economical on the other, the earning capacity of the building as pure investment, and many other factors also have to do with the question of value as of any specific date.

It is contended by the petitioner that the only evidence of value introduced before the Board of Tax Appeals being this opinion evidence of experts and that which is also in its nature opinion evidence—the tax valuations of land and building, which were testified to be 60 per cent of the true value—the Board was under obligation to accept the petitioner's valuation and to render judgment accordingly. While the opinions of experts are competent and often very helpful, such evidence is not considered binding upon the tribunal before which it is produced, at least not to the extent that such tribunal is bound to follow it if contrary to the best judgment of its members. (*Anchor Co.* v. *Commissioner*, 42 F. (2d), 99 (C. C. A. 4); *Am-Plus Storage Battery Co.* v. *Commissioner*, 35 F. (2d), 167 (C. C. A. 7).) But it is true that no administrative board may act arbitrarily and without evidence, and this suggests other questions which here arise, viz, whether there was substantial evidence before the Board to support its findings, and, if so, the effect to be given to this fact.

It must first be observed that the Board of Tax Appeals is an administrative tribunal, not a court. (*Old Colony Trust Co.* v. *Commissioner*, 279 U. S., 716, 725 [Ct. D. 80, C. B. VIII–2, 222].) The mere fact that the Board may exercise judicial, or quasi judicial, powers in the performance of its official duties, does not militate against this position. In organization and function the Board is administrative. Many, if not most, executive and administrative officers are called upon to make determinination of facts in the performance of their official duties, and to apply the law as they construe it to the facts so found. In so doing they do not exercise "judicial power" as that phrase is used in the Federal Constitution and laws. (*Reetz* v. *Michigan*, 188 U. S., 505, 507.)

The power conferred upon the various Circuit Courts of Appeals by the Act of February 26, 1926 (ch. 27, section 1003, 44 Stat., 110, 26 U. S. C., section 1226), is one of review, not of appeal. The jurisdiction conferred is to affirm or, if the decision of the Board is not in accordance with the law, to modify or reverse such decision. The power of review is thus almost identical in scope with that given the courts in relation to other administrative officers, boards, and commissions.

The Supreme Court has many times outlined in a comprehensive way the conditions under which administrative orders or decisions are to be considered as void and as "not in accordance with law." Thus in *Interstate Commerce Commission* v. *Louisville & N. R. Co.* (227 U. S., 88. 91), Mr. Justice Lamar said: "In the comparatively few cases in which such questions have arisen it has been distinctively recognized that administrative orders, quasi judicial in character, are void if a hearing was denied; if that granted was inadequate or manifestly unfair; if the finding was contrary to the 'indisputable character of the evidence,'" citing authorities. Thus, also, in *Tagg Bros.* v. *U. S.* (280 U. S., 420, 442), it is said: "It has been settled in cases arising under the Interstate Commerce Act that if an order rests upon an erroneous rule of law (*Interstate Commerce Commission* v. *Diffenbaugh*, 222 U. S., 42); or is based upon a finding made without evidence (*Chicago Junction case*, 264 U. S., 258, 263); or upon evidence which clearly does not support it (*Interstate Commerce Commission* v. *Union Pacific R. R. Co.*, 222 U. S., 541, 547; *New England Divisions case*, 261 U. S., 184, 203; *Colorado* v. *U. S.*, 271 U. S., 153, 166), the order must be set aside. These rules are applicable also to suits arising under the Packers and Stockyards Act." On pages 443 and 444 the opinion continues: "The validity of an order of the Secretary, like that of an order of the Interstate Commerce Commission, must be determined upon the record of the proceedings before him—save as there may be an exception of issues presenting claims of constitutional right, a matter which need not be considered or decided now. * * * (Citing authorities). On all other issues his findings must be accepted by the court as conclusive, if the evidence before him was legally sufficient to sustain them and there was no irregularity in the proceeding."

But whatever doubt there may have been as to the extent to which courts will accept the findings of fact of the Board of Tax Appeals, such doubts are laid at rest by the decision in the case of *Phillips* v. *Commissioner* (283 U. S., 589, 600 [Ct. D. 350, C. B. X–1, 264]). There objection was specifically raised to the rule under which the Board's findings of fact are treated by the Circuit Courts of Appeals as final if there is any evidence to support them (page 599). This objection was said to be without weight, the court, by Mr. Justice Brandeis, saying: "It has long been settled that determinations of fact for ordinary administrative purposes are not subject to review. * * * (citing authorities). Save as there may be an exception for issues presenting claims of constitutional right, such administrative findings on issues of fact are accepted by the court as conclusive if the evidence was legally sufficient to sustain them and there was no irregularity in the proceedings."

We assume, therefore, that the court may, and should, in every case in which a hearing was had and evidence was introduced before the Board, look into such evidence to determine whether it was "legally sufficient to sustain" the findings made. The court need go no further. It is not required to weigh the evidence, or to determine the credibility of witnesses; nor may it usurp the power of administrative decision. The opinion of the court may not be substituted for that of the administrative body in matters involving the exercise of judgment or discretion. (Compare *Interstate Commerce Commission* v. *Illinois Central R. Co.*, 215 U. S., 452, 470.) The analogy to an appeal in equity, suggested but not adopted in our decision in *Collin* v. *Commissioner* (32 F. (2d), 753), can not now be considered a close one. The question of the March 1, 1913, value of property is a question of fact, and a decision of this sort reached by the taxing officer or board within the scope of the authority conferred by law, when made in good faith, and in the absence of gross mistake or other irregularity, has long been held by the courts as conclusive. (Cf. *Hagerty* v. *Huddleston, Hubbard & Co.*, 60 O. S., 149, 165, 166.) This is but another way of saying that the decision of the taxing board must prevail if it is not contrary to the "indisputable character of the evidence" or if the evidence is "legally sufficient to sustain" such finding. The evidence is legally sufficient to sustain the finding if there be substantial evidence to support it, and the record as a whole does not clearly, convincingly, or even, possibly, "indisputably" requires a contrary conclusion. This is not inconsist-

having a depth of 120 feet. The purchase price was $45,000. In 1904 a retail store and commercial loft building was constructed on the lot at a cost of $90,940.71. On December 1, 1921, the petitioner sold these premises for the net sum of $213,340. The principal question for decision before the Commissioner and the Board of Tax Appeals related to the March 1, 1913, value to be used in computing the profit derived from the sale. The Commissioner fixed this value at $132,310.64. The Board of Tax Appeals increased it to $176,000, and, since much of the evidence was directed to the valuation of land and buildings separately, apportioned $96,000 of this sum to the land and $80,000 to the building. The Board also held that the value of the building on March 1, 1913, should be reduced by 2 per cent depreciation, from March 1, 1913, to January 1, 1921, in computing the profit on the sale in 1921. The petitioner contends that the March 1, 1913, value should not be less than $211,000 and that the Board acted arbitrarily in fixing it at $176,000; that the conclusion of the Board was not supported by any evidence, was contrary to the evidence, and was not based upon the independent knowledge of the Board. It also contended that the Board erred in deducting depreciation, in refusing to allow, as a proper charge to depreciation reserve, certain sums said to represent capital expenditures, and in rejecting and excluding certain evidence tendered by petitioner.

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The evidence introduced by the petitioners consisted largely of the testimony of experts, all of whom attempted to place a separate value upon the land and to arrive at the reconstruction cost of the building, less depreciation, as of March 1, 1913. This separate valuation of land and building was necessary and proper in determining the amount of annual depreciation, but is not particularly helpful in arriving at the market or sound value of a parcel of improved real estate. In such case building and land constitute a unit, the market value of which has been frequently said to be the price which one, who is under no compulsion to sell, is willing to take for the property, and which another, who is under no compulsion to buy, but is able and desires to buy, is willing to pay for the property. This price may or may not be largely influenced by reproduction costs. The type of the building, its suitability to the neighborhood in which it is located, whether construction expenditures were needlessly lavish and extravagant on the one hand, or wise and economical on the other, the earning capacity of the building as pure investment, and many other factors also have to do with the question of value as of any specific date.

It is contended by the petitioner that the only evidence of value introduced before the Board of Tax Appeals being this opinion evidence of experts and that which is also in its nature opinion evidence—the tax valuations of land and building, which were testified to be 60 per cent of the true value—the Board was under obligation to accept the petitioner's valuation and to render judgment accordingly. While the opinions of experts are competent and often very helpful, such evidence is not considered binding upon the tribunal before which it is produced, at least not to the extent that such tribunal is bound to follow it if contrary to the best judgment of its members. (*Anchor Co.* v. *Commissioner*, 42 F. (2d), 99 (C. C. A. 4); *Am-Plus Storage Battery Co.* v. *Commissioner*, 35 F. (2d), 167 (C. C. A. 7).) But it is true that no administrative board may act arbitrarily and without evidence, and this suggests other questions which here arise, viz, whether there was substantial evidence before the Board to support its findings, and, if so, the effect to be given to this fact.

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ent with our previous decisions. (Compare *Cartier* v. *Commissioner*, 37 F. (2d), 894; *C. F. Medaris Co.* v. *Commissioner*, 38 F. (2d), 812; and *Guarantee Bond & Mortgage Co.* v. *Commissioner*, 44 F. (2d), 297.) Further citations seem unnecessary.

The Board of Tax Appeals did not act without evidence or without full opportunity to the petitioners to be heard. Such Board accepted the petitioner's evidence as to the independent or separate valuation of the land. The Board had before it not only the cost of the land in 1902, the cost of constructing the building which was completed in 1904, the tax values of land and building in 1913 and 1915, and the opinions of the experts as to the separate valuations to be placed on both, but the record is devoid of any evidence of sales of closely comparable buildings, or of the value of the property as a unit and for investment purposes. The burden of producing such evidence, if it was to be determinative of the case in whole or in part, was upon the petitioner. In connection with investment value, also, earning power is of the greatest importance. Prior to 1913 such earnings ranged between $5,699.08, in 1910, and $2,361.54, in 1912. The maximum earnings prior to 1922 were for the year 1920, $7,845.12. For the 10 years commencing with 1908 the average was approximately $5,000 per year. This is a return of but 2.8 per cent upon the valuation of $176,000. The Board also had before it that which is common statistical knowledge—the tremendous increase in the price of building materials, equipment, and the like, which followed the beginning of the World War in 1914, as well as the lower cost of labor at or about that time, and comparative costs in 1904, 1914 and 1921. The weight to be given to each of these elements of evidence was within the sound discretion of the Board, and we can not say that such discretion was abused, that the evidence was not legally sufficient to sustain the Board's decision, or that such evidence clearly showed a value in excess of that fixed by the Board.

In view of the decision of the Supreme Court in *United States* v. *Ludey* (274 U. S., 295 [T. D. 4046, C. B. VI–2, 157]), the petitioners do not here press the claim that depreciation was improperly deducted from the March 1, 1913, value found, in arriving at the profits resulting from the sale. Depreciation is largely dependent upon the fact that buildings are known to become obsolete and of greatly decreased value, or even worthless, after the passage of many years. The extent of such depreciation depends upon a variety of factors, and the rate to be applied in any individual case lies largely within the sound discretion of the Commissioner and the Board of Tax Appeals. We can not say that the rate of 2 per cent per annum, fixed by the Board, is so clearly wrong as to be arbitrary or as to constitute an abuse of discretion. Nor can we say that the amounts claimed as capital expenditures or credit against such depreciation were not properly classified by the Board as general maintenance and repair. They were so treated by the petitioner in its books and, we assume, in its annual income tax returns. Upon these questions, therefore, the findings of the Board of Tax Appeals are also affirmed.

The petitioner complains that the Board of Tax Appeals erred in a matter of law in rejecting evidence tendered by the petitioner to show the general development in the immediate vicinity of the building in question between the years 1913 and 1921. This, it is claimed, would have tended to show a great stability in market value during that period and that practically all of the increase occurred prior to 1913. While the evidence might have some slight effect in this direction, the probative force would be inconsequential. Conceding the truth of the proffer, but without admitting the necessity or propriety of the inference to be drawn from such evidence, we can not see that a different result would be required.

The respondent questions the jurisdiction of the court in the matter of the petition of Thomas H. Tracy upon the ground that such petition was not filed within six months after the decision of the Board of Tax Appeals. This petitioner contends that the decision in his case was entered of record by the Board of Tax Appeals on May 25, 1929, by inadvertence and mistake and in violation of the stipulation between the parties, and that the Board erred in denying petitioner's motion to vacate and set aside its earlier decision and to enter a *nunc pro tunc* order as of July 8, 1929. Since, as has already been stated, relief in this case is dependent upon relief in the matter of the petition of the Huron Building Co., it becomes unnecessary for us to determine this question. We accept jurisdiction and affirm the decision rendered by the Board.

The decision of the Board of Tax Appeals is affirmed in both cases.

Remanding case to Board of Tax Appeals. (See Ct. D. 471, page 308.)

SECTIONS 1003 AND 1004. XI-17-5462
Ct. D. 475

INCOME TAX—REVENUE ACT OF 1926—DECISION OF COURT.

REMANDING CASE TO BOARD—POWER OF CIRCUIT COURT OF APPEALS.

Where the Supreme Court held that on the record before the Board of Tax Appeals the Board correctly decided an issue before the Board on which it based its decision and which was raised on appeal from the Board to the Circuit Court of Appeals, and the Supreme Court remanded the cause to the Circuit Court of Appeals and commanded it to take such further proceedings in the case, in conformity with its opinion and judgment, as according to right and justice ought to be had, under section 1003(b) of the Revenue Act of 1926, the Circuit Court of Appeals has no power to remand the case to the Board where the question of its power to remand the case was not decided by the Supreme Court.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT. OCTOBER TERM, 1929.

No. 4210. *Samuel F. Houston, petitioner,* v. *Commissioner of Internal Revenue, respondent.*

No. 4211. *Sallie H. Henry, petitioner,* v. *Commissioner of Internal Revenue, respondent.*

No. 4224. *William Hobart Porter and Andrew W. Porter, Executors of the Estate of William W. Porter, Deceased, petitioners,* v. *Commissioner of Internal Revenue, respondent.*

On motion to remand to the United States Board of Tax Appeals for further proceedings.

Before WOOLLEY and DAVIS, Circuit Judges, and JOHNSON, District Judge.

[October 30, 1931.]

OPINION.

DAVIS, Circuit Judge: These cases are here on motion to remand to the United States Board of Tax Appeals. A single question of law is involved and all three cases will be disposed of in one opinion.

The petitioners in making their income tax returns for the year 1920 claimed that they had sustained losses in a certain transaction entered into in 1906. This transaction related to the reorganization of the Real Estate Trust Co. of Philadelphia which was closed because of excessive loans made to Adolph Segal who deposited with it certain stocks and bonds as collateral security. It was proposed to reorganize and reopen the company if a fund of $2,500,000 could be raised by subscriptions. The petitioners subscribed to this fund and these subscriptions gave them an interest in the Segal securities which were to be administered by the Trust company. The subscribers hoped to realize from these securities enough to pay the subscriptions and also a profit. But their hopes did not materialize and in 1920 it was thought best to dispose of the securities and so they were sold. The petitioners were allotted their pro rata share of the securities. In making their income tax returns for the year 1920 they claimed as a loss the difference between their subscriptions (cost to them of the securities) and what they received for them when sold.

The Commissioner of Internal Revenue disallowed the claims and the United States Board of Tax Appeals sustained his determination on the ground that the value of the securities on March 1, 1913, must be established as well as their cost and this had not been done. On appeal to this court, the redetermination of the Board of Tax Appeals was reversed, and the income tax returns of the petitioners, so far as they were affected by the deductions

here in question, were approved. The Commissioner appealed to the United States Supreme Court which reversed our judgment and remanded the case to this court for further proceedings in a mandate which contains the following language:

"On consideration whereof, It is now here ordered and adjudged by this court that the judgment of the United States Circuit Court of Appeals in this cause, be, and the same is hereby reversed.

"And it is further ordered, That this cause be, and the same is hereby, remanded to the said Circuit Court of Appeals for further proceedings in conformity with the opinion of this court.

"April 13, 1931.

"You, therefore, are hereby commanded that such further proceedings be had in such cause, in conformity with the opinion and judgment of this court, as according to right and justice, and the laws of the United States, ought to be had, the said writ of certiorari notwithstanding."

Thereupon the petitioners filed a motion in this court to remand the cases to the Board of Tax Appeals so as to give them an opportunity to submit before it evidence of the value of the Segal securities here involved on March 1, 1913. The Commissioner opposes that motion on the ground that this court is without power to remand the cases to the Board. The question of the power of this court is, therefore, the first issue.

The statute creating the United States Board of Tax Appeals (U. S. C. A., Title 26, section 1226(b)) gives this court power "to affirm, or if the decision of the Board is not in accordance with law, to modify or reverse the decision of the Board, with or without remanding the case for a rehearing, as justice may require." We, therefore, had power when the case was here before to remand it to the Board of Tax Appeals, if its decision was not in accordance with law.

We were commanded by the mandate of the Supreme Court to take such further proceedings in the case, in conformity with its opinion and judgment, as according to right and justice ought to be had. The Supreme Court did not specifically tell us what ought to be done, but following its usual policy, as laid down in the case of *Ex parte Medway* (90 U. S., 504), it left us free to proceed in accordance with our own idea of what law and justice required when all the facts in the case, and the power conferred upon us by the statute, are considered.

The mandate of the Supreme Court restored to this court the power which it had when the case was first here, other than the questions which it decided. The question of our power to remand this case was not decided. (*Liberty National Bank* v. *Bear*, 4 Fed. (2d), 240, 242, certiorari denied 268 U. S., 693; *In re Sanford Fork & Tool Co.*, 160 U. S., 247, 256; *In re Louisville*, 231 U. S., 639, 645; *Arkadelphia Milling Co.* v. *St. Louis Southwestern Railway Co.*, 249 U. S., 134, 143.)

We, therefore, have power to deal with that question just as we could have done when the case was here before. The question arises as to what power we then had. This is stated by the statute which confers upon us power to remand the case for a rehearing "if the decision of the Board is not in accordance with law." The final question is whether or not the decision of the Board was "in accordance with law." If it was, we can not remand; if it was not, we can.

The vital issue on which the decision of this case turned, was the value of the rights of the petitioners in the Segal securities on March 1, 1913. This issue was raised in the answer in two of the suits and on this issue the Board of Tax Appeals based its opinion, saying: "If he disposed of them (rights in the Segal securities) in 1920 or in 1921, then under section 202(a)1 of the Revenue Act of 1918, as interpreted by the courts and by this Board, and under the express provisions of section 202(b), the loss, if any, from the disposition of those rights, the subject matter of the entire transaction, would be the difference between what was ultimately received for the rights and their cost, or March 1, 1913, value, whichever was lower." In the determination, therefore, of the loss sustained by the petitioners, it was necessary to establish the fair market value of the rights on March 1, 1913, and their cost in 1906, but they did not submit any evidence of the value on March 1, 1913.

This issue was squarely raised on appeal to this court. The petitioners contended that their loss could be determined only by finding the difference between the value of what was received and the cost of their rights; while the Commis-

sioner contended that their loss, if any, was the difference between what was ultimately received for the rights in 1920 and their cost in 1906, or their value on March 1, 1913, whichever was lower. We held that it was impossible to determine the value of the rights on March 1, 1913, and accordingly the only basis of determining loss was cost and return, what they subscribed in 1906 and what they received on liquidation in 1920. But in this we were in error.

The Supreme Court said that the value of the rights on March 1, 1913, was a necessary element; that it was just as necessary for the petitioners on whom the burden rested, to prove value on that date as it was to prove cost in 1906 and that the impossibility of proving value on March 1, 1913, did not under the statute relieve the petitioners from the necessity of establishing the fact which the statute makes a prerequisite to the allowance of a loss; that if a litigant in a tax case does not or can not submit evidence from which one of these essential facts can be established, it is a misfortune to be borne by him, just as it must be borne in any other case on the failure of proof.

In other words, the Supreme Court held that on the record before the Board of Tax Appeals, it correctly decided the case and so its decision "was in accordance with law," just as it would have been upon the failure of proof in any other case coming from a judicial tribunal to an appellate court. However sorry we may feel for these or any litigants who fail to produce evidence so that the case may be considered on its merits, we are bound by the rules of law. The petitioners had the burden of establishing the necessary facts from which their loss could be determined. They had their day in court and opportunity to submit evidence, if they had any, to establish this fact. They either could not produce such evidence or thought it was unnecessary. However that may be, the Board of Tax Appeals decided the case in accordance with the law as declared by the Supreme Court and its decision being "in accordance with law," we have never had power to remand the case. It follows that the petitions must be denied.

TITLE XI.—GENERAL ADMINISTRATIVE PROVISIONS.

SECTION 1110.—LIMITATION ON PROSECUTIONS BY THE UNITED STATES.

SECTION 1110.

REVENUE ACT OF 1926.

Period of limitation on indictment for evasion of tax. (See Ct. D. 482, below.)

SECTION 1114.—PENALTIES.

ARTICLE 1361: Penalties. XI-19-5476
(Also Section 1110.) Ct. D. 482

FEDERAL TAXES—REVENUE ACT OF 1926—DECISION OF SUPREME COURT.

PENALTY—EVASION OF TAX—INDICTMENT—LIMITATION.

A willful attempt to evade a tax, which is made a felony by section 1114(b) of the Revenue Act of 1926, is not an offense involving "the attempting to defraud the United States" within the intent of the proviso in section 1110(a) of that Act. Accordingly, the period of limitation after the commission of the offense within which an indictment under section 1114(b) must be found is three years, as fixed by the first clause of section 1110(a), and not six years, the period specified in the proviso thereof.

SUPREME COURT OF THE UNITED STATES. No. 621.—OCTOBER TERM, 1931.

United States of America, appellant, v. *William Randolph Scharton.*

Appeal from the District Court of the United States for the District of Massachusetts.

[April 11, 1932.]

OPINION.

Mr. Justice ROBERTS delivered the opinion of the court.

The appellee was indicted under section 1114(b) of the Revenue Act of 1926,[1] the charge being attempts to evade taxes for 1926 and 1927 by falsely understating taxable income. In bar of the action he pleaded that the face of the indictment showed the offenses were committed more than three years prior to the return of a true bill. The plea was sustained and the indictment quashed, on the ground that the period of limitations is fixed by the first clause of section 1110(a) of the Act,[2] and not, as the appellant contended, in the proviso thereof. The basis of this ruling was that the offense defined by use of the words "evade or defeat" does not involve defrauding or attempting to defraud within the intent of the proviso.

The appellant contends fraud is implicit in the concept of evading or defeating; and asserts that attempts to obstruct or defeat the lawful functions of any department of the Government (*Haas* v. *Henkel*, 216 U. S., 462, 479–480) or to cheat it out of money to which it is entitled (*Capone* v. *United States*, 51 F. (2d), 609, 615) are attempts to defraud the United States if accompanied by deceit, craft, trickery or other dishonest methods or schemes (*Hammerschmidt* v. *United States*, 265 U. S., 182, 188). Any effort to defeat or evade a tax is said to be tantamount to and to possess every element of an attempt to defraud the taxing body.

We are required to ascertain the intent of Congress from the language used and to determine what cases the proviso intended to except from the general statute of limitations applicable to all offenses against the internal revenue laws. Section 1114(a) makes willful failure to pay taxes, to make return, to keep necessary records, or to supply requisite information, a misdemeanor; and section 1114(c) provides that willfully aiding, assisting, procuring, counseling, or advising preparation or presentation of a false or fraudulent return, affidavit, claim, or document shall be a felony. Save for that under consideration these are the only sections in the Revenue Act of 1926 defining offenses against the income tax law. There are, however, numerous statutes expressly making intent to defraud an element of a specified offense against the revenue laws.[3] Under these, an indictment failing to aver that intent would be defective; but under section 1114(b) such an averment would be surplusage, for it would be sufficient to plead and prove a willful attempt to evade or defeat. (Compare *United States* v. *Noveck*, 271 U. S., 201, 203.)

As said in the Noveck case, statutes will not be read as creating crimes or classes of crimes unless clearly so intended, and obviously we are here concerned with one meant only to fix periods of limitation. Moreover, the concluding clause of the section, though denominated a proviso, is an excepting clause and therefore to be narrowly construed. (*United States* v. *McElvain*, 272 U. S., 633, 639.) And as the section has to do with statutory crimes it is to be liberally interpreted in favor of repose, and ought not to be extended by construction to embrace so-called frauds not so denominated by the statutes creating offenses. (*United States* v. *Hirsch*, 100 U. S., 33; *United States* v. *Rabinowich*, 238 U. S., 78, 87–88; *United States* v. *Noveck*, supra; *United States* v. *McElvain*, supra.) The purpose of the proviso is to apply the 6-year period to cases "in which defrauding or an attempt to defraud the United States is an ingredient under the statute defining the offense." (*United States* v. *Noveck*, supra.)

Judgment affirmed.

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[1] United States Code, Supplement V, Title 26, section 1266: "Any * * * person who willfully attempts in any manner to evade or defeat any tax imposed by this title or the payment thereof shall * * * be guilty of a felony. * * *"

[2] United States Code, Supplement V, Title 18, section 585: "No person shall be prosecuted, tried, or punished for any of the various offenses arising under the internal revenue laws of the United States unless the indictment is found or the information instituted within three years next after the commission of the offense: *Provided*, That for offenses involving the defrauding or attempting to defraud the United States or any agency thereof, whether by conspiracy or not, and in any manner, the period of limitation shall be six years. * * *"

[3] See United States Code, Title 26, sections 261, 306, 316, 555, 667, 775, 843, 1180, 1181, 1184, 1186.

SECTION 1116.—INTEREST ON REFUNDS AND CREDITS.

ARTICLE 1371: Interest on refunds and credits. XI–1–5343 Ct. D. 435

INCOME TAX—REVENUE ACT OF 1926—DECISION OF COURT.

1. INTEREST — CREDIT — COMPUTATION — "ADDITIONAL ASSESSMENT MADE UNDER"—CONSTRUCTION.

An additional assessment of tax for the year 1920 made in 1926, after the enactment of the Revenue Act of 1926, is not "made under" the Revenue Act of 1926 within the meaning of section 1116(a) of the Revenue Act of 1926, but is made under the Revenue Act of 1918, which imposed the tax. Accordingly, under that subdivision interest on credits allowed under the Revenue Act of 1926 is payable only to the due date of the amount against which the credits are taken.

2. SAME—"DUE DATE"—INSTALLMENTS.

The due date of an additional tax assessed under the Revenue Act of 1918 is the same as that of the original assessment provided by that Act, namely, if paid in installments, the date provided for the payment of the installments and interest on a claim allowed under the Revenue Act of 1926 should be computed under section 1116(a) of the Revenue Act of 1926 to the due dates of the installments of such additional tax against which credits are taken.

COURT OF CLAIMS OF THE UNITED STATES. No J–87.

American Exchange Irving Trust Co., Successor to Irving National Bank and Irving Trust Co., v. *The United States.*

[October 20, 1931.]

OPINION.

LITTLETON, Judge, delivered the opinion of the court.

The first claim urged by the plaintiff that the additional assessment for 1920 was made under the Revenue Act of 1926, and that it is therefore entitled to interest on the overpayments for 1918 and 1919 from the date on which such tax was paid to the date of the additional assessment, is controlled by the decision of this court in *Riverside & Dan River Cotton Mills, Inc.*, v. *United States* (69 C. Cls., 70, 37 Fed. (2d), 965 [Ct. D. 215, C. B. IX–2, 269]). Upon the authority of that case it is held that plaintiff is entitled to interest on the overpayments only to the due date of the tax to which they were credited.

The next question is whether the due date of the additional tax assessed for 1920 was March 15, 1921, as determined by the Commissioner, or the dates on which the quarterly installments of the tax for 1920 were due and were paid during 1921. This question is also controlled by the decision in *Riverside & Dan River Cotton Mills, Inc.*, v. *United States*, supra, in which we held "that the words 'due date' used in the section (section 1116 of the Revenue Act of 1926) mean the date fixed by the statute for the payment of the tax, or the several installments thereof; that is, that the due date of a tax is not changed because there is an additional assessment, that the due date here referred to is the same as that of the original assessment, namely, March 15, 1919, the date fixed by law for filing of a calendar-year return, or, if paid in installments, then the date provided for the payment of the installments."

Section 250 of the Revenue Act of 1918 (40 Stat., 1057, 1082) provides for the payment of the tax in installments, the due date of the first installment being at the time fixed by law for filing the return, and the due date of the remaining three installments being the 15th day of the third, sixth, and ninth months thereafter. Plaintiff paid its tax for 1920 in installments. Section 250(b) of the Revenue Act of 1918 further provides that "As soon as practicable after the return is filed, the Commissioner shall examine it. If it then appears that the correct amount of the tax is greater or less than that shown

in the return, the installments shall be recomputed. If the amount already paid exceeds that which should have been paid on the basis of the installments as recomputed, the excess so paid shall be credited against the subsequent installments; and if the amount already paid exceeds the correct amount of the tax, the excess shall be credited or refunded to the taxpayer in accordance with the provisions of section 252. If the amount already paid is less than that which should have been paid, the difference shall, to the extent not covered by any credits then due to the taxpayer under section 252, be paid upon notice and demand by the collector." See, also, section 274(i) of the Revenue Act of 1926.

We are of opinion that the purpose of section 1116 of the Revenue Act of 1926 is to provide for the payment of interest to the due date of the installments. There is nothing in the section to indicate that for the purpose of payment of interest on credits the due date of the tax otherwise fixed by the statute should be changed. That Congress intended the term "due date" used in section 1116 of the Revenue Act of 1926 to mean the date on which the several installments of the tax were due if paid in installments is evidenced by the fact that this very matter was considered in connection with section 274(j) of the same Act, in which it was provided that interest at 6 per cent per annum should be assessed and collected on deficiencies from the date prescribed for the payment of the tax, or, if paid in installments, from the date prescribed for the payment of the first installment to the date of assessment. In other words, Congress recognized that, in the absence of a provision to the contrary, the due date of a deficiency in tax would be the dates on which the installments were due. See Ways and Means Committee Report No. 1, page 11, Sixty-ninth Congress, and the Finance Committee Report No. 52, page 28, Sixty-ninth Congress, on the revenue bill of 1926. Defendant relies upon *Blair* v. *United States ex. rel Birkenstock* (271 U. S., 348 [T. D. 3886, C. B. V–1, 142]). That case involved the question of when an overpayment had been made, and is not in point here.

The following tabulation shows the total of the deficiency in each installment of tax for 1920:

	Payments of installments of total tax shown on original 1920 return.	Corrected installments.	Installment deficiency.
Mar. 15, 1921	$139,795.78	$215,444.50	$75,648.72
June 15, 1921	139,795.78	215,444.50	75,648.72
Sept. 15, 1921	139,795.78	215,444.51	75,648.73
Dec. 15, 1921	139,795.78	215,444.51	75,648.73
	559,183.12	861,778.02	302,594.90

Inasmuch as no interest was payable on the overpayments for 1918 and 1919 in the amounts of $8,618.44, $13,494.89, and $8,962.21 credited to the 1920 tax, these amounts, together with the net deficiency of $87,344.41 applied in reduction of the installment deficiencies, show installment deficiencies of $46,043.74, as follows:

	Installment deficiency.	Amounts credited without interest and net deficiency collected with interest.	Balance of installment deficiencies.
Mar. 15, 1921	$75,648.72	$29,604.98	$46,043.74
June 15, 1921	75,648.72	29,604.99	46,043.73
Sept. 15, 1921	75,648.73	29,604.99	46,043.74
Dec. 15, 1921	75,648.73	29,604.99	46,043.74
	302,594.90	118,419.95	184,174.95

The total of the last-mentioned installment deficiencies, i. e., $184,174.95, equals the sum of $97,504.54 of the 1918 overpayment and $86,670.41 of the 1919 overpayment credited to the 1920 tax upon which credits the Commissioner allowed interest only to the due date of the first installments, to wit, March 15, 1921. Plaintiff is therefore entitled to additional interest of $4,143.90 upon the last three installments, as follows:

On $46,043.73 from Mar. 15, 1921, to June 15, 1921	$690.65
On $46,043.74 from Mar. 15, 1921, to Sept. 15, 1921	1,381.30
On $46,043.74 from Mar. 15, 1921, to Dec. 15, 1921	2,071.95

Judgment will be entered in favor of the plaintiff for $4,143.90. It is so ordered.

SECTION 1122.—JURISDICTION OF COURTS.

SECTION 1122.

REVENUE ACT OF 1926.

Jurisdiction of the Court of Claims of the United States in suits for refund of taxes. (See Ct. D. 440, page 315.)

INCOME TAX RULINGS.—PART III.

REVENUE ACT OF 1924.

TITLE II.—INCOME TAX.

PART II.—INDIVIDUALS.

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

ARTICLE 31: What included in gross income.

REVENUE ACT OF 1924.

Modification of I. T. 2352 (C. B. VI–1, 32), relating to income of husband and wife in California. (See I. T. 2616, page 161.)

ARTICLE 32: Compensation for personal services. (Also Section 213(b), Article 73.)

XI–19–5473
Ct. D. 480

INCOME TAX—REVENUE ACT OF 1924—DECISION OF COURT.

1. GIFTS—COMPENSATION—TAXABILITY.

Payments received by officers and employees of a corporation in recognition of long and faithful services, referred to as "compensation" at the time the payments are made, are not gifts, but constitute taxable income under section 213(a) of the Revenue Act of 1924.

COURT OF CLAIMS OF THE UNITED STATES. M–26.

Thomas M. Schumacher v. *The United States.*

[February 8, 1932.]

OPINION.

WILLIAMS, Judge, delivered the opinion of the court.

The plaintiff in this case seeks to recover $25,000, with interest thereon, an alleged overpayment of his income taxes for the calendar year 1925.

The sole issue in the case is whether an amount of $100,000 received by the plaintiff from the stockholder's committee of the El Paso & Southwestern Co. in January, 1925, was income derived from compensation for personal services within the meaning of section 213(a) of the Revenue Act of 1924, or was a gift within the meaning of section 213(b)3 of said Act.

The rule is that whether a payment is taxable compensation or a gift exempt from tax depends upon the intention of the parties and the facts and circumstances surrounding the transaction. The facts have been stipulated and briefly stated are:

Prior to October 31, 1924, the plaintiff was president of the El Paso & Southwestern Railroad Co., the stock of which company was owned by the El Paso & Southwestern Co., a holding corporation.

On November 1, 1924, the El Paso & Southwestern Co. transferred the capital stock of the El Paso & Southwestern Railroad Co. to the Southern Pacific Co. and received in exchange therefor certain securities of that company. Upon the transfer of the El Paso & Southwestern Railroad Co. to the

Southern Pacific Co. the plaintiff's employment by the former company was terminated and he performed no further service for that company thereafter. The plaintiff was paid in full the salary due him as an employee of the El Paso & Southwestern Railroad Co. up to the conclusion of his employment.

On November 10, 1924, the secretary of the El Paso & Southwestern Co. addressed a letter to the stockholders of the holding company explaining in detail the plan of reorganization whereby the stock of the El Paso & Southwestern Railroad Co. was transferred to the Southern Pacific Co. and asking on behalf of the directors of the El Paso & Southwestern Co. full approval, ratification, and confirmation of the plan and all the acts of the directors in carrying out the same. This letter contained the following statement:

"The directors of the El Paso & Southwestern Co. request that the stockholders of the company authorize them, in recognition of the long and faithful services of the officers and employees of the railroad, to pay the officers and employees, to be designated by the board of directors, additional compensation to be decided by the board of directors, and that they be authorized to set aside for such compensation a sum not to exceed $1,000,000."

The secretary inclosed in this communication a letter which the stockholders were requested to sign and return to him. In this letter appears the following statement:

"As a stockholder of the El Paso & Southwestern Co., I hereby ratify, approve, and confirm the plan of reorganization and the actions of the board of directors and the officers, as set forth in said plan of reorganization, and the documents accompanying your letter.

"I understand that there are certain unsettled expenses, obligations to the Southern Pacific Co., bonuses to the employees, agreed upon by the board of directors, estimated at about $1,000,000, and other debts, expenses, and liabilities incidental to the plan of reorganization and otherwise."

The stockholders approved the plan of reorganization and confirmed and ratified the action of the board of directors as set out in the letter of the secretary of the company. They also appointed five of their number as a committee "to pay the expenses, to compensate employees, to adjust and settle the accounts, to discharge and provide for the debts and liabilities of the company and generally to do every act and thing necessary or proper in pursuance of the provisions of the plan of reorganization. * * *"

This stockholder's committee, on December 23, 1924, took the following action:

"Upon motion duly seconded and carried, the secretary was authorized to release the checks in payment of certain bonuses to amount of $893,690 as per memo on file.

"*Resolved*, That the officers be authorized to secure a loan of $1,000,000 from the Hanover National Bank."

Out of the $893,690 paid as bonuses to certain former officers and employees of the El Paso & Southwestern Railroad Co., the plaintiff on January 2, 1925, received the $100,000 payment involved in suit.

Under the facts and circumstances shown we are clearly of the opinion this payment was not intended to be, and was not, a gift. The language employed by the secretary of the company in his letter to the stockholders "to pay to officers and employees, to be designated by the board of directors, additional compensation," negatives the contention a gift was being contemplated, as does the letter signed by the stockholders authorizing the payment "to compensate employees." That the stockholders did not understand a gift was being made to plaintiff and other employees is evident from the statement, "I understand that there are certain * * * bonuses to the employees, agreed upon by the board of directors, estimated at about $1,000,000, * * *." That the payment was not intended as a gift is further evidenced, and, we think, conclusively so, by the language of the resolution adopted by the stockholder's committee at the time the checks were released—"the secretary was authorized to release the checks in payment of certain bonuses."

The plaintiff suggests the use of the words "compensate employees" and "additional compensation," in the secretary's letter, "merely emphasizes that inartistic and unintentionally misleading language was employed to describe what was intended to be, and what actually were, gifts." We do not agree with plaintiff that these expressions are inartistic, or that they are misleading. The words "compensate employees," "additional compensation," and "bonus" have a precise and well-understood meaning, and in the absence of any fact or

circumstance showing they were not used in their ordinary sense they must be accorded their usual signification. It is significant of the intention of the parties that the word "gift" nowhere appears in the entire transaction. When the payments are referred to, they are invariably designated as "additional compensation," "compensate employees," or "bonus," indicating beyond question that the payments were not gifts or gratuities.

It is an essential characteristic of a gift that it be a transfer without consideration. If there is a consideration for the transaction, it is not a gift. (28 C. J., 621.) In this case there was a consideration for the payment made to plaintiff. It is stated in the resolutions of the board of directors, and in the letter of the secretary of the company to the stockholders, "in recognition of the long and faithful services of the officers and employees of the railroad." The payment was made to the plaintiff as additional compensation in consideration of former services rendered the railroad company and not as a gift or gratuity. (*Parrott* v. *Commissioner*, 1 B. T. A., 1; *Mount* v. *Commissioner*, 10 B. T. A., 1156; *Garey* v. *Commissioner*, 16 B. T. A., 274; *Binger* v. *Commissioner*, 22 B. T. A., 111; *Noel* v. *Parrott*, 15 Fed. (2d), 669 [T. D. 3908, C. B. V–2, 149].)

We hold, therefore, that the payment of $100,000 to the plaintiff, on January 2, 1925, by the stockholder's committee was intended to be, and was, additional compensation for services rendered and is subject to the tax under section 213(a) of the Revenue Act of 1924, which reads:

"SEC. 213. For the purposes of this title, except as otherwise provided in section 233—

"(a) The term 'gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * * of whatever kind and in whatever form paid * * *."

It is immaterial that the payment received by the plaintiff was made by the holding company rather than by the company for which he had rendered services. The entire capital stock of the railroad company was owned by the holding company. The economic interests of the two companies were identical. The purchase price received from the sale of the railroad company went to the holding company. That the money received by the plaintiff was not paid directly by the railroad company but was paid by the stockholder's committee of the holding company does not change the essential character of the transaction, and make a gift out of what was intended to be, and in fact was, additional compensation for services rendered.

The petition is dismissed. It is so ordered.

ARTICLE 32: Compensation for personal services.

REVENUE ACT OF 1924.

Commission allowed insurance agent on policy taken out on own life. (See G. C. M. 10486, page 14.)

ARTICLE 50: When included in gross income.

REVENUE ACT OF 1924.

Payment for early termination of long-term contract. (See Ct. D. 459, page 219.)

ARTICLE 52: Examples of constructive receipt.

REVENUE ACT OF 1924.

Assignment of portion of renewal commissions due and to become due under insurance contract. (See Ct. D. 477, page 164.)

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

ARTICLE 73: Gifts and bequests.

REVENUE ACT OF 1924.

Payments received by officers and employees of a corporation in recognition of long and faithful services. (See Ct. D. 480, page 216.)

ARTICLE 88: Compensation of State officers and employees.

REVENUE ACT OF 1924.

Income received by member of partnership employed under contract by a county to index judgment docket. (See Ct. D. 448, page 167.)

SECTION 214(a)8.—DEDUCTIONS ALLOWED INDIVIDUALS: DEPRECIATION.

ARTICLE 167: Depreciation of patent or copyright. XI–12–5420 Ct. D. 459
(Also Section 213(a), Article 50.)

INCOME TAX—REVENUE ACTS OF 1921 AND 1924—DECISION OF COURT.

1. DEDUCTION—DEPRECIATION—"PROPERTY"—SECRET PLAN.

A copyrighted plan devised by a taxpayer and known as the "Taylor plan," which is designed to enable newspapers purchasing it to acquire supremacy in the field of classified advertising in its territory, which is an idea, theory, or system in his head, the details of which the taxpayer refuses to divulge and the value of which, if any, lies not simply in the plan but in a retention of its details in secret, is not "property" within the meaning of section 214(a)8 of the Revenue Acts of 1921 and 1924, and therefore no deduction under those paragraphs is allowable either in respect of the plan or the copyright of the same.

2. INCOME—AMOUNT RECEIVED IN SETTLEMENT OF CONTRACT—ACCRUAL BASIS.

Where a taxpayer sells the use of a plan under a contract which provides for the payment to him of a specified amount a week for 10 consecutive years beginning in 1921 and in 1924 he and the purchaser effect a settlement in full of the obligations arising under the contract whereby the purchaser pays an amount to the taxpayer, the contract is terminated and superseded by the settlement and the amount received in 1924, which under the contract is due in that year and in subsequent years, is income in the year 1924, even though the taxpayer's books are kept on the accrual basis.

3. DECISION AFFIRMED.

The decision of the Board of Tax Appeals (17 B. T. A., 1107) is affirmed.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT. No. 4524.—MARCH TERM, 1931.

Thomas D. Taylor, petitioner, v. *Commissioner of Internal Revenue, respondent.*

Petition to review the decision of the United States Board of Tax Appeals.

Before BUFFINGTON, WOOLLEY, and DAVIS, Circuit Judges.

[August 19, 1931.]

OPINION.

DAVIS, Circuit Judge: This case is here on petition to review an order of redetermination made by the United States Board of Tax Appeals. (17 B. T. A., 1107.) The case involves income taxes for the years 1921, 1922, 1923, and 1924, in the aggregate amount of $14,370.17, being the amount of the deficiency found by the Commissioner and approved by the Board.

The petitioner Taylor, devised a plan designed to enable a newspaper purchasing it to acquire supremacy in the field of classified advertising in its territory. The plan was copyrighted in 1899, and renewed in 1926, as the "Taylor plan." The details of the plan remain a mystery. The petitioner has continually refused to divulge the details, and each purchaser of the plan must, as a condition of its contract, keep the plan a secret.

Prior to March 1, 1913, the petitioner made four sales of his plan, from which he realized a total compensation of $10,000. After 1919 he sold his plan to a number of newspapers. In particular, this controversy arises out of the sale of the Taylor plan to the Minneapolis Journal on January 19, 1921.

Section 214(a)8 of the Revenue Acts of 1921 and 1924 provides:

"That in computing net income there shall be allowed as deductions: A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence. In case of such property acquired before March 1, 1913, this deduction shall be computed upon the basis of its fair market price or value as of March 1, 1913, * * *."

The petitioner claims (a) that his plan for effecting supremacy of classified advertising is an exhaustible asset within the meaning of the Revenue Act, and (b) that its value is to be based on its fair market value of March 1, 1913.

The Board disposed of these contentions as follows:

"It is doubtful, to say the least, whether the petitioner has or had on March 1, 1913, an exhaustible asset in the copyrighted plan in question. We know nothing about it and the petitioner refused to divulge its detail. Whether the petitioner was protected by the copyright in the use of the plan or only in the name 'Taylor plan,' we know not. However, passing that question and assuming for the moment that the Taylor plan was an exhaustible asset, we are unable to find any basis for holding that it had any value on March 1, 1913, except a speculative or potential value."

The petitioner says the Board erred in thus disposing of the case because he produced a number of expert witnesses who testified that his plan was worth at least $500,000 and their testimony should have been accepted as to its value. But no facts were disclosed to show on what grounds their conclusions were based. The whole structure, on which they are built, is carefully concealed. The Government is not obliged to accept the conclusion of these experts as to the value of the plan without being shown what it is and without being shown some sound basis on which their opinion rests. We are inclined to feel that the intrinsic value of the plan lies in secrecy and in salesmanship.

The determination of this case depends in the final analysis upon whether or not the "Taylor plan" is "property" within the meaning of the Act, because the deductions it allows are for the exhaustion, wear and tear of "property." It is the use in the trade or business of "*property*" that entitled the taxpayer to a deduction. Unless property is used, no deduction is allowable. In other words before any plan, idea, theory or system can be used as an exhaustible asset in an income tax computation, it must be determined that it is "property."

It appears that the "plan" is copyrighted and the question at once arises as to whether or not the copyright is property. It is true that copyrights are subject to depreciation and may be charged off under the same procedure as patents, taking the term of the copyright into consideration. (Klein, Federal Income Taxation, page 628, et seq.) Copyright laws afford protection for a

limited time against the publication only and not against the use of a system or plan or idea of which the work is an exposition. (*Stone & McCarrick* v. *Dugan Piano Co.*, 210 Fed., 399; *Baker* v. *Selden*, 101 U. S., 99.) A copyright does not give its owner any property in the thing copyrighted. It simply gives him protection against anybody else copying it. Nor does it prevent anyone from using the copyrighted matter, if it is not copied or published. The value of the "Taylor plan" lies in its application and not publication. And so the copyright of the "plan," whether it discloses the secret features or not, does not help the petitioner, for it is not "property," on the exhaustion, wear and tear of which a deduction may be based.

The scope of the meaning of the term "property," as it is used in the Revenue Acts, includes both tangibles and intangibles. A taxpayer has the right to take a reasonable allowance for depreciation of an intangible just as in the case of a tangible, if it is property used in the trade or business. But the plan of the petitioner can not meet the real and definite characteristics that the law requires of "property."

What was the "Taylor plan"? Taylor had an idea, theory or system in his head. It could not be subject to ownership in a legal sense any more than the multiplication table. Its value, if it has other than the benefit of Taylor's salesmanship, lies not simply in the plan itself, but in the retention of its details in secret, in being withheld from the public. This in itself is a demonstration that it is not property which is subject to possession and control and may be used as an exhaustible asset in computing deductions in income taxes.

The petitioner and his witnesses did not regard the plan as property but simply as an idea which, conceivably, might have a potential value of some $500,000. Thus, if it can be thought of as analogous to some inventive idea in any art, it would not become property until it was reduced to practice and patented or, being a secret idea, like a secret process, it might be sold and by virtue of the executory or executed contract be reduced to a chose in action which is "property."

Again, if it is remotely possible that the secret feature of the petitioner's plan might be property, the petitioner was obliged to prove, inter alia, its duration of usefulness. (Klein, Federal Income Taxation, page 630.) This he did not do and we can only speculate that the petitioner would possess the exclusive right to enjoy and use the plan in his business so long as he retained the secret features.

Whatever the "Taylor plan" may be, the petitioner has failed to show that it is "property" within the meaning of section 214(a)8 of the Revenue Acts of 1921 and 1924. He must, therefore, fail as he has not fulfilled the requirements of the statute.

Another question remains for our disposal: The proper treatment of the $80,000 that the petitioner received in 1924 in settlement of his contract with the Journal Printing Co. of Minneapolis.

The petitioner sold the use of his plan to the Journal Printing Co. at $300 a week for 10 consecutive years beginning May 28, 1921, or within three years from that date the Journal Printing Co. was to pay the petitioner $100,000 in full settlement of the contract. All weekly payments theretofore made were to be credited as a part of the $100,000. However, during the years 1921, 1922 and 1923, the weekly payments were not made and the petitioner, who kept his accounts on the accrual basis, charged off at the end of each year all but $1 of the accounts, leaving them open with that balance. In 1924, the petitioner and the Journal Printing Co. effected a settlement of the obligations arising under the contract of 1921, whereby the Journal Printing Co. paid to the petitioner a total of $80,000 in full settlement. The petitioner then without objection reentered on his books the amounts that had been accrued under the contract during the years 1921, 1922 and 1923, but also accrued for 1924, 1925 and 1926, maintaining his tax return so as to pay the taxes on the moneys received. The Commissioner of Internal Revenue allowed the petitioner to accrue the sum of $300 a week from May 28, 1921, through 1924, but treated the balance of the settlement as income for 1924 for the reason that even under the accrual system periodical payments can not be spread into the future.

Before the settlement in 1924, the petitioner had a right to receive $300 a week during the coming years in which the contract was in force. He could have continued using the accrual basis to reflect his income until the term of the contract was ended. But a settlement was reached. No further payments were to be made and the moneys accepted by the petitioner were in lieu of prior and future payments due under the contract. With the settlement the

contract was completed and nothing further could be accrued under the closed transaction. It is clear that no accrual entries can be made in the future and advantage be taken of them when in fact no payments are to be made or accrued in the future. The law requires a taxpayer's return to reflect his true income.

Relying on the recent case of *Burnet* v. *Sanford & Brooks* (282 U. S., 359 [Ct. D. 277, C. B. X–1, 363]), and related cases the petitioner says: "The clear inference (from these cases) is that if the taxpayer had kept its books on the accrual basis (and the present petitioner does so keep his books), payments under a contract, even when the contract is enforced by suit by the taxpayer, are income not when the money is received, but as it accrues under the contract." That is a correct statement of the law and we are of the opinion that if it is applied in this case, the amount of the settlement (except that part allocated to the years 1921, 1922 and 1923) is income for the year 1924 for the reason that it accrued in that year, the contract being at an end and superseded by the settlement.

The redetermination of the Board of Tax Appeals is affirmed.

SECTION 214(a)9.—DEDUCTIONS ALLOWED INDIVIDUALS: DEPLETION.

ARTICLE 225: Charges to capital and to expense in the case of oil and gas wells.

REVENUE ACT OF 1924.

Restatement of article 225, Regulations 65. (See T. D. 4333, page 31.)

SECTION 215.—ITEMS NOT DEDUCTIBLE.

ARTICLE 291: Personal and family expenses.

REVENUE ACT OF 1924.

Payments from trust provided in consideration of release of all claims for alimony, dower, maintenance, and support. (See I. T. 2628, page 34.)

SECTION 216.—CREDITS ALLOWED INDIVIDUALS.

ARTICLE 302: Personal exemption of head of family.

REVENUE ACT OF 1924.

Child adopted without legal proceedings. (See I. T. 2611, page 36.)

ARTICLE 305: Date determining exemption.

REVENUE ACT OF 1924.

Computation of personal exemption where status changes during taxable year. (See G. C. M. 10129, page 38.)

ARTICLE 305: Date determining exemption.

REVENUE ACT OF 1924.

Revocation of Mimeograph 3288 (C. B. IV–1, 40) in so far as inconsistent with General Counsel's Memorandum 10129. (See I. T. 2610, page 41.)

SECTION 219.—ESTATES AND TRUSTS.

ARTICLE 342: Method of computation of net income and tax.

REVENUE ACT OF 1924.

Depletion claimed by beneficiaries of a trust having an interest in the corpus. (See G. C. M. 10273, page 169.)

PART III.—CORPORATIONS.

SECTION 231.—CONDITIONAL AND OTHER EXEMPTIONS OF CORPORATIONS.

ARTICLE 522: Cooperative associations. XI-26-5529
Ct. D. 506

INCOME TAX—REVENUE ACTS OF 1924 AND 1926—DECISION OF COURT.

EXEMPTION—FARMERS' ASSOCIATION.

Where a corporation, having capital stock, does not act as sales agent but is engaged in its own behalf as a dairy and creamery company, obtaining from producers, nonstockholders as well as stockholders, milk and cream and manufacturing their products, which, together with the milk and cream, it sells, and where it does not distribute the proceeds of sales, less necessary expenses, among the producers upon the basis of the produce furnished, does not make any distribution to nonstock-holding producers from whom it derives 30 per cent of its profits but distributes the proceeds to stockholders, except for a small part, in proportion to their stock interest in the capital and surplus which through the business done with stockholders and nonstockholders it is building up for them, it is not a farmers' association that is exempt from tax under section 231(11) of the Revenue Act of 1924 and section 231(12) of the Revenue Act of 1926.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT.

Producers Creamery Co., appellant, v. *United States of America, appellee.*

Appeal from the District Court of the United States for the Northern District of Texas.

[January 21, 1932.]

OPINION.

HUTCHESON, Circuit Judge: Appellant, a corporation organized under the general corporation laws of Texas as a dairy and creamery company, with a capital stock of $20,000 paid in, paid substantial income taxes in 1924 and 1925. Its claim for refund on the ground that it was a cooperative farmers' organization doing business in accordance with section 231 of the Revenue Acts of 1924 and 1926, and therefore exempt from taxation, was allowed and paid on October 16, 1928. The money had no sooner been paid than the Government demanded it back on the ground that it had erroneously refunded it. This suit followed appellant's refusal to comply with the demand. A jury waived, the case was submitted to the court upon substantially the same facts upon which the Bureau had first made and then demanded back, the refund. These facts are: While all of its members were producers of milk, the company was not at any time a mere sales agent for its members. It was actively engaged in its own behalf as a dairy and creamery company, obtaining from producers, nonmembers as well as members, milk and cream, and manufacturing butter, cheese, and other dairy products, which together with the milk and cream. it sold, and the proceeds from which it used to build up and establish its business and acquire a plant and equipment. Its established policy was not to pay

dividends, at least until it had thoroughly established its plant and business. A stockholder, however, was paid a bonus over the regular market price on milk brought in by him up to 10 gallons per day for each $100 of stock owned by him. It was the policy of the company to, and it did, purchase its raw milk from its stockholders, except when they were unable to supply its demands; then it purchased from nonstockholders, paying them the current market price without bonus. In 1924 and 1925 the company made large net profits of almost $15,000 a year, all of which it plowed back into buildings and equipment. During this period it purchased 70 per cent of its supplies from members; 30 per cent from nonmembers. At no time did the company simply deduct the cost of handling the shipments and return the proceeds to the members. It could not do so, for it was in the business of selling and distributing milk and cream, and bought milk for itself. At no time did it in any way distribute to or set apart for its nonmember customers any part of the profits arising from these purchases.

Appellant comes here complaining of the judgment for the Government entered on these facts. We think the judgment was right. The most casual reading of the invoked sections of the Revenue Acts will show that appellant's operations do not bring it within their letter. The most careful reading of those Acts and the regulations promulgated to enforce them will show that appellant comes within neither their letter nor their spirit. The Act of 1924 extends the exemption to "farmers', fruit growers', or like associations organized and operated as sales agents for the purpose of marketing the products of members and turning back to them the proceeds of sales, less the necessary selling expenses, on the basis of the quantity of products furnished by them," while that of 1926 substantially enacting into law the provisions of article 522 of the regulations promulgated for the enforcement of the Act of 1924, extended the exemption to (12) "farmers', fruit growers', or like associations organized and operated on a cooperative basis (a) for the purpose of marketing the products of members and other producers, and turning back to them the proceeds of sales, less the necessary marketing expenses, on the basis of either the quantity or the value of the products furnished by them."

Conceding *arguendo*, though *Riverdale Cooperative Creamery Assn.* v. *Commr.* (48 Fed. (2d), 714) is to the contrary, that article 522 of the regulations in itself, and in the light of its enactment into law in the Act of 1926, is effective to enlarge the exemption conferred by section 231 of the 1924 Act, appellant can take nothing from the concession. This article does indeed by affirmatively recognizing the right of such associations to act for producers generally, to pay dividends, to accumulate a reserve, and to have a capital stock, clear up for appellant the terms of the 1924 Act limiting the benefits of the section to associations operating merely as sales agents for members, and turning back to members the proceeds of the sales less costs. It, however, specifically provides that the proceeds, less the necessary operating expenses, must be distributed among the producers upon the basis of the quantity of milk or butter fat in the milk, and that "If the proceeds of the business are distributed in any other way than on such proportionate basis, the association does not meet the requirements of the statute and is not exempt."

Appellant does not distribute the proceeds less expenses among the producers with whom it deals in this way. It does not distribute them in any way to 30 per cent of its producer customers. These get no bonuses, are entitled to no dividends; have no interest in the company. Nor does it even distribute the proceeds in this way to its members. In a small way it makes some distribution based upon supplies furnished, that is, a bonus is paid on 10 gallons of milk a day on each $100 of stock, but its real distribution is made and to be made to its stockholders, not in proportion to the milk supplied, but in proportion to their stock interest in the capital and surplus which, through the business done with members and nonmembers, it is building up for them.

It is plain, therefore, that appellant was not in 1924 either under the terms of the statute standing alone, or as liberalized by the regulations, a cooperative association as contemplated in the Act. (*South Carolina Products Assn.* v. *Commr.*, 50 Fed. (2d), 742.) We think it equally clear that it was not exempt under the 1926 Act. This Act does expressly extend the exemption to corporations having a capital stock, paying dividends on the stock, and accumulating a reserve, and does specifically provide that such an association may market the products of nonmembers to the extent of 50 per cent of its business. It, however, just as the 1924 statute does, bases the tax exemption upon the fact that the association is organized to and in operation does, turn back to those

for whom it markets their produce, the proceeds of the sales less operating costs. Here the undisputed proof shows that appellant makes at least 30 per cent of its profit from nonmembers to whom it turns nothing back.

It is a universal rule that one who would claim the benefits of a statute must bring himself, at least substantially, within its terms. Especially is this true of claimants under statutes purporting to exempt from taxation. (*Bank of Commerce* v. *State of Tennessee*, 161 U. S., 134; *Heiner* v. *Colonial Trust Co.*, 275 U. S., 232 [T. D. 4112, C. B. VII–1, 207]; *Ins. & Title Guarantee Co.* v. *Commr.*, 36 Fed. (2d), 843 [Ct. D. 155, C. B. IX–1, 279].) Appellant, in the face of the language of the statutes, and of these undoubted rules governing its construction and application, pressing upon us considerations of the policy to foster cooperative efforts which Congress is supposed to have had in mind in enacting these statutes, asks that we construe them to mean other than as they provide. That we extend them to embrace institutions which neither a literal nor a liberal construction of their language will embrace. This we may not do.

Opinions treating questions similar to the one before us, and taking the same general view of them that we have taken, are *South Carolina Products Co.* v. *Commr.*, supra; *Northwestern Jobbers' Credit Bureau* v. *Commr.* (37 Fed. (2d), 880 [Ct. D. 206, C. B. IX–2, 228]); *Riverdale Cooperative Creamery Assn.* v. *Commr.*, supra; *Burr Creamery Co.* v. *Commr.* (23 B. T. A., 1007); *Fruit Growers Supply Co.* v. *Commr.* (21 B. T. A., 315).

The judgment is affirmed.

SECTION 238.—CREDIT FOR TAXES IN CASE OF CORPORATIONS.

ARTICLE 611: Credit for foreign taxes.

REVENUE ACT OF 1924.

Time of accrual of British income taxes. General Counsel's Memorandum 5971 (C. B. VIII–1, 182) revoked in so far as inconsistent with General Counsel's Memorandum 10613 (page 173).

PART V.—PAYMENT, COLLECTION, AND REFUND OF TAX AND PENALTIES.

SECTIONS 273 AND 274.—DEFICIENCY IN TAX.

ARTICLE 1232: Assessment of a deficiency. XI–25–5519
Ct. D. 501

INCOME TAX—REVENUE ACT OF 1924—DECISION OF COURT.

1. NOTICE OF DEFICIENCY—SUFFICIENCY—MERGER OF CORPORATION.

Where the A Corporation and the B Corporation merge under the statutes of Pennsylvania to form the C Corporation and thereafter the Commissioner pursuant to section 274(a) of the Revenue Act of 1924 mails to the A Corporation a notice of a deficiency in tax of the A Corporation, the notice which is received by the C Corporation is a sufficient notice to the C Corporation of the deficiency determined.

2. ESTOPPEL—DISMISSAL OF APPEAL TO BOARD—RIGHT TO ASSESS AFTER DISMISSAL—MERGER OF CORPORATION.

Where the A Corporation and the B Corporation merge under the statutes of Pennsylvania to form the C Corporation and thereafter the Commissioner pursuant to section 274(a) of the Revenue Act of 1924 mails to the A Corporation a notice of a deficiency in tax of the A Corporation and the C Corporation files an appeal in its own name with the Board of Tax Appeals from the determina-

tion of the Commissioner, the C Corporation is estopped to contend that it is not the taxpayer on a motion to dismiss the appeal filed by the C Corporation five years later; and where the Board dismisses the appeal for lack of jurisdiction as to the C Corporation on the erroneous ground that the latter had never received any notice of deficiency and had no right to appeal, the Commissioner's right to make an assessment, after the dismissal, against the "A Corporation now merged into and existing as the C Corporation" existed as if the dismissal on motion of the C Corporation were not because of lack of jurisdiction.

8. INJUNCTION.

Where the A Corporation and the B Corporation merge under the statutes of Pennsylvania to form the C Corporation, section 3224 of the Revised Statutes prohibits a suit to restrain the collection of a tax from the C Corporation which is assessed against the "A Corporation now merged into and existing as the C Corporation."

DISTRICT COURT OF THE UNITED STATES FOR THE WESTERN DISTRICT OF PENNSYLVANIA.

Pittsburgh Terminal Coal Corporation, complainant, v. *Daniel B. Heiner, Individually and as Collector of Internal Revenue for the Twenty-third Collection District of Pennsylvania, defendant.*

[January 26, 1932.]

OPINION.

GIBSON, District Judge: The complainant has filed its bill of complaint wherein it seeks an injunction against the collector of internal revenue by which he shall be enjoined from subjecting the property of complainant to distraint for the collection of taxes assessed against a corporation which has, since original assessment, been merged and consolidated with another corporation under the laws of Pennsylvania to form the complainant corporation.

The defendant has moved to dismiss the bill, alleging, in substance, that the court is without jurisdiction to enjoin the collector, that the complainant has an adequate remedy at law, and that the bill presents no facts which would entitle the complainant to equitable relief.

The facts set forth in the bill are as follows:

On the 28th day of April, 1902, letters patent were issued by the Governor of the Commonwealth of Pennsylvania to Pittsburgh Terminal Railroad & Coal Co., a corporation chartered under the act of Assembly of Pennsylvania, approved April 29, 1874.

In 1918 Pittsburgh Terminal Railroad & Coal Co. filed its income and excess profits tax return for the taxable year 1917 and paid the taxes shown by such return to be due.

On the 30th day of December, 1922, the corporate name of Pittsburgh Terminal Railroad & Coal Co. was changed to Pittsburgh Terminal Coal Co. by certificate duly filed for that purpose with the secretary of the Commonwealth of Pennsylvania.

On November 24, 1924, Pittsburgh Terminal Coal Co. and Meadow Lands Coal Co., a Pennsylvania corporation, entered into an agreement of merger and consolidation for the purpose of forming one corporation to be known as "Pittsburgh Terminal Coal *Corporation.*" This agreement was authorized by and consummated under an act of the General Assembly of the Commonwealth of Pennsylvania entitled "An act authorizing merger and consolidation of certain corporations," approved May 3, 1909, as amended by the act of April 29, 1915.

Pursuant to this agreement of merger and consolidation and on December 1, 1924, letters patent were issued by the Governor of Pennsylvania to the complainant, Pittsburgh Terminal Coal *Corporation,* and thereupon Pittsburgh Terminal Coal Co., formerly Pittsburgh Terminal Railroad & Coal Co., and Meadow Lands Coal Co. were dissolved and ceased to exist.

On August 26, 1925, approximately 10 months after Pittsburgh Terminal Railroad & Coal Co., by change of name Pittsburgh Terminal Coal Co., had been dissolved, the Commissioner of Internal Revenue, pursuant to the provisions of section 274(a) of the Revenue Act of 1924, mailed to "Pittsburgh Terminal

Railroad & Coal Co." two 60-day letters purporting to advise "Pittsburgh Terminal Railroad & Coal Co." of two deficiency assessments for the year 1917, one in the amount of $59,034.70 for the first three months of 1917, and the other in the amount of $228,923.63 for the last nine months of 1917. Similar letters were mailed by the Commissioner to other companies with which, in 1917, Pittsburgh Terminal Railroad & Coal Co. was affiliated, with the result that on October 23, 1925, a petition was filed with the Board of Tax Appeals and given docket No. 8349, captioned "Appeal of The Pittsburgh & West Virginia Railway Co. and affiliated companies hereinafter mentioned, Wabash Building, Pittsburgh, Pa." The petition stated:

"The above-named taxpayer, the Pittsburgh & West Virginia Railway Co., its predecessor company, the Wabash Pittsburgh Terminal Railway Co. and its affiliated companies, the Pittsburgh Terminal Coal Corporation (formerly Pittsburgh Terminal Coal Co. and prior thereto Pittsburgh Terminal Railroad & Coal Co.), West Side Belt Railroad Co., Mutual Supply Co., Pittsburgh Terminal Clay Manufacturing Co., and Pittsburgh Terminal Land Co., hereby appeal from the determination of the Commissioner of Internal Revenue set forth in his deficiency letters (Bureau symbols IT:CR:RR:TJH-60D), dated August 26, 1925. * * *."

On November 22, 1930, a motion was filed by Pittsburgh Terminal Coal *Corporation* with the Board of Tax Appeals in docket No. 8349 to dismiss the proceeding as to it upon the grounds that the appeal to the Board was taken by Pittsburgh Terminal Coal Corporation with respect to a deficiency notice addressed to Pittsburgh Terminal Railroad & Coal Co.; that Pittsburgh Terminal Coal Corporation was an entirely different entity and corporation from Pittsburgh Terminal Railroad & Coal Co., by change of name Pittsburgh Terminal Coal Co., a dissolved corporation, and no notice of deficiency or proposed assessment was ever given to Pittsburgh Terminal Coal Corporation. On March 20, 1931, the Board of Tax Appeals promulgated its opinion upon such motion, holding and finding that Pittsburgh Terminal Coal Corporation was an entirely separate and distinct corporate entity from Pittsburgh Terminal Railroad & Coal Co., by change of name Pittsburgh Terminal Coal Co., and that Pittsburgh Terminal Coal Corporation, the complainant, was not the taxpayer, and had never received any notice of deficiency of tax or proposed assessment and consequently had no right to appeal from the notice of deficiency and proposed assessment which the Commissioner, on August 26, 1925, mailed to Pittsburgh Terminal Railroad & Coal Co., a dissolved corporation. In accordance with such opinion the Board of Tax Appeals, on March 23, 1931, entered its formal order dismissing, for lack of jurisdiction, the proceeding pending before it in so far as the Pittsburgh Terminal Coal Corporation was concerned, and on April 29, 1931, the Board of Tax Appeals denied the Commissioner's application for a rehearing.

The Commissioner, on May 18, 1931, made two assessments against "Pittsburgh Terminal Railroad & Coal Co., now merged into and existing as Pittsburgh Terminal Coal Corporation," for the same taxes which were involved in the proceeding before the Board of Tax Appeals, one of such assessments being in the sum of $77,548.95 for the first three months of 1917, and the other being in the amount of $300,717.84 for the last nine months of 1917, and the list containing such assessments was certified to the defendant collector and received by him on May 23, 1931.

On May 25, 1931, the defendant collector left with the complainant two notices and demands addressed to "Pittsburgh Terminal Railroad & Coal Co., now merged into and existing as Pittsburgh Terminal Coal Corporation," one being in the amount of $77,548.95 for the first three months of 1917, and the other being in the amount of $300,717.84 for the last nine months of 1917.

On May 25, 1931, two notices of tax liens were filed by the defendant collector, one with the clerk of the United States district court, Federal Building, Pittsburgh, Pa.. and the other with the prothonotary of Allegheny County, Pittsburgh, Pa., such notice of tax liens being for taxes in the amount of $378,266.79 alleged to be due for the year 1917, and giving the name of the taxpayer as "Pittsburgh Terminal Railroad & Coal Co., now merged into and existing as Pittsburgh Terminal Coal Corporation." On June 5, 1931, the defendant collector mailed to the complainant two second notices and demands for the payment of the taxes aforesaid, which were addressed to "Pittsburgh Terminal Railroad & Coal Co., now merged into and existing as Pittsburgh Terminal Coal Corporation." On June 15, 1931, the defendant collector issued his warrants

for distraint for the collection of taxes in the sum of $78,084.35 alleged to be due for the first three months of 1917, and in the sum of $302,794.03 alleged to be due for the last nine months of 1917, from "Pittsburgh Terminal Railroad & Coal Co., now merged into and existing as Pittsburgh Terminal Coal Corporation," and pursuant to such warrants for distraint the defendant collector levied upon all the property and rights to property of the complainant, including its bank accounts, and is threatening to proceed under such warrants for distraint to sell the property of the complainant so levied upon for the payment of the taxes aforesaid alleged to be due from Pittsburgh Terminal Railroad & Coal Co.

Thereupon and on the 23d day of June, 1931, this proceeding was instituted to restrain the defendant collector from proceeding further with such warrants for distraint and to declare the levy and seizures of complainant's property made thereunder null and void.

The entire case of the complainant is based upon sections 274(a) and 280(a) of the Revenue Act of 1926. The first named section provides that the Commissioner of Internal Revenue, if he determines that a deficiency in respect to tax exists, shall send the taxpayer notice of the deficiency by registered mail, and thereupon the taxpayer shall have 60 days within which to appeal to the Board of Tax Appeals for a redetermination of the deficiency, and in case of appeal no action shall be taken pending the decision of the Board. Section 280(a) prescribes the same procedure in respect to the liability of a transferee of property of a taxpayer as is provided in regard to the taxpayer. The complainant alleged that the Commissioner, in the assessment of the tax and the levy upon its property, has not obeyed the statute in that he sent no 60-day notice to complainant of the deficiency assessment for which he now proposes to hold complainant liable. It asserts that the notice sent to the Pittsburgh Terminal Railroad & Coal Co., one of two corporations whose merger resulted in complainant's corporate existence, was a notice sent to a nonexistent corporation, and was not the notice to complainant required by statute before the Commissioner could proceed to the collection of the tax claimed by him.

The objection raised by complainant to the procedure in the instant matter is quite technical, and we do not attribute to it the weight claimed by the complainant. The Pennsylvania merger statute to which complainant owes its corporate existence enacts that all debts not of record, duties and liabilities of each of the merged corporations shall attach to the new corporation after merger and may be enforced as if contracted by it. There is, in fact, no contention that complainant is not ultimately liable for the amount of the tax legally due from its constituent corporations. It received notice of the assessment of a deficiency tax for which it knew it was liable, accepted that notice as applying to it and appealed to the Board of Tax Appeals, thus delaying the collection of the tax for five years. Having accepted the notice as its own, and having so acted pursuant to that acceptance, it may not now be allowed to deny notice for the sole reason that the communication of the assessment was directed to its constituent company. It will be noted that while sections 274(a) and 280(a), supra, require notice of the determination of the tax, they do not prescribe any form in which it shall be given. When actually given by one party, and accepted and acted upon by the other, the notice was sufficient. To hold otherwise is to allow the technical an undue triumph over the substantial.

The contention of the complainant in respect to the alleged insufficiency of the notice because directed to one of the merged corporations, has a parallel in one advanced by the complainant in *Bailey* v. *Railroad Company* (89 U. S., 604). In that case it appeared that the New York Central Railroad Co. and the Hudson River Railroad Co. had been merged under a statute practically the same as the Pennsylvania act under which the merger in the instant case had been effected. After the consolidation, a tax was assessed against the New York Central Railroad. Later, a warrant of distraint issued against "The New York Central Railroad Co., or the New York Central & Hudson River Railroad Co." The assessment against The New York Central Railroad was attacked as made against a nonexistent company, and also the warrant, but the Supreme Court sustained the procedure. If the assessment was sufficient in form to bind the new company in that case, it would seem to be even more certain that it sufficed in this one, in view of the recognition and long acceptance of the notice as binding by the complainant.

Complainant has further contended that the Commissioner's action in proceeding to collect the tax by distress was illegal, even though the Board of Tax Appeals were in error in its dismissal of complainant's petition for review

because the notice of assessment had been directed to the constitutent company rather than the existing company. It asserts that Congress has provided for the correction of error by the Board by giving the right of appeal to the Circuit Court of Appeals to each party injured by its decision, and that an adverse decision is binding unless reversed upon appeal. In the majority of cases before the Board this contention is correct. In the present case, it will be remembered, the dismissal of the appeal to the Board was not upon the motion of the Commissioner, but of complainant. In view of this fact, it is very doubtful if any appeal could be successfully maintained. A taxpayer who disputes an assessment has two remedies: (1) He may pay the tax demanded and bring suit to recover that part wrongfully collected, or (2) he may, within 60 days after assessment, if aggrieved, have the assessment reviewed by the Board of Tax Appeals. The second alternative is a privilege conferred upon him by Congress. If he chooses to waive it, he may do so; and, if having undertaken to exercise his privilege, he later successfully seeks to withdraw his appeal to the Board, his withdrawal, it would seem, has the sole effect of limiting his remedies to payment and suit to recover. The appeal being out of the way, the status of the matter was left as when the review was sought, and the Commissioner was unaffected by the dismissal, being left with the same power as to collection as he had before the matter was taken to the Board. True, the Board expressed the opinion that the Commissioner had no right to make a deficiency assessment, or distrain to collect the amount of such assessment, by reason of the fact that no 60-day notice had been given complainant by name. But appeals lie to the actions of courts, or similar bodies, not to the mere expression of their opinions. In the instant case the Commissioner was not aggrieved by the action of the Board, but only by its expression of opinion. While the Commissioner should, and doubtless does, duly respect the opinions of the Board, the authority of the Board in mere matters of law, unconnected with any judgment in regard to a tax liability, is not such as to require him to accept its opinions upon legal matters if such opinions are, after consideration, believed by him to be incorrect.

In our opinion, the notice given by the Commissioner in the instant matter was a sufficient compliance with section 274(a) of the Act of 1926. But even if we were to admit error in this respect, it still would seem that the complainant is in no position to appeal to a court of equity. By filing its petition for review it affirmed the sufficiency of the notice as to itself. It maintained that position for five years and thus delayed the Commissioner in the collection of the tax due for that period. Had it not filed its petition for review after the notice, or even had it asserted its mistake in filing it within a reasonable time after doing so, the complainant's bill, looking at it only from the standpoint of the equities involved, would have had considerably more weight than at present, but after accepting the notice as sufficient, and thus disarming the Commissioner, and then delaying for a period of five years before alleging the insufficiency of the notice, it plainly should be held to be estopped from assuming a new position and so obtaining further delay.

In the foregoing we have endeavored to consider the merits of the bill of complaint. In view of section 3224, R. S., and section 604 of the Revenue Act of 1928, quoted below, such a consideration was seemingly a work of supererogation.

Revised Statutes (U. S. C. A., Title 26, section 154):

"SEC. 3224. No suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court."

Revenue Act of 1928 (ch. 852, 45 Stat., 791):

"SEC. 604. No suit shall be maintained in any court for the purpose of restraining the assessment or collection of (1) the amount of the liability, at law or in equity, of a transferee of property of a taxpayer in respect of any income, war-profits, excess-profits, or estate tax, or (2) the amount of the liability of a fiduciary under section 3467 of the Revised Statutes in respect of any such tax."

We do not undertake to review the cases wherein section 3224, R. S., has been considered by the courts. On its face a rule without exceptions, a number of decisions may be cited which, on first reading, appear to limit its scope. Those cases, however, disclose exceptional circumstances. In each case, almost without exception, the court has based the injunction granted upon the ground that the collector was engaged in collecting a penalty, not a tax. In the present case the injunction is sought against him in his attempt to collect a

tax, and where the complainant still has a remedy by suit to recover any tax wrongfully collected. Under such circumstances the statute controls us.

The bill of complaint must be dismissed.

TITLE X.—GENERAL ADMINISTRATIVE PROVISIONS.

SECTIONS 1014 AND 1015.—LIMITATIONS UPON SUITS AND PROCEEDINGS BY THE TAXPAYER.

ARTICLE 1351: Suits for recovery of taxes erroneously collected. XI-2-5350 Ct. D. 438

INCOME TAX—REVENUE ACT OF 1924—DECISION OF COURT.

SUIT—LIMITATION—CLAIM FOR REFUND.

The provisions of section 3228 of the Revised Statutes as amended are mandatory and if no claim for refund has been filed a suit can not be maintained, by reason of section 3226, Revised Statutes, as amended, to recover an overpayment which the Commissioner is authorized to credit or refund under section 281(c) of the Revenue Act of 1924 without the filing of a claim therefor, notwithstanding the period of limitation provided for in subdivision (b) has expired.

DISTRICT COURT OF THE UNITED STATES, DISTRICT OF MASSACHUSETTS.

Renfrew Manufacturing Co. v. *United States of America.*

[October 30, 1931.]

OPINION.

BREWSTER, J.: Suit against the United States to recover income taxes for the years 1913 to 1916, both inclusive. Defendant has demurred to the petition, assigning as grounds that the petitioner has not complied with R. S. 3226, as amended by the several Revenue Acts (26 U. S. C. A., section 156), and has not seasonably commenced the action.

It is alleged in the petition that in 1924 the Commissioner of Internal Revenue, after an investigation respecting the excess-profits tax due from petitioner for the year 1917, saw fit to reduce the amount of its invested capital. This action was based on the discovery that the petitioner had not made adequate deductions for depreciation in its tax returns for 1913, 1914, 1915, and 1916. Under section 281(c) of the Revenue Act of 1924 (26 U. S. C. A., section 1065), the petitioner thereby became entitled to a credit or refund of any overpayment of income, war-profits or excess-profits taxes for these years resulting from the inadequate deductions for depreciation for the previous years. It is not alleged that the petitioner filed a claim for a refund of any overpayment of taxes but only that demand was duly made therefor upon the United States through its Department of Internal Revenue, which demand was refused. The Revenue Act of 1924 was in force when the Commissioner decreased the invested capital, due to inadequate deduction for depreciation. That Act provided in section 281 (b) and (c) as follows:

"(b) Except as provided in subdivisions (c) and (e) of this section, (1) no such credit or refund shall be allowed or made after four years from the time the tax was paid, unless before the expiration of such four years a claim therefor is filed by the taxpayer, nor (2) shall the amount of the credit or refund exceed the portion of the tax paid during the four years immediately preceding the filing of the claim or, if no claim was filed, then during the four years immediately preceding the allowance of the credit or refund.

"(c) If the invested capital of a taxpayer is decreased by the Commissioner, and such decrease is due to the fact that the taxpayer failed to take adequate deductions in previous years, with the result that there has been an overpayment of income, war-profits, or excess-profits taxes in any previous year or

years, then the amount of such overpayment shall be credited or refunded, without the filing of a claim therefor, notwithstanding the period of limitation provided for in subdivision (b) has expired."

Congress also at the same time amended R. S. section 3228 by enacting section 1012, which reads in part as follows:

"SEC. 3228. (a) All claims for the refunding or crediting of any internal-revenue tax alleged to have been erroneously or illegally assessed or collected, or of any penalty alleged to have been collected without authority, or of any sum alleged to have been excessive or in any manner wrongfully collected must, except as provided in section 281 of the Revenue Act of 1924, be presented to the Commissioner of Internal Revenue within four years next after the payment of such tax, penalty, or sum."

The intent is apparent to except from the provisions of the statutes limiting the time within which a taxpayer must file a claim for refund, claims for any overpayment of taxes due to increased allowance for depreciation with respect to previous years, and to authorize the Commissioner to credit or refund such excess without the necessity of any such claim being filed. In other words, the right of the taxpayer to such refund or credit did not at all depend upon whether a claim had been filed therefor. The Act of 1924 expressly avoids any conflict between sections 1012 and 281.

But the petitioner contends that there is an irreconcilable conflict between section 281 and section 1014(a) of the Act of 1924 (reenacted without change in the Revenue Act of 1926) which amended R. S. 3226 to read as follows:

"SEC. 1014. (a) Section 3226 of the Revised Statutes, as amended, is amended to read as follows:

"SEC. 3226. No suit or proceeding shall be maintained in any court for the recovery of any internal-revenue tax alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority, or of any sum alleged to have been excessive or in any manner wrongfully collected until a claim for refund or credit has been duly filed with the Commissioner of Internal Revenue, according to the provisions of law in that regard, and the regulations of the Secretary of the Treasury established in pursuance thereof; but such suit or proceeding may be maintained, whether or not such tax, penalty, or sum has been paid under protest or duress. No such suit or proceeding shall be begun before the expiration of six months from the date of filing such claim unless the Commissioner renders a decision thereon within that time, nor after the expiration of five years from the date of the payment of such tax, penalty, or sum, unless such suit or proceeding is begun within two years after the disallowance of the part of such claim to which such suit or proceeding relates. The Commissioner shall within 90 days after any such disallowance notify the taxpayer thereof by mail."

It is to be noted that section 1014(a) does not except from its provisions suits to recover taxes overpaid as a result of additional deductions made pursuant to section 281(a).

The right to recover from the United States may differ materially from the right to maintain in the courts a suit to enforce such recovery. The distinction is important. The United States as a sovereign power can not be sued except with its consent, and unless its case comes clearly within the terms of the statute by which such consent is given, the taxpayer is without remedy. (*United States* v. *Michel*, 282 U. S., 656 [Ct. D. 310, C. B. X–1, 297]; *United States* v. *Felt & Tarrant Mfg. Co.*, 283 U. S., 269 [Ct. D. 336, C. B. X–1, 431].)

It is equally well settled that the suit can not be maintained by a taxpayer if he has failed to file a claim for refund unless that prerequisite is waived. (*Tucker* v. *Alexander*, 275 U. S., 228 [T. D. 3973, C. B. VI–1, 287]; *United States* v. *Felt & Tarrant Mfg. Co.*, supra.)

I am unable to discover any conflict between section 281(c) and R. S. 3226 as amended prior to the bringing of this proceeding. A diligent taxpayer is not left without a remedy. He has full opportunity to take all steps necessary to literally comply with the statute. There is nothing in the Act of 1924, or subsequent Revenue Acts, which forbids the filing of a claim for refund if the credit or refund to which he is entitled by virtue of section 281(c) is denied to him. He can file it notwithstanding other provisions of law limiting the time for the filing of such claims. After six months from date of filing, or sooner, if the claim is disallowed, he may institute his proceedings at any time within two years after such disallowance. Whether that procedure is still open

to petitioner after the lapse of over six years since its rights accrued, is a question not now raised. I have before me only the question whether a petition is demurrable which fails to allege compliance with the provisions of the statute giving a taxpayer the right to sue the United States. I rule that it is and sustain the demurrer.

TITLE XII.—REDUCTION OF INCOME TAX PAYABLE IN 1924.

SECTION 1201.

SECTION 1201. XI-1-5344
Ct. D. 436

INCOME TAX—REVENUE ACT OF 1924—DECISION OF COURT.

1. TWENTY-FIVE PER CENT REDUCTION OF INCOME TAX—PARTNERSHIP FISCAL YEAR 1924—PARTNER'S CALENDAR YEAR 1924.

The provisions of Title XII of the Revenue Act of 1924 do not authorize a 25 per cent reduction of tax on that part of partnership income for the fiscal year 1924 which is by section 207(b) of the Revenue Act of 1924 taxable at 1923 rates and shown in the individual return of a partner for the calendar year 1924.

2. DECISION AFFIRMED.

The decision of the Board of Tax Appeals (18 B. T. A., 393) affirmed.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

William A. W. Stewart, appellant, v. *Commissioner of Internal Revenue, appellee.*

George L. Shearer, appellant, v. *Commissioner of Internal Revenue, appellee.*

Appeals from the United States Board of Tax Appeals.

Before L. HAND, AUGUSTUS N. HAND, and CHASE, Circuit Judges.

[July 17, 1931.]

OPINION.

Petitions by William A. W. Stewart and George L. Shearer, taxpayers, to review orders of the United States Board of Tax Appeals, sustaining the action of the Commissioner of Internal Revenue in determining a deficiency in the income taxes of each taxpayer for the year 1924. Affirmed.

AUGUSTUS N. HAND, Circuit Judge: The above appeals were argued together and relate to the income taxes of the appellants who are law partners doing business under the name of Stewart & Shearer. They made and filed their individual returns on the basis of a calendar year, and the additional taxes found against them are for the calendar year 1924. The partnership filed a partnership return on the basis of a fiscal year ending April 30, 1924. The appellants included in their individual returns for the calendar year 1924, their distributive shares of the partnership profits for its fiscal year, thus including eight months of firm profits earned in 1923. The Commissioner correctly found the taxes on income attributable to 1923 at the rates prevailing for that year, but refused to allow the appellants a reduction of 25 per cent of such taxes under sections 1200 and 1201(b) of the Revenue Act of 1924. As a result, the appellants say that they have been improperly held for a deficiency in their income taxes to the amount of $6,811.08 in the case of Shearer and $5,933.23 in the case of Stewart. The Board of Tax Appeals affirmed the action of the Commissioner.

The question before us is whether the appellants are entitled to receive a 25 per cent reduction of their income taxes on that portion of the partnership income which was, by section 207(b) of the Revenue Act of 1924, taxable at 1923 rates.

Section 218(a) of the Act of 1924 provided that persons carrying on business in partnership should be liable for income taxes only in their individual capacity. It required that, if the income of a partner was computed for a period different from that of the partnership, there should be included in his individual return his distributive share of the net income of the partnership for any accounting period ending within the taxable year upon the basis of which his own income was computed.

In other words, section 218(a) required each appellant when he filed his return on March 15, 1925, for the calendar year 1924, to bring in his distributive share of the partnership income for the entire fiscal year, that ending April 30, 1924. Thus each return, though for the year 1924, necessarily included income of the partnership for eight months of 1923.

By the Revenue Act of 1924, rates for income taxes were greatly reduced. Section 207(a) dealt with cases where taxpayers make returns for a year, different from the calendar year, and the rates are changed during the period. It provided that in such cases the tax on the entire income for the fiscal year should be computed at the rate prevailing during the first calendar year and the proportion of the tax which the period in which these rates were in effect bore to the entire fiscal year should be ascertained. To this sum should be added the proper proportion of the tax computed at the rates prevailing during the second calendar year in order to get the total. This section covered individual taxes only, for, by reason of section 218(a), supra, individuals, and not partnerships, are liable for income taxes and the return of a partnership is essentially no more than an information return.

The method of calculating the tax upon partnership income to be included in individual returns, in cases where rates have changed and the income has accrued in calendar years having different tax rates, was prescribed by section 207(b) of the same Revenue Act. Section 207(b) applies the 1923 rates to the proportion of the fiscal year of the partnership falling within the calendar year 1923 and applied the 1924 rates to the proportion of the fiscal year falling within the calendar year 1924. For purposes of surtax it places the partnership income subject to the 1924 rates in the lower brackets, and the income subject to the 1923 rates in the higher brackets. In doing this, Congress, so far as possible, effectuated the high surtaxes of 1923 by applying them to the proportion of the income allocated to 1923 at the top.

Owing to the surplus in the Treasury in 1923, it was decided to lower income tax rates and it was at first proposed to make the new Revenue Act applicable to 1923 income. But as the bill was not ready for passage until after the returns for 1923 income had been filed, it was thought best to limit the relief to 1923 income to a credit or refund of 25 per cent. Accordingly the following provisions were inserted in the Act of 1924:

"SEC. 1200. (a) Any taxpayer making return, for the calendar year 1923, of the taxes imposed by Parts I and II of Title II of the Revenue Act of 1921 shall be entitled to an allowance by credit or refund of 25 per centum of the amount shown as the tax upon his return. * * *

"SEC. 1201. (a) Any taxpayer making return, for a period beginning in 1922 and ending in 1923, of the taxes imposed by Parts I and II of Title II of the Revenue Act of 1921 shall be entitled to an allowance by credit or refund of 25 per centum of the same proportion of his tax for such period (determined under the law applicable to the calendar year 1923 and at the rates for such year) which the portion of such period falling within the calendar year 1923 is of the entire period.

"(b) Any taxpayer making return, for a period beginning in 1923 and ending in 1924, of the taxes imposed by Parts I and II of Title II of this Act, shall be entitled to an allowance by credit or refund of 25 per centum of the same proportion of a tax for such period (determined under the law applicable to the calendar year 1923 and at the rates for such year) which the portion of such period falling within the calendar year 1923 is of the entire period. * * *"

We think it clear that none of the statutory provisions just quoted afford appellants the relief which they ask. Section 1200(a) does not, for it only relates to a taxpayer making a return for the calendar year 1923 and Stewart and Shearer each made a return for the calendar year 1924. It allows a 25 per

cent credit or refund upon the whole amount properly shown as the tax upon a return for that calendar year, whenever the income may have accrued. Under section 218(a) taxpayers had to bring in the distributive share of any partnership income for an accounting period of the partnership ending within the taxable year, upon the basis of which the partners' net income was computed. Owing to this later section, as construed by the Department, Stewart and Shearer would have been entitled to a 25 per cent deduction upon income of their partnership accruing during the entire fiscal year from April 30, 1922, to April 30, 1923.

Section 1201(a) applies only to a taxpayer making a return for a period beginning in 1922 and ending in 1923. If the appellants had been making their individual returns for a period beginning April 30, 1922, and ending April 30, 1923, this section would have applied, but they were making them for the calendar year 1924, and not for a fiscal year

Section 1201(b) applies to a taxpayer making a return for a period beginning in 1923 and ending in 1924. The appellants were not making a return for such a period, but for the calendar year 1924. By its terms, section 1201(b), as section 1201(a), relates only to taxpayers reporting income for a fiscal year different from a calendar year—a situation not involved here. Section 1201(a) covers only cases where a taxpayer, not a partner, is reporting income under section 207(a) for a split fiscal year. Under section 207(a), section 1201(b) deducts 25 per cent from the proportion of the tax allotted under section 207(a) to 1923. Section 1201(b) is not applicable to a case where partnership income, and not the tax, is allocated between separate years as provided in the case of partnerships by section 207(b).

The strongest argument for the taxpayers is that Congress intended to allow a general reduction of taxes paid for all income accruing in the year 1923. This prevailed with the Court of Appeals of the First Circuit in *White* v. *Maddison* (45 Fed. (2d), 335). Congress allowed reductions under section 1200(a) to those who filed returns for 1923 on a calendar-year basis, and under section 1201(a) and section 1201(b) to those who filed for 1923 or 1924 on a fiscal-year basis. Must we not suppose that it intended to allow a reduction of the tax on an individual who reported for his 1924 return his distributive share of the net income earned partly in 1923?

An affirmative answer to this query seems impossible. In the first place Congress might well have thought that most partnerships were continuous during the periods covered by the remedial legislation relating to 1923 income and that when a partner whose year for accounting ended in 1923 got a 25 per cent deduction on earnings embracing firm income accruing in 1922, as well as down to the termination of the partnership fiscal year, in 1923, this was sufficient relief from the high tax rates prevailing in 1923. If, however, the contention of the appellants were adopted, such a partner would get not only a deduction on partnership income for a split year beginning in 1922 and ending in 1923, he would also obtain a deduction on partnership income during the remainder of 1923. In other words, in a case like the present, he would get a deduction on 20 months of partnership income.

Another argument even more fatal to appellants' position is that section 1201(b), if applicable, would allow a credit or refund of 25 per cent on the proportion of the total tax paid by the reporting taxpayer at 1923 rates which the portion of the period falling within the calendar year bore to the fiscal year of the partnership.

An allowance of 25 per cent of the portion of the tax upon firm income, required by section 207(b) to be placed in the higher brackets, and thus to be calculated at the highest rates, would be for a different sum than that allowed by section 1201(b). In other words, it would not be on two-thirds of the whole tax for the fiscal year as required by section 1201(b), but on a tax which two-thirds of the net firm income would yield when placed in the higher brackets.

The difficulties which the position of appellants involves may be further amplified. If the tax is computed under section 207(b) the method is for the taxpayer to divide his income into two parts according to the year in which it was earned; the income attributable to 1924 is then put in the lower brackets, and the income attributable to 1923 is put in the next higher brackets.

If the tax is computed under section 207(a) the method is for the taxpayer first to consider all his income as earned in 1923, to compute his tax on that basis, and then to take such proportion of the tax as the portion of the fiscal year falling within the calendar year 1923 is of the entire period. Then the taxpayer considers all his income as earned in 1924, computes his tax on that

basis, and takes such proportion of the tax as the portion of the fiscal year falling within the calendar year 1924 is of the entire period. In that way he gets the two items that make his total tax for a fiscal year.

These two methods of computing taxes are different and would produce entirely different taxes on the same income. Those computed under section 207(b) would, in the present case, be more than two-thirds of the total tax figured at 1923 rates because of the higher brackets in which the portion of the income applicable to 1923 would be placed. Taxes computed under section 207(a) would be exactly two-thirds of such total tax.

The refund provided under sections 1201(a) and 1201(b) is based upon a tax computed under section 207(a) because sections 1201(a) and 1201(b) allow a refund on the "proportion" of the tax for the entire fiscal year which the portion of the fiscal year falling within 1923 bears to the entire period. Such a "proportion" of the tax is employed only in section 207(a). It has no relation to section 207(b) by which the "*income*," and not a "*proportion*" of the tax, is allocated between separate years. Therefore a refund of 25 per cent of the amount which is placed in the higher brackets under section 207(b) finds no warrant in the statute.

If it be contended that the taxpayers, though not entitled to a refund based on the taxes computed for 1923 under section 207(b), are entitled to a refund of two-thirds of the tax for the partnership year calculated under section 207(a), the answer is that a refund based upon such a tax would bear no relation to the taxes which must be computed on partnership income under section 207(b). To maintain this last contention would be to allow the refund of a percentage of a tax that was not, under the statute, the tax to be computed against the partnership income.

The Board of Tax Appeals has uniformly adopted the construction of the statute which seems to us inevitable and indeed the only interpretation that will reconcile the various statutory provisions relating to the 25 per cent credit or refund. The opinion of Mr. Sternhagen in *Appeal of Charles Colio* (5 B. T. A., 123) appears to reach the correct result rather than in *White* v. *Maddison*, supra, from which, with all deference, we feel compelled to differ.

The appellants argue that a refusal to allow a refund on partnership income accruing in 1923 because under the Revenue Act it has to be returned as part of the 1924 income of the partners is arbitrary and violates the fifth amendment of the Constitution. But all taxpayers similarly situated are treated alike. There may be individual hardships and a firm which did not exist in 1922 and began business in 1923 would be unable to obtain any refund under the remedial provisions of the Act of 1924. On the other hand, as we have pointed out, if the contention of the appellants were adopted a partnership having business beginning April 30, 1922, would secure a refund on taxes arising from the partnership business that was based not upon 1923 income, but upon eight months also of income accruing in 1922. The revenue law is full of such hardships. If a man happens to sell property in a year when the tax rates are high he will be obliged to pay a tax often attributable to the accumulation of years upon capital gain. Except for practical considerations it would be more consistent with an ideal system to tax accruals in value from year to year, and not to wait for realization of capital gain. But such a method would require the business world to spend most, instead of much, of its time in accounting. Taxation can rarely be scientifically uniform, and it does not have to be. It need only be based on a reasonable classification which we can not say was absent here. (*Barclay* v. *Edwards*, 267 U. S., 450 [T. D. 3691, C. B. IV–1, 207]; *Evans* v. *Gore*, 253 U. S., 256 [T. D. 3037, C. B. 3, 93]; *Diamond Shoe Co.* v. *Commissioner*, 42 Fed. (2d), 148.)

The order of the Board of Tax Appeals is affirmed.

INCOME TAX RULINGS.—PART IV.

REVENUE ACT OF 1921 AND PRIOR REVENUE ACTS.

TITLE II.—INCOME TAX.

PART I.—GENERAL PROVISIONS.

SECTION 201.—DIVIDENDS.

ARTICLE 1541: Dividends. XI-4-5369
(Also Section 202, Article 1561.) G. C. M. 10110

REVENUE ACT OF 1921.

Where distributions are made from the segregated assets of two merging corporations to the holders of certificates of beneficial interest who acquired the certificates on the basis of their ownership of stock in the two merging corporations, such payments constitute taxable dividends to the extent that the merging corporations at the time of their merger had earnings or profits accumulated since February 28, 1913. To the extent that the segregated assets did not consist of profits or earnings accumulated since February 28, 1913, the payments should be applied against the basis of the stock of the merged corporation.

Where distributions are made to holders of certificates of beneficial interest who acquired them by purchase, the distributees derive taxable gain, or suffer deductible loss, to the extent that the value of the distributions exceeds, or is less than, the cost of the certificates of beneficial interest.

An opinion is requested regarding the treatment for income tax purposes of amounts received by stockholders of the M Bank and the N Trust Co. from certificates of beneficial interest in segregated assets of these two companies issued in connection with the merger of the two companies in 1923.

It has been suggested that the payments made to holders of certificates who acquired the certificates by reason of their ownership of stock in the merging corporations can be treated in one of two ways, namely, by treating the payments as ordinary dividends or by treating them as payments in liquidation of the certificates which are regarded as having a basis of zero in the hands of such certificate holders, and hence taxable in their entirety both at normal and surtax rates. It has also been suggested that in cases of taxpayers who purchased certificates the payments should be treated as liquidating dividends and taxable only after the basis has been recovered.

The Board of Tax Appeals considered a similar question in *William E. Fulton* v. *Commissioner* (15 B. T. A., 1018), affirmed by the Court of Appeals of the District of Columbia (47 Fed. (2d), 436), and in *Allen* v. *Commissioner* (19 B. T. A., 1005), affirmed by the Circuit Court of Appeals for the Second Circuit (49 Fed. (2d), 716, Ct. D. 417, C. B. X-2, 315, certiorari denied, 52 Sup. Ct., 34), both of which have a direct bearing on the matters referred to.

In *Fulton* v. *Commissioner*, supra, the Board held in effect that certificates of beneficial interest in segregated assets of merging corporations, received by stockholders in such corporations, were not part of the consideration received by them in the exchange of their stock in the merging corporations for stock in the continuing corporation (which would have brought the transaction in the instant case within the purview of section 202(e) of the Revenue Act of 1921), but that the turning over of certain assets to trustees for the ultimate benefit of the stockholders constituted the declaration of a dividend by the corporations concerned, and that the distributions made by the trustees were taxable as dividends to the stockholders in the year in which the distributions were made.

In *Allen* v. *Commissioner*, supra, the Board held in effect that where distributions from such segregated assets were not made to holders of certificates of beneficial interest who had received such certificates on the basis of their stock holdings in the merging corporations at the time of their merger, but were made to holders of the certificates who had acquired them by way of purchase or assignment, the distributions lost the character of dividends and the certificate holders derived taxable gain, or suffered a deductible loss, to the extent that the distributions were greater than, or less than, the cost (or March 1, 1913, value) of the certificates of beneficial interest.

It is the opinion of this office that the principles laid down in these two Board decisions (which, as previously stated, have been affirmed by appellate courts) should be applied in determining the treatment for income tax purposes of amounts distributed to stockholders of the N Trust Co. and the M Bank from the assets segregated in connection with the merger of these two companies. Applying the principles laid down in *Fulton* v. *Commissioner* and *Allen* v. *Commissioner* leads to the following conclusions:

1. Where distributions are made from the segregated assets of the N Trust Co. and the M Bank to the holders of certificates of beneficial interest who acquired the certificates on the basis of their ownership of stock in the merging corporations at the time of their merger, such payments constitute taxable dividends to the extent that the merging corporations at the time of the merger had earnings or profits accumulated since February 28, 1913. To the extent that the segregated assets did not consist of profits or earnings accumulated by the merging corporations since February 28, 1913, the payments should be applied against the basis of the stock in the merged corporations held by the stockholders.

2. Where the distributions from the segregated assets are made to holders of beneficial interest in these assets who acquired the certificates by way of purchase, the distributees derive taxable gain, or suffer deductible loss, to the extent that the value of the distributions exceeds, or is less than, the cost of the certificates of beneficial interest.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

ARTICLE 1541: Dividends. XI-19-5474
Ct. D. 481

INCOME TAX—REVENUE ACT OF 1921—DECISION OF COURT.

1. DISTRIBUTIONS BY CORPORATIONS—DIVIDENDS OF SUBSIDIARIES.

Where three West Virginia corporations in 1920 conveyed approximately all of their outstanding stock to a newly formed Delaware corporation in exchange for shares of its stock, and in 1921, 1922, and 1923 paid dividends to the Delaware corporation out of earnings and surplus accumulated after March 1, 1913, such dividends do not constitute a return of capital to the Delaware corporation but are income to it, and when distributed in turn to its shareholders, are taxable as ordinary dividends.

DISTRICT COURT OF THE UNITED STATES, DISTRICT OF MARYLAND.

Joseph Coudon, plaintiff, v. *Galen L. Tait, Collector of Internal Revenue, defendant.*

[February 4, 1932.]

OPINION.

CHESNUT, D. J.: In this case the plaintiff sues to recover the surtax on income received during the taxing years 1921, 1922 and 1923, from dividends on stock held by the plaintiff in the Wheeling Steel Corporation, of Delaware. The plaintiff's contention is that the dividends on which the alleged excessive tax was paid was not income, but a return of capital. The applicable Revenue Act is that of 1921.

The facts are entirely embraced within a written stipulation filed October 28, 1931. Both parties have moved for a directed verdict on these facts. Much abridged, the controlling facts may be stated as follows: As of August 1, 1920, three separate West Virginia corporations, all engaged in the manufacture and sale of steel and iron products, were merged into a newly formed Delaware corporation known as the Wheeling Steel Corporation. The merger took the form of the issuance of stock of the Delaware corporation in exchange for the stock of the West Virginia corporations, which acquired approximately 98 per cent of all the outstanding stock of the latter. The West Virginia corporations continued their separate corporate organizations and business until May 1, 1923, when the physical properties were conveyed to the Delaware corporation and the subsidiaries shortly thereafter dissolved.

The Delaware corporation issued its preferred and common stocks in exchange for the stocks of the subsidiaries, on a basis agreed upon by the stockholders, in the aggregate principal amount of $66,179,800. At that time the par value of the aggregate outstanding paid-up capital stock of the subsidiaries was $63,964,755; and the aggregate undistributed earned surplus of these three subsidiaries, accumulated from the operation of their respective businesses since March 1, 1913, was $21,459,085.56. During the period from August 1, 1920, to May 1, 1923, the three subsidiary corporations made payments of dividends to the Wheeling Steel Corporation in excess of their earnings during said period, this excess being paid from their separate surpluses accumulated after March 1, 1913, and existing at August 1, 1920; and the Delaware corporation in turn distributed the amount so received to its shareholders (including the plaintiff) as its dividends. The stipulation of facts does not contain any information as to the bookkeeping entries made by the Wheeling Steel Corporation at the time of the issuance of its stock or with relation to the receipt and distribution of the dividends. It appears that the merger of the corporations was actuated purely by ordinary business reasons without thought of income taxation on stockholders.

The plaintiff's contention is that to the extent that the dividends received by the Delaware corporation from its subsidiaries during the period mentioned exceeded the earnings of the subsidiaries during that period (the excess being paid from surplus accumulated since March 1, 1913), they constituted a return of capital to the Delaware corporation and were not income to it; and therefore,

when in turn distributed by the Delaware corporation as dividends to its stockholders the latter were to the extent mentioned receiving a return of their capital investment in the Delaware corporation and not income therefrom. The argument on behalf of the plaintiff is that the Wheeling Steel Corporation through its ownership of the stock of the subsidiaries, acquired all of the capital of the subsidiaries, including their accumulated surplus (with the exception of that represented by the small outstanding minority stock interest); and it is said that the effect of the transaction was, so far as the Delaware corporation is concerned, to capitalize the surplus of the subsidiaries so that any distribution of this surplus, flowing from the subsidiaries to the Delaware corporation and by it passed on to its own stockholders by way of dividends, was a distribution of a part of the capital of the Delaware corporation and not income.

I am unable to accept this view of the matter for a number of reasons. In the first place, the argument confuses the ownership of stock and the ownership of physical assets. The Delaware corporation, by owning the stock of the subsidiaries, did not thereby become the owner of their physical assets. The distinction is a well-known concept of corporate law. It has been recently well expressed by the Supreme Court in the case of *Rhode Island Hospital Trust* v. *Doughton* (270 U. S., 69).

Likewise, the real capital of the Delaware corporation was not the physical assets of the subsidiaries, but their share of capital stock. The Delaware corporation was a mere holding company, and dividends paid by the subsidiaries on their stock to the holding company were admittedly income payments from earnings so far as the subsidiaries were concerned. And if the stock of the subsidiaries had been held by an individual instead of a holding corporation it is also admitted that the dividends would have been taxable in the ordinary way. It seems equally clear that dividend payments were income to the Delaware corporation. The stocks of the subsidiaries owned by the Delaware corporation constituted its capital and the dividends paid by the subsidiaries on their stocks constituted distributed income. Ordinarily, a purely holding corporation receives its own earnings and income from dividends on the stock held by it.

It may also be noted, although the consideration may not be controlling, that the Delaware corporation did not undertake in form to capitalize the aggregate surplus of the subsidiaries because, as above stated, the aggregate par value of stock issued by the Delaware corporation for a like aggregate par value of stock of the subsidiaries was $63,179,800, while the total par value of the stock of the subsidiaries was $63,964,755, and the aggregate accumulated surplus (since March 1, 1913), was, in addition thereto, $21,459,085.56. That is to say, the Delaware corporation did not in form undertake to capitalize the total value of the assets of the three subsidiaries by issuing its own shares of stock of a par value equal to the aggregate of the capital and surplus of the subsidiaries.

The argument as to capitalization of the surplus of the subsidiaries by the Delaware corporation submitted by plaintiff's counsel is based very largely on the statutory definition of the phrase "invested capital," in the Revenue Act relating to the excess profits tax. This definition seems to me to have no real bearing on the problem here involved, which does not arise under the excess profits tax law.

Furthermore, the exact question here is whether the plaintiff is liable for this tax, that is to say, was the dividend received by him, *income to him*. As was said in *United States* v. *Phellis* (257 U. S., 175 [T. D. 3270, C. B. 5, 37]):

"The liability of a stockholder to pay an individual income tax must be tested by the effect of the transaction upon the individual."

The Income Tax Act of 1921, section 213, provides:

"That for the purpose of this title * * * the term 'gross income'—

"(a) Includes gains, profits, and income * * * from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever."

The term "dividend" is defined for the purposes of the Act by section 201 (a) and (b) as follows:

"(a) That the term 'dividend' when used in this title * * * means any distribution made by a corporation to its shareholders or members, whether in cash or in other property, out of its earnings or profits accumulated since February 28, 1913, except * * *

"(b) For the purposes of this Act every distribution is made out of earnings or profits, and from the most recently accumulated earnings or profits, to the extent of such earnings or profits accumulated since February 28, 1913; but any earnings or profits accumulated or increase in value of property accrued prior to March 1, 1913, may be distributed exempt from the tax, after the earnings and profits accumulated since February 28, 1913, have been distributed."

The Act makes it entirely clear that dividends from surplus built up from earnings after February 28, 1913, are taxable income. In this case there is no contention that any part of the dividends represented earnings prior to March 1, 1913. The burden of proof would seem to be very clearly upon the plaintiff to show that the ordinary form of dividend is not taxable either because it is from earnings accumulated prior to March 1, 1913, or is not income at all but a return of capital. In my opinion, the plaintiff has not met this burden under the facts stipulated.

The plaintiff's contention, to succeed, must go to the effect of showing that the dividends received by him to the extent of the amount in dispute were not paid out of earnings or profits within the meaning of these terms as contained in the definition of dividends above quoted. For the reasons already stated, I am of the opinion that the dividends distributed by the Delaware corporation were from its earnings or profits, and it is not disputed that no part were from earnings or profits accumulated prior to February 28, 1913, whether the matter be considered from the standpoint of the Delaware corporation or of its subsidiaries.

A somewhat elaborate argument has been offered by the plaintiff's counsel and answered by counsel for the defendant with regard to the true nature of capital and income, respectively, both from the economic and legal aspects. I think it unnecessary to enter into a discussion of the matter from the economic aspect because the subject is very clearly determined in the legal aspect by controlling decisions of the Supreme Court. In *Eisner* v. *Macomber* (252 U. S., 189 [T. D. 3010, C. B. 3, 25]) (the stock dividend case), legal distinctions between income and capital are clearly stated. It was there held that what is or is not income within the meaning of the sixteenth amendment must be determined in each case according to truth and substance without regard to form; that income may be defined as the gain derived from capital, from labor or effort or both combined, including profit or gain through sale or conversion of capital. Income is not a gain accruing to capital or a growth in the value of the investment; "but a gain, a profit, something of exchangeable value, *proceeding from the property, severed from the capital* however invested or employed, and *coming in*, being *derived*, that is, *received or drawn* by the recipient (the taxpayer) for his *separate* use, benefit and disposal; *that* is income derived from property."

See also *United States* v. *Phellis* (257 U. S., 156); *Taft* v. *Bowers* (278 U. S., 470 [Ct. D. 49, C. B. VIII–1, 226]).

The argument of plaintiff's counsel is that the dividends paid by the Delaware corporation diminished its capital. But this is really true in the case of every dividend distributed, as is well stated by the Supreme Court in *Lynch* v. *Hornby* (274 U. S., 339, at 346), where the court said:

"We do not overlook the fact that every dividend distributed diminishes by just so much the assets of the corporation, and in a theoretical sense, reduces the intrinsic value of the stock, but, at the same time, it demonstrates the capacity of the corporation to pay dividends, holds out a promise of further dividends in the future, and quite probably increases the market value of the shares. In our opinion, Congress laid hold of dividends paid in the ordinary course as de facto income of the stockholders, without regard to the ultimate effect upon the corporation resulting from their payment."

More extended reasoning to the same effect is contained in *United States* v. *Phellis*, supra. Compare *Gulf Oil Corporation* v. *Lewellyn* (248 U. S., 71).

In form the dividend in this case was that of the ordinary current dividend payable by a corporation to its stockholders. And when the transaction is analyzed closely the substance does not vary from the form or take the case out of the ordinary run of dividends.

While taxing statutes are to be strictly construed and applied only to situations which fairly come within the words of the statute, the latter must be given their reasonable meaning and application. To sustain this tax, the situation here does not require a forced construction of the words of the taxing statute, but on the contrary to defeat the tax necessitates argument on behalf of the taxpayer contrary to the ordinary meaning of the words as applied to a customary transaction. The extreme nature of the taxpayer's contention is seen in the consideration that, if the argument is sound, practically all current dividends from earnings would escape taxation if the stockholders would from time to time form successive holding companies and capitalize earned surplus of subsidiaries in the way contended for in this case. To give such application to the taxing statute would, I think, be forcing an utterly unreasonable construction thereof which must have been contrary to the intention of Congress. At the best, plaintiff's contention is based upon a conception of the organization and capitalization of the Delaware corporation which converts it into a mere legal buffer against dividend taxation. As the Delaware corporation is a mere holding company and a convenient conduit for the transfer of dividends from the operating and earning companies to the ultimate owners (the stockholders of the Delaware corporation), it would be legally possible, if necessary, to disregard the corporate fiction of the holding company in order that the obvious purpose of Congress to tax income from dividends in the ordinary form should be accomplished. As was said by the Circuit Court of Appeals for the Ninth Circuit in the somewhat similar case of *Osburn* v. *Welch* (39 Fed. (2d), 41 [Ct. D. 173, C. B. IX–1, 250]):

"The notion that a corporation is an entity, separate and distinct from its stockholders, is a fiction of law which the court will regard for some purposes and disregard for others. For tax purposes this fiction is often disregarded."

See also similar statement of the principle in *McDonald* v. *Commissioner of Internal Revenue* (4th C. C. A.), decided October 12, 1931, reported in the Daily Record of Baltimore, November 26, 1931.

Plaintiff's counsel refer to the decision of the Board of Tax Appeals in the case of *Robeson* v. *Commissioner of Internal Revenue* (18 U. S. B. T. A., 323) as an authority in support of their position. These two New York corporations consolidated in the technical sense by forming a new corporation which acquired all of the assets of the former corporations. The new corporation took over the physical properties of the former corporations. It was held that a dividend paid by the new corporation shortly after its formation in excess of its earnings since formation did not constitute taxable dividends to the extent of the excess, as the latter was to be regarded as a return of capital. The essential point on which the decision was based was that the corporate earnings comprehended by a definition of dividends in section 201(a) of the Revenue Act of 1921 referred to the earnings of the particular corporation—that is to say, *its* earnings. It is stated by the assistant district attorney that the decision has not been acquiesced in by the Commissioner of Internal Revenue and the question is still pending, and further, it is contended that the decision is in effect inconsistent with the recent decision of the Circuit Court of Appeals of this circuit in the McDonald case above cited. But however that may be, the Robeson case is clearly distinguishable from the present case. Indeed the whole of the plaintiff's claim as made in its declaration seeks to recover excess taxes paid for the years 1924 and 1925, as well as 1921–1923, but the controversy for 1924 and 1925 has been disposed of by an agreement between the Commissioner and the taxpayer as to the proper amount of tax due for those years, the result having been arrived at in view of the *changed legal conditions consequent upon the acquisition by the Delaware corporation of the physical assets of the subsidiaries and their dissolution.*

It may be added that in this case the taxpayer in his several returns for the years in question included the whole of the dividends received by him and seemingly paid the tax thereon without question. It was not until several years later that the point herein discussed was made by way of petitions for refund which have been denied in due course. That is to say, the taxpayer originally treated the dividends received as in the ordinary form of current income. And in conclusion, I am of the opinion that they did constitute current income from earnings both in form and in substance. After a careful consideration of the facts stipulated, I see nothing in the case to make it substantially distinct from the ordinary dividend paid from earnings.

At the oral argument counsel for both parties agreed that the court's consideration of the stipulation of facts need not embrace any detailed examination of the numerous and lengthy exhibits attached thereto, consisting principally of formal proceedings affecting the four corporations. It was agreed that these were annexed to the stipulation merely for the purpose of supporting the facts stipulated which are contained in the first 13 typewritten pages of the whole document. For this reason I have not found it necessary to read the exhibits in extenso. I express my thanks to counsel on both sides for their full and excellent oral and written arguments.

I grant the request for a directed verdict for the defendant, which will accordingly be entered by the clerk.

ARTICLE 1545: Distributions in liquidation. XI-18-5470
Ct. D. 478

INCOME TAX—REVENUE ACT OF 1921—DECISION OF COURT.

1. DISTRIBUTIONS—SALE OF STOCK.

Where, pursuant to the resolution of its board of directors, a corporation within four days from the date of the resolution purchases from all its stockholders at an authorized price per share all the outstanding shares of stock of the corporation except a part of the number of shares owned by B and within two weeks from the date of the resolution the capital stock of the corporation is decreased to the number of shares retained by B by retiring and canceling the purchased shares, the transaction is not a sale of stock by the shareholders but a distribution in liquidation of the corporate assets and the amounts received by the shareholders are dividends taxable in accordance with section 201 of the Revenue Act of 1921.

2. DECISION AFFIRMED.

The decision of the Board of Tax Appeals (20 B. T. A., 866) is affirmed.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT. OCTOBER TERM AND SESSION, 1931.

No. 4529. *Martha Briggs Phelps, Executrix of the Estate of W. L. Phelps, petitioner,* v. *Commissioner of Internal Revenue, respondent.*

No. 4530. *The Northern Trust Co., Trustee under the Will of Clinton Briggs, petitioner,* v. *Commissioner of Internal Revenue, respondent.*

No. 4531. *Martha Briggs Phelps, petitioner,* v. *Commissioner of Internal Revenue, respondent.*

Petitions for review of decisions of United States Board of Tax Appeals.

Before ALSCHULER and SPARKS, Circuit Judges, and WOODWARD, District Judge.

[December 4, 1931.]

OPINION.

These appeals are from decisions of the Board of Tax Appeals by way of petitions for review pursuant to the Revenue Act of 1926 (ch. 27, sections 1001, 1002, and 1003, 44 Stat., 9, 109, 110). They involve individual income and sur taxes for the year 1922.

Clinton Briggs died testate in September, 1908. His will created a trust for the benefit of his two daughters, Mrs. Jane Briggs Voorhees and Mrs. Martha Briggs Phelps, and named the Northern Trust Co. as trustee of that

trust. W. L. Phelps, the son-in-law, died testate on June 30, 1923, and Martha Briggs Phelps is the duly appointed executrix of his estate.

The Star & Crescent Milling Co., an Illinois corporation, was incorporated September 18, 1882, and was engaged in the flour milling business. In April, 1922, it sold the greater part of its assets, including its plant, tools, equipment, good will, and brands and trade marks of the business, retaining a warehouse and a lot of land called the Jefferson Street property. On June 26, 1922, the corporation changed its name to W. L. Phelps Co. The total outstanding common stock of the corporation, as of March 1, 1913, consisted of 2,500 shares of the par value of $250,000. This remained the same until December 27, 1920, at which time there was declared and paid a stock dividend of 200 per cent, thereby increasing the common stock to 7,500 shares of the par value of $750,000, of which Northern Trust Co., trustee, owned 2,250 shares, W. L. Phelps owned 2,550 shares, and Mrs. Phelps and Mrs. Voorhees each owned 900 shares.

On December 27, 1922, the board of directors by resolution authorized and directed its president, W. L. Phelps, to purchase, on behalf of the corporation, shares in its outstanding capital stock in such amounts and at such times and prices as he in his discretion should see fit, but not to exceed in price the sum of $130 a share. Pursuant to this resolution the corporation, by Mr. Phelps, in December, 1922, purchased all of the outstanding stock at $130 a share, except 300 shares which were retained by Mr. Phelps. It was his intention that the corporation would thereafter conduct a flour brokerage business instead of a milling business. In January, 1923, the authorized capital stock was decreased to $30,000, consisting of 300 shares of the par value of $100 each by retiring and canceling 7,200 shares, and this decrease was certified to by the secretary of state.

Since 1922 the corporation has rented the Jefferson Street property at an annual rental of about $5,000. It has rendered income tax returns annually since and including 1922. In its 1922 return it stated that its business was that of milling in liquidation; and in answer to what was the main income-producing business, and if inactive or in liquidation, stated: "Milling of wheat and other grain and wholesale distribution of flour and feed. Now in process of liquidation." In its return for 1924 it was stated that "This corporation was not engaged in business during the preceding year."

Upon these facts the Board found that the action so taken was in effect the performance of an agreement among the stockholders to surrender their stock, except the 300 shares held by W. L. Phelps, in exchange for a pro rata share of the distributable surplus, and charged petitioners with deficiencies on account of liquidating dividends received by them. Under section 201(c), Revenue Act of 1921 (ch. 136, 42 Stat., 227), the Board apportioned the total amounts received by petitioners respectively as shown in margin.[1]

SPARKS, Circuit Judge: There being no controversy over the facts, the sole question presented is whether the amounts received by petitioners should be considered, for the purposes of taxation, as dividends under section 201, Revenue Act of 1921 (ch. 136, 42 Stat., 227), as claimed by respondent, or as gains derived from sales of property under section 202 of the same statute, as claimed

[1]

	(1)	(2)	(3)
	Earnings or profits since Feb. 28, 1913.	Earnings or profits prior to Mar. 1, 1913	Distribution otherwise than from (1) or (2).
Northern Trust Co., trustee	$179,221.73	$48,561.30	$64,716.97
Martha Briggs Phelps, executor	179,221.73	48,551.30	64,716.97
Martha Briggs Phelps	71,688.69	19,424.52	25,886.79
Jane Briggs Voorhees	71,688.69	19,424.52	25,886.79
Frank B. Rice	67,705.99	18,345.38	24,448.63

by petitioners. So much of those sections as are pertinent are set forth in the margin.[2]

If, under the facts stated, we are bound by the plain meaning of the language employed in the resolution referred to in the statement of facts, then of course the transactions in controversy should be considered as sales, for that is what the resolution termed them, and pursuant thereto there was an exchange of stock for money. But in all relations of life it oftentimes happens that the thing done speaks so audibly that equity is prevented from hearing the language of the parties, and will classify the act by its real name rather than by the name which the interested parties have given it. In such instances the substance of the transaction will control the form, and the Board therefore was warranted in considering both form and substance in arriving at its conclusion. (*United States* v. *Phellis*, 257 U. S., 156 [T. D. 3270, C. B. 5, 37]; *United States* v. *Klausner*, 25 F. (2d), 608.)

That taxing statutes can not be intentionally circumvented by anticipatory arrangements and contracts is settled by the principle laid down in *Lucas* v. *Earl* (281 U. S., 111). It is obvious that if the stockholders of the W. L. Phelps Co. intended to, and in fact did, liquidate wholly or partially by distributing its assets to its stockholders and taking up their stock, the earnings and profits so received by them would be governed by section 201, supra. In liquidation of corporations it is quite proper and usual to take up the certificates of stock upon making the final distribution of assets. Such a transaction, however, is not to be regarded primarily as a sale of stock, although it has some such characteristics. It is more than a sale; it is primarily a liquidating distribution, and the sale, if it be such, is but an incident to the transaction. We think it was clearly the intention of Congress that section 201, supra, should apply to such transactions. Can it be said that a corporation desiring to liquidate may be permitted to characterize such a transaction as a sale rather than a liquidating dividend, in order to avoid a higher rate of taxation? This would defeat

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[2] SEC. 201. (a) That the term "dividend" when used in this title * * * means any distribution made by a corporation to its shareholders or members, whether in cash or in other property, out of its earnings or profits accumulated since February 28, 1913, except a distribution made by a personal service corporation out of earnings or profits accumulated since December 31, 1917, and prior to January 1, 1922.

(b) For the purposes of this Act every distribution is made out of earnings or profits, and from the most recently accumulated earnings or profits, to the extent of such earnings or profits accumulated since February 28, 1913; but any earnings or profits accumulated or increase in value of property accrued prior to March 1, 1913, may be distributed exempt from the tax after the earnings and profits accumulated since February 28, 1913, have been distributed. If any such tax-free distribution has been made the distributee shall not be allowed as a deduction from gross income any loss sustained from the sale or other disposition of his stock or shares unless, and then only to the extent that, the basis provided in section 202 exceeds the sum of (1) the amount realized from the sale or other disposition of such stock or shares, and (2) the aggregate amount of such distributions received by him thereon.

(c) Any distribution (whether in cash or other property) made by a corporation to its shareholders or members otherwise than out of (1) earnings or profits accumulated since February 28, 1913, or (2) earnings or profits accumulated or increase in value of property accrued prior to March 1, 1913, shall be applied against and reduce the basis provided in section 202 for the purpose of ascertaining the gain derived or the loss sustained from the sale or other disposition of the stock or shares by the distributee.

(d) A stock dividend shall not be subject to tax but if after the distribution of any such dividend the corporation proceeds to cancel or redeem its stock at such time and in such manner as to make the distribution and cancellation or redemption essentially equivalent to the distribution of a taxable dividend, the amount received in redemption or cancellation of the stock shall be treated as a taxable dividend to the extent of the earnings or profits accumulated by such corporation after February 28, 1913.

SEC. 202. (a) That the basis for ascertaining the gain derived or loss sustained from a sale or other disposition of property, real, personal, or mixed, acquired after February 28, 1913, shall be the cost of such property; except that—

* * * * * * *

(3) In the case of such property, acquired by bequest, devise, or inheritance, the basis shall be the fair market price or value of such property at the time of such acquisition. The provisions of this paragraph shall apply to the acquisition of such property interests as are specified in subdivision (c) or (e) of section 402.

(b) The basis for ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, acquired before March 1, 1913, shall be the same as that provided by subdivision (a); but—

(1) If its fair market price or value as of March 1, 1913, is in excess of such basis, the gain to be included in the gross income shall be the excess of the amount realized therefor over such fair market price or value;

(2) If its fair market price or value as of March 1, 1913, is lower than such basis, the deductible loss is the excess of the fair market price or value as of March 1, 1913, over the amount realized therefor; and

(3) If the amount realized therefor is more than such basis but not more than its fair market price or value as of March 1, 1913, or less than such basis but not less than such fair market price or value, no gain shall be included in and no loss deducted from the gross income.

the very purpose for which the statute was enacted and we think it can not be done, under the ruling of *Lucas* v. *Earl*, supra.

In the instant case we think it is clear that the stockholders intended to liquidate, and the mere fact that the company first purchased and canceled all the stock except 300 shares, which were owned by Mr. Phelps, is not sufficient under all the circumstances to constitute the transaction one of purchase and sale for the purposes of taxation under section 202, supra. Of course a corporation may purchase its own stock under the Illinois statute, but such statutes are not ultimately decisive in Federal income tax matters. (*Burk-Waggoner Assn.* v. *Hopkins*, 269 U. S., 110 [T. D. 3790, C. B. V–1, 147]; *Rosenberger* v. *McCaughn*, 25 F. (2d), 699 [T. D. 4171, C. B. VII–2, 253]; *California Iron Yards Co.* v. *Commissioner*, 47 F. (2d), 514.)

It is quite probable, as petitioners suggest, that the sale of stock to a corporation by one shareholder would be considered as a sale rather than as a liquidating dividend, for the act of one of several stockholders could not well be considered as evidence of an intention of all the stockholders; but in the instant case the Board evidently considered the concerted action of all the directors and stockholders in the disposition of practically all the stock as probative of intention of the company to liquidate, and we think the Board was right in so considering it.

The intention of the parties weighs heavily in determining the nature of such a transaction, and this intention may be fairly arrived at in the instant case by the acts of the parties. On December 27, 1922, the determination to act was first expressed, and it was made of record by resolution. It authorized the president to purchase for the company such amounts of the company's capital stock and at such prices—not to exceed $130 a share—as he might deem fit. Within 4 days from that date he bought and paid for all the stock, except 300 shares of his own, and at the highest price authorized. Within less than two weeks from the date of the resolution the board of directors had authorized a reduction of the capital stock to 300 shares, all of which were owned by Mr. Phelps. The entire transaction was remarkable for its celerity and lack of discord, and impels the conclusion that it was a voluntary distribution by the stockholders of all the assets of the company. The fact that Mr. Phelps received money for part of his stock and retained the remaining outstanding stock can not militate against such conclusion. He was thereby, in effect, the owner of the undisposed of assets of the corporation, which consisted only of the Jefferson Street property. Technically, as between the stockholders and the corporation, it was not a complete liquidation in the sense that all the assets had been converted into cash and distributed; but as between the stockholders themselves, for all practical purposes, there was in effect a complete distribution, which was evidently made by agreement of the parties and one which they were fully authorized to make. (*Breslin* v. *Fries-Breslin Co.*, 70 N. J. L., 274; *Joseph Goodnow & Co.* v. *Commissioner*, 5 B. T. A., 1154; *F. G. Lamb* v. *Commissioner*, 14 B. T. A., 814.)

That Mr. Phelps thought the transaction was in fact a liquidation distribution can not well be doubted, for in the company's income tax return for the year 1922 he stated that the company was then in process of liquidation; and in the company's return for 1924 he stated that it was not engaged in business in the preceding year.

Petitioners contend that the decision of the Board is inconsistent with its former decisions to the effect that the tax must be based upon the transaction which in fact occurred, and not upon a transaction which might have happened and did not. In other words, they contend that the Board should have accepted the appellation which the resolution gave to the transaction. We think there is no inconsistency. In *Appeal of Harkness* (1 B. T. A., 127), petitioner sought to have profits on her stock classified as dividends. By her own agreement she was to have no dividends in a certain corporation until she had sold her stock in another, which she had not done. Her stock in the first company became more valuable, however, by the accretion of undivided profits, and upon the sale of such stock the Board classified the earnings as gain and not dividends, because she still retained her stock in the other company. In *Regal Shoe Co.* (1 B. T. A., 896), petitioner besought the Board to hold that ownership of capital stock was an indirect ownership of corporation assets, which of course could not be done. In *Filer* v. *Commissioner* (14 B. T. A., 1084), petitioner, as an investor, exchanged stock in one corporation for stock in another, pursuant to a contract to that effect, and the Board held that the transaction was not a liquidating dividend but was an exchange of one investment for another of

like kind, and was therefore taxable under a different statute from the one governing liquidating dividends. In *Brackett* v. *Commissioner* (19 B. T. A., 1154), petitioner received a check from a newly organized corporation for certain stock which he owned in another corporation. With this check he purchased stock in the new corporation, and asked the Board to construe the transaction as an exchange of stock. The Board held the transaction to be a sale and purchase of stock and not an exchange. In *Remington-Rand* v. *Commissioner* (33 F. (2d), 77 [Ct. D. 149, C. B. IX–1, 268]), petitioner requested the court to construe accumulated earnings as dividends when dividends had not been declared, and the court refused to do so.

In each of the above cases the Board and the court, respectively, classified the transaction before it according to the facts presented, and we think rightly so. Of course the facts in each case are different, and each case must be governed by its own facts. It may be said, however, that the cases cited by petitioners herein support the rule that it is the duty of both the Board and the court to classify such transactions consistently with the facts presented. It will be observed that in the cases just discussed there was no effort on the part of any petitioner to give any particular name to the transaction until the hearing was had before the Commissioner. In the instant case the order of procedure is somewhat changed, in that petitioner had given a name to the transaction before the issue was formed. But names mean nothing unless they are supported by the facts.

Petitioners further contend that the Board, without authority of law, disposed of the earnings prior to March 1, 1913, and subsequently to February 28, 1913, under section 201, and invoked section 202 in the disposition of the other assets distributed. We think this is not the case. The Board considered the entire amount received by the stockholders as a distribution and separated it into three parts, as contemplated by section 201(c). In this we find no inconsistency.

The Board in determining the deficiencies followed decisions in *Darrow* v. *Commissioner* (8 B. T. A., 276), *Gates* v. *Commissioner* (9 B. T. A., 1133), and *McCaughn* v. *McCahan* (39 F. (2d), 3), and we think its determinations are correct. We think the fact that in each of the last named cases the stock was not transferred can make no material difference in view of the broad terms of section 201.

The orders of the Board of Tax Appeals are affirmed.

SECTION 202.—BASIS FOR DETERMINING GAIN OR LOSS.

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

REVENUE ACT OF 1921.

Basis of stock in merged corporation continuing in hands of stockholders at time of merger as affected by subsequent distributions on certificates of beneficial interest in assets of merged corporations segregated at time of merger. (See G. C. M. 10110, page 236.)

ARTICLE 1565: Determination of gain or loss from the exchange of property. XI–3–5361 Ct. D. 441

INCOME TAX—REVENUE ACT OF 1921—DECISION OF COURT.

GAIN OR LOSS—EXCHANGES OF PROPERTY—CONSTITUTIONALITY.

Where in the reorganization of the S Company a person receives in 1922 in place of stock owned by him in that corporation stock and debenture bonds of the H Corporation having a readily realizable market value, no gain or loss on the exchange being recognized under section 202(c)2 of the Revenue Act of 1921, and where on February 28, 1923, the debenture bonds are exchanged for State and municipal bonds having a readily realizable market value on that date the same as the debenture bonds, no gain or loss being

recognized on the exchange under subdivision (c)1 of that section in effect at the time of the exchange, by virtue of subdivision (d)1 of that section the debenture bonds and stock received in 1922 take the place of the stock exchanged therefor and by virtue of section 202(c)1 of the Revenue Act of 1921 as amended by the Act of March 4, 1923, the amendment being retroactive to January 1, 1923, taxable gain is realized in 1923 in the amount of the excess of the fair market value of the State and municipal bonds on February 28, 1923, over the proportionate part of the basis of the stock in the S Corporation which is applicable to the debenture bonds. As so construed, section 202(c)1 of the Revenue Act of 1921, as amended by the Act of March 4, 1923, is constitutional.

COURT OF CLAIMS OF THE UNITED STATES. No. K-262.

Oscar Heineman v. *The United States.*

[October 20, 1931.]

OPINION.

WILLIAMS, Judge, delivered the opinion of the court.

The plaintiff seeks to recover $82,634.09, an alleged overpayment of his income taxes for the year 1923, with interest thereon from date of payment.

The challenged taxes were imposed under authority of the Revenue Act of 1921 (42 Stat., 227), as amended by the Act of March 4, 1923 (42 Stat., 1560).

The facts, about which there is no controversy between the parties, briefly stated, are:

The plaintiff, on January 8, 1912, acquired all the capital stock of the Oscar Heineman Silk Co., an Illinois corporation, consisting of 5,000 shares of common stock of a par value of $100 each. The fair market value of the said 5,000 shares of stock was, at March 1, 1913, $493,511.27.

On December 30, 1922, the Oscar Heineman Silk Co. was reorganized. A new corporation, the Oscar Heineman Corporation, was formed under the laws of the State of Illinois. The new corporation, on December 30, 1922, acquired from the plaintiff all of the capital stock of the Oscar Heineman Silk Co., and gave the plaintiff in exchange therefor the following of its securities: 20,000 shares preferred stock; 45,000 shares class "A" common stock of no par value, and 5 per cent debenture bonds of the face value of $1,000,000. The new securities received by the plaintiff all had a readily realizable market value on December 30, 1922. The $1,000,000 face value 5 per cent debenture bonds had on that date a readily realizable market value of $99 per share, or $990,000, and could have been sold for that amount.

On February 28, 1923, the plaintiff exchanged the $1,000,000 face value 5 per cent debenture bonds for certain State and municipal bonds having a readily realizable market value on that date of $990,000. The proportion of the fair market value at March 1, 1913, of the 5,000 shares of the old Oscar Heineman Silk Co. apportioned to and applicable to the $1,000,000 face value 5 per cent debenture bonds of the new corporation was $121,709.17.

In determining the plaintiff's tax liability for the calendar year 1923 the Commissioner of Internal Revenue treated the difference between $990,000 (the fair market value of the debenture bonds on February 28, 1923) and $121,709.17 (the fair market value at March 1, 1913, of the proportionate part of the stock in the old company exchanged for the debenture bonds), or $868,290.83, as a taxable gain realized in the year 1923, on which asserted gain the plaintiff paid an income tax of $82,634.09.

The applicable provisions of the Revenue Act of 1921 read as follows:

"SEC. 202. (a) That the basis for ascertaining the gain derived or loss sustained from a sale or other disposition of property, real, personal, or mixed, acquired after February 28, 1913, shall be the cost of such property; except that—

* * * * * * *

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

but even if the property received in exchange has a readily realizable market value, no gain or loss shall be recognized—

"(1) When any such property held for investment, or for productive use in trade or business (not including stock-in-trade or other property held primarily for sale), is exchanged for property of a like kind or use;

"(2) When in the reorganization of one or more corporations a person receives in place of any stock or securities owned by him, stock or securities in a corporation a party to or resulting from such reorganization. * * *

* * * * * * *

"(d) (1) Where property is exchanged for other property and no gain or loss is recognized under the provisions of subdivision (c), the property received shall, for the purposes of this section, be treated as taking the place of the property exchanged therefor, except as provided in subdivision (e)."

Section 202(c)1 of the Revenue Act of 1921 as amended (Act of March 4, 1923, 42 Stat., 1560) reads as follows:

"(1) When any such property held for investment, or for productive use in trade or business (not including stock-in-trade or other property held primarily for sale, and in the case of property held for investment not including stock, bonds, notes, choses in action, certificates of trust or beneficial interest, or other securities or evidences of indebtedness or interest), is exchanged for property of a like kind or use."

Under the provisions of the Revenue Act of 1921, no taxable gain was realized by plaintiff on account of the exchange of stock and securities on December 30, 1922, as that transaction resulted from a reorganization of the Oscar Heineman Silk Co. (Section 202(c)2.)

No gain was recognized from the transfer of the debenture bonds for the State and municipal bonds, February 28, 1923, as that was an exchange of property of a like kind held for investment, or for productive use in trade or business. (Section 202(c)1.)

Under the amendatory Act of March 4, 1923, the profit on exchanges of property similar to that made by plaintiff February 28, 1923, was recognized as taxable gain.

The Act was made retroactive to January 1, 1923. Under this retroactive provision the Commissioner of Internal Revenue held that a taxable gain of $868,290.83 was realized by the plaintiff from the exchange, on February 28, 1923, of the debenture bonds for State and municipal bonds.

The plaintiff contends:

(1) That section 202(c)1 of the Revenue Act of 1921, as amended March 4, 1923, is unconstitutional because it fixes an arbitrary and capricious date as to when it shall become retroactively effective, resulting in an unjust discrimination between taxpayers similarly situated.

It is urged that all taxpayers who made exchanges of property, similar to the one made by plaintiff in this case, between the effective date of the 1921 Revenue Act and March 4, 1923, the date of the amendatory Act, constitute a class of taxpayers, all of whom are similarly situated; that they are all nontaxable, by the express provisions of the 1921 Act; and that the fixing by Congress, retroactively, of a date whereby a part of that class of taxpayers are made taxable while a part of the same class remain nontaxable, unjustly discriminates between taxpayers similarly situated, and is in contravention of the prohibition of the fifth amendment against taking property without due process of law.

The plaintiff says in his brief:

"Probably Congress could constitutionally have made the amendment effective as of the effective date of the 1921 Act, because in that case all persons who had acted on the strength of that Act would be similarly treated; but it did not do so. It took certain taxpayers situated exactly the same as others and made 'fish of one and fowl of the other,' without any reasonable or just basis for the distinction."

Again it is said:

"Yet because plaintiff falls on one side of the arbitrarily fixed date of January 1, 1923, his profit is made taxable (when at the time the exchange was made it was not taxable) and the profits of others whose exchanges were made on the other side of this arbitrary date are not made taxable. * * * The classification of the profits thus taxable and nontaxable, respectively (fixed only by the arbitrary date of January 1, 1923), does not rest upon any difference which bears a reasonable and just relation to the classification."

The plaintiff does not challenge the constitutional power of Congress to make a taxing statute effective retroactively, but insists that power was arbitrarily and capriciously exercised in the amendatory Act of March 4, 1923, by fixing a date which resulted in unjust discrimination between taxpayers similarly situated who are entitled to like treatment.

We are of the opinion the plaintiff's contention on this point can not be sustained. If the amendatory Act was to be retroactive in its scope, some date, necessarily, had to be fixed from which it would become effective. Whatever date was fixed would be an arbitrary one, in the sense that profits on exchanges made subsequent to such date would be made taxable, while profits on similar exchanges made prior to that date would remain nontaxable. When a new tax is retroactively imposed there is no way to avoid the result about which plaintiff complains, certain persons who were nontaxable under the law as it stood before still remain nontaxable, while others, who were likewise nontaxable under the law as it stood, are made taxable. This result inevitably follows the retroactive imposition of a tax.

Conceding the power of Congress to declare that a taxing statute shall operate retroactively, we think it has the power, as defendant's counsel well say, "to declare the period for which it shall operate." The amendatory Act of March 4, 1923, retroactively fixes January 1, 1923, as the effective date of the Act. After that date profits arising on all exchanges of property similar to the one involved in this case is recognized as taxable gain.

The Act is general in its application. All taxpayers who make gains on exchanges of property, similar to that made by the plaintiff, during the calendar year 1923, are placed on the same footing. They are all required to pay taxes on such gains. No discrimination is made between taxpayers similarly situated. The fact that taxpayers making profits on similar exchanges in the years 1921 and 1922 are not taxed on such profits is immaterial, and does not render the Act repugnant to the due-process clause of the fifth amendment. Under the law and the rule in effect in those years such profits are not exempted from tax but deferred until the property received in exchange is sold.

(2) The plaintiff contends the tax in dispute is invalid because the profit on which it is based was realized by the plaintiff in the year 1922 and not in the year 1923; that it is, therefore, a tax on capital, and not a tax on income.

It is urged the profit on which the tax is imposed was realized on December 30, 1922, on the exchange of the stock of the Oscar Heineman Silk Co. for the stock and debenture bonds of the Oscar Heineman Corporation; that since the debenture bonds received by plaintiff had on that date a readily realizable market value of $990,000, and had the same readily realizable market value on February 28, 1923, when they were exchanged by plaintiff for State and municipal bonds of like value, the plaintiff did not realize a profit from such exchange. In other words, the plaintiff says the debenture bonds exchanged on February 28, 1923, had a cost value to him of $990,000, and since that is the exact value of the State and municipal bonds received he did not realize a profit from the exchange, and therefore there was no 1923 income to tax.

The plaintiff's position on this point is disposed of by the provision of section 202(d)1 of the 1921 Revenue Act:

"Where property is exchanged for other property and no gain or loss is recognized under the provisions of subdivision (c), the property received shall, for the purposes of this section, be treated as taking the place of the property exchanged therefor, * * *."

Under section 202(c)2 no gain or loss was recognized on the exchange of December 30, 1922, wherein the plaintiff acquired the debenture bonds, that transaction resulting from the reorganization of the old Oscar Heineman Silk Co. Therefore the debenture bonds must be treated as merely taking the place of the proportionate part of the stock of the old corporation exchanged for them. Their cost value to the plaintiff was the March 1, 1913, value of the stock of the Oscar Heineman Silk Co. applicable to them, or $121,709.17. The Commissioner of Internal Revenue correctly used this figure as the cost of the said bonds to the plaintiff as a basis for determining the taxable gain realized on their exchange for State and municipal bonds on February 28, 1923.

In *Newman, Saunders & Co.* v. *United States* (68 C. Cls., 641), this court passed upon the constitutionality of section 204(a)8 of the Revenue Act of 1924, which provides that no gain or loss shall be recognized, if property is transferred to a corporation, in exchange for stock or securities in such corporation, and immediately after the exchange the transferor is in control of the corpora-

tion. On July 1, 1922, a partnership transferred its property to a corporation in exchange for the securities of the corporation. The members of the partnership were immediately in control of the corporation. The property transferred cost the partnership $191,309.33. The fair market value of the stock of the corporation issued in exchange for the property of the partnership was on the day of the exchange $288,140. In 1924 the corporation sold the property acquired from the partnership for $408,393.45. It was contended by the Commissioner of Internal Revenue that the gain to the corporation was the difference between the original cost of the property to the partnership and its sale price in 1924. The taxpayer contended the taxable gain was the difference between the sale price in 1924 and the fair market value of the stock when issued to the partnership for its property July 1, 1922. After citing *United States* v. *Phellis* (257 U. S., 156 [T. D. 3270, C. B. 5, 37]); *Taft* v. *Bowers* (278 U. S., 470 [Ct. D. 49, C. B. VIII–1, 226]), the court said:

"Following the rule laid down in the cases above cited, we hold that the tax involved was not a tax upon capital but a deferred tax upon profits, and one which was within the power of Congress to levy. * * * The Commissioner did not take as the basis for computing gain the value of the stock at the time of the exchange, and his action was correct under the rule hereinabove laid down. * * * We do not think that this ignores the corporate entity. It merely recognizes the fact that in making the exchange the original transferor had simply received another instrument which evidenced the same or at least a corresponding right to the same property. Here, again, we find there is nothing unconstitutional in the statute. * * * The rule is simply that in such cases the original transferor does not pay any tax on the gain which has accrued while he held the property, but the tax is deferred to be paid by the corporation receiving the property."

The identical principle is involved in the instant case as in the case cited. As hereinbefore pointed out, under the provisions of section 202(c)2, no gain was recognized with reference to the exchange, December 30, 1922, of stock of the Oscar Heineman Silk Co. for the debenture bonds of the Oscar Heineman Corporation, and there was and could be no tax upon it. The plaintiff at the time this exchange of securities was made was charged with notice that the securities he received were simply taking the place of those exchanged therefor. It was as though no such transaction had taken place, and when later the plaintiff, on February 28, 1923, exchanged the debenture bonds for the State and municipal bonds, a gain was realized subject to tax under section 202(c)1 of the Revenue Act of 1921 as amended, retroactively, by the Act of March 4, 1923.

We hold, therefore, that the tax in question was not a tax on capital, but a tax upon profits realized by the plaintiff during the taxable year 1923.

The plaintiff's petition is dismissed. It is so ordered.

SECTION 203.—INVENTORIES.

ARTICLE 1582: Valuation of inventories.

REVENUE ACT OF 1918.

Valuation of inventories of war ammunition on hand at end of 1918. (See Ct. D. 460, page 282.)

SECTION 206.—CAPITAL GAIN.

ARTICLE 1651: Definition and illustration of capital net gain. XI–24–5512 Ct. D. 498

INCOME TAX—REVENUE ACT OF 1921—DECISION OF COURT.

1. "CAPITAL GAIN"—"CAPITAL ASSETS"—SALE BY DONEE ON DAY OF GIFT.

Property sold by a person on the day a gift of it is made to him does not come within the term "capital assets" as used in section 206 of the Revenue Act of 1921 and the donee is not entitled to be

taxed in accordance with subdivision (b) of that section, although his donor acquired and held the property for profit or investment for more than two years, and the basis for ascertaining the gain derived from the sale of the property by the donee is the same, under section 202(a)2 of that Act, as that which it would have in the hands of the donor.

2. DECISION AFFIRMED.

The decision of the Board of Tax Appeals (19 B. T. A., 399) affirmed.

COURT OF APPEALS OF THE DISTRICT OF COLUMBIA.

Sydney M. Shoenberg, appellant, v. *David Burnet, Commissioner of Internal Revenue, appellee.*

Before MARTIN, Chief Justice, and ROBB, HITZ, and GRONER, Associate Justices.

[December 28, 1931.]

OPINION.

HITZ, Associate Justice: This is an appeal under section 1002(d) of the Revenue Act of 1926, from a decision and order of redetermination of the United States Board of Tax Appeals.

It involves income taxes for the year 1923, amounting to $35,361.20.

On January 23, 1923, the appellant, hereinafter called the taxpayer, was given by his father 1,820 shares of the common stock of the May Department Stores Co., which he sold the same day for $132,860.

The stock had been purchased by the father, Moses Shoenberg, prior to March 4, 1918, for $30,454.06 and held by him until given to the son.

The difference between the purchase price paid by the father and the sale price received by the son being taxable to the son as gain under section 202(a)2 of the Revenue Act of 1921 (ch. 136, 42 Stat., 227), the taxpayer contends he is entitled to compute his tax under the beneficial provisions of section 206(b) of the Act.

That section reads as follows:

"In the case of any taxpayer (other than a corporation) who for any taxable year derives a capital net gain, there shall (at the election of the taxpayer) be levied, collected and paid, in lieu of the taxes imposed by sections 210 and 211 of this title, a tax determined as follows:

"A partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner provided in sections 210 and 211, and the total tax shall be this amount plus 12½ per centum of the capital net gain; but if the taxpayer elects to be taxed under this section the total tax shall in no such case be less than 12½ per centum of the total net income. The total tax thus determined shall be computed, collected and paid in the same manner, at the same time and subject to the same provisions of law, including penalties, as other taxes under this title."

The taxpayer contends that his gain made taxable by section 202(a) was "capital net gain" under section 206(a)4 from "capital gain" under 206(a)1 derived from "capital assets" as intended to be defined by 206(a)6, and therefore he is entitled to the benefits of section 206(b).

The difficulty in maintaining this position is that the Act of 1921, divided as it is into different sections, dealing with different matters and situations, does no more by section 202(a)2 than say that he shall pay a tax on the difference between what his donor paid for the stock and the sale price thereof.

The percentage of tax thereon is prescribed by the later sections 210 and 211.

But section 206 comes between, and offers an alternative method of computing the tax to any individual taxpayer who for any taxable year derives a capital net gain. (b.)

And it does more. It contains its own definition of "capital net gain" as being the excess of the total amount of "capital gain" over the sum of the capital deductions and capital losses. (206(a)4.)

And it also contains its own definition of "capital gain" as being taxable gain from the sale or exchange of "capital assets." (206(a)1.)

While its sixth and final definition is that of "capital assets" as property acquired and held by the taxpayer for profit or investment for more than two years. (206(a)6.)

By that definition Congress indicated a purpose to benefit by 206(b) only taxpayers (other than corporations) who having acquired property held it for profit or investment for more than two years.

And a purpose was also indicated thereby to exclude from such benefits corporations and holders of property for a shorter period than two years.

The taxpayer having held his stock less than a day does not come within the provisions of 206(b) unless, as he claims, he is entitled to rely on the time his donor held it before him, and stand in his donor's shoes.

This he claims the right to do on the theory that the price paid for the stock by his donor having been made the basis for determining the taxable gain by section 202(2), the time held by donor having contributed to its increase in value, and the tax having devolved on him instead of his donor, Congress intended that he should have the benefits of section 206(b).

He suggests that his donor could have availed himself of that section had he sold the stock at the time of the gift and given him the proceeds instead of the stock.

It is true the donor might have done this, and might have benefited thereby, because he would have been in the class intended to be benefited, and in the situation provided for by the statute, but not so the purchaser of the stock, and it is in the shoes of the purchaser rather than of the donor that the taxpayer stands.

This statute was intended to benefit tax-paying vendors, not their vendees or donees, except, possibly, by indirection, in procuring a lower price.

Two things were necessary for its availability to a taxpayer: First, a holding for more than two years; and, second, a sale resulting in a taxable gain to which the statute could apply.

This donor by his donation became neither a vendor making a taxable gain, nor such a taxpayer as the statute contemplates.

He was not entitled to the benefits of section 206(b), and there was nothing in existence to which that section could apply, or on which it could operate.

Since the donor had no rights under that section for himself he had none to transmit to his donee, and since the statute does not otherwise provide a right for the appellant, the decision of the Board of Tax Appeals is affirmed.

Affirmed.

PART II.—INDIVIDUALS.

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

ARTICLE 31: What included in gross income. XI-5-5375
Ct. D. 445

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

INCOME—EXEMPTION—LAND OF ALLOTTEE OF FIVE CIVILIZED TRIBES.

Section 6 of the Act of Congress of May 27, 1908 (35 Stat., 312), does not operate to retain restrictions against alienation upon land of a minor allottee of the Five Civilized Tribes, a mixed-blood Indian having less than half Indian blood, from whose land restrictions against alienation were removed by section 1 of that Act. Income derived from such land is not exempt from the tax imposed by the Revenue Act of 1918, section 4 of the Act of May 27, 1908, providing that land from which restrictions have been removed is subject to taxation as though it were the property of other persons than allottees of the Five Civilized Tribes.

UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF OKLAHOMA.

Dora Ellen Bagby, née Parks, plaintiff, v. *United States of America, defendant.*

[November 7, 1931.]

OPINION.

KENNAMER, District Judge: This action was instituted February 18, 1930, for the recovery of Federal income taxes collected for the year 1918. Plaintiff is

enrolled as a member of the Creek Tribe of Indians of ⅛ Indian blood, and held title during the year 1918 to the lands described in her petition, which had been theretofore allotted to her from the tribal lands as her surplus allotment. The tax sought to be recovered was assessed upon income derived by plaintiff from this allotment. During the year 1918 and at the times of the payment of the tax in March and June, 1919, plaintiff was a minor, subject to the jurisdiction of the County Court of Tulsa County, Okla., and having a guardian appointed by said court. The payment of the tax was made by her guardian at the times aforesaid. Plaintiff arrived at her majority on August 12, 1920, and December 12, 1929, filed claim for refund on her taxes, alleging that income from the surplus allotment during her minority was not subject to taxation because of the Act of Congress of May 27, 1908 (35 Stat., 312). The claim for refund was rejected by the Commissioner of Internal Revenue and this suit was brought.

The defendant has demurred to plaintiff's petition, the demurrer consisting of a general demurrer and also that the petition disclosed that neither the claim for refund nor this suit were filed within the time required by law.

The first and decisive question to be decided is, "Was the income derived by plaintiff from her surplus allotment during her minority subject to taxation by the Government?" If this be decided in the affirmative, the demurrer should be sustained without further consideration. In deciding this question it is necessary to construe certain provisions of the Act of Congress of May 27, 1908 (35 Stat., 312), which is entitled "An Act for the removal of restrictions from part of the lands of allottees of the Five Civilized Tribes and for other purposes," and the purpose of which was to revise and restate the law as to restrictions on alienation and administration of the allotted lands of the Five Civilized Tribes. The following provisions of said Act are here involved:

"SEC. 1. That from and after 60 days from the date of this Act the status of the lands allotted heretofore or hereafter to allottees of the Five Civilized Tribes shall, as regards restrictions on alienation or incumbrance, be as follows: All lands, including homesteads, of said allottees enrolled as intermarried whites, as freedmen, and as mixed-blood Indians having less than half Indian blood including minors shall be free from all restrictions. All lands, except homesteads, of said allottees enrolled as mixed-blood Indians having half or more than half and less than three quarters Indian blood shall be free from all restrictions. All homesteads of said allottees enrolled as mixed-blood Indians having half or more than half Indian blood, including minors of such degrees of blood, and all allotted lands of enrolled full-bloods and enrolled mixed-bloods of three quarters or more Indian blood, including minors of such degrees of blood, shall not be subject to alienation, contract to sell, power of attorney, or any other incumbrance prior to April 26, 1931, except that the Secretary of the Interior may remove such restrictions, wholly or in part, under such rules and regulations * * * as he may prescribe.

"SEC. 2. * * * That the * * * term minor or minors, as used in this Act, shall include all males under the age of 21 years and all females under the age of 18 years.

"SEC. 4. That all land from which restrictions have been or shall be removed shall be subject to taxation and all other civil burdens as though it were the property of other persons than allottees of the Five Civilized Tribes; * * *.

"SEC. 6. That the person and property of minor allottees of the Five Civilized Tribes shall, except as otherwise specifically provided by law, be subject to the jurisdiction of the probate courts of the State of Oklahoma. The Secretary of the Interior is hereby empowered, under rules and regulations to be prescribed by him, to appoint such local representatives within the State of Oklahoma * * * to inquire into and investigate the conduct of guardians or curators having in charge the estates of such minors, and whenever such representative or representatives of the Secretary of the Interior shall be of the opinion that the estate of any minor is not being properly cared for by the guardian or curator, or that the same is in any manner being dissipated or wasted or being permitted to deteriorate in value by reason of the negligence or carelessness or incompetency of the guardian or curator, said representative or representatives of the Secretary of the Interior shall have power and it shall be their duty to report said matter in full to the probate court and take the necessary steps to have such matter fully investigated, and go to the further extent of prosecuting any necessary remedy, either civil or criminal, or both, to preserve the property and protect the interests of said minor allottees: and it shall be the further

duty of said representative or representatives to make full and complete reports to the Secretary of the Interior * * *."

It is the above-quoted provisions of section 6 of this Act upon which the plaintiff relies for her contention that the income from her surplus allotment is not taxable by the Government, it being the plaintiff's theory that said section 6 expressly continues the guardianship of the Federal Government over her entire estate and imposes restrictions upon the alienation of the estate, including the surplus allotment, to such an extent as that it can not be classified as "land from which restrictions have been removed" as contemplated by the provisions of section 4, supra, so as to be subject to taxation. It will be noted that section 1 provides that "all lands, including homesteads, of said allottees enrolled as intermarried whites, as freedmen, and as mixed-blood Indians having less than one-half Indian blood, including minors, shall be free from all restrictions" and that section 4 provides, as heretofore said, "that all lands from which restrictions have been or shall be removed shall be subject to taxation and all other civil burdens as though it was property of other persons than allottees of the Five Civilized Tribes; * * *." The language of section 1 and section 4 are so plain that it is clearly apparent that plaintiff is correct in her statement that if her surplus allotment is nontaxable something must be found in section 6 to support such contention. Plaintiff contends that because of the presence of section 6 in the Act of 1908, supra, it was not intended by the Act to emancipate plaintiff as a ward of the Government until she had attained her majority. It is contended that the provisions of this section, reciting that the person and property of minor allottees shall be subject to the jurisdiction of the probate courts of the State of Oklahoma, and empowering the Secretary of the Interior to appoint local representatives within the State of Oklahoma to inquire into and investigate the conduct of guardians or curators having charge of the estates of such minors, and authorizing such representatives, when necessary, to report any dereliction of duty of any such guardian or curator to the probate court and take such steps as may be necessary to have such matter fully investigated and to prosecute any necessary remedy, either civil or criminal, to preserve the property and protect the interest of minor allottees, are in effect a continuation of the guardianship of the National Government over such minor allottees, and that the restrictions from their allotments have not been wholly removed. It is plaintiff's position that that part of section 6 providing that the person and property of minors shall be subject to jurisdiction of the probate courts of Oklahoma, constitute such courts agencies of the Federal Government. The power exercised by such courts over such minor estates is a jurisdiction vested in them by the National Government.

I can not agree that this is the proper construction of the Act of May 27, 1908 (35 Stats., 312, supra), and particularly section 6 thereof. By section 1 of the Act, Congress in definite and plain language removed all restrictions upon alienation of the allotments of certain members of the Five Civilized Tribes, including minors having less than half Indian blood. The Act did not confer any jurisdiction upon the county courts of Oklahoma in the exercise of their probate jurisdiction, but the Congress by the Act relinquished its superior and paramount jurisdiction and control over the allotments made to members of the tribe of less than half Indian blood, and when this paramount power and control over such lands were relinquished by Congress, the land and property of such members of the tribe located within the State became subject to the laws of the State and the jurisdiction of its courts. While Congress may constitute the county courts Federal agencies to perform ministerial duties with reference to Indians and their property located within the State, it will not be assumed that Congress has attempted to confer probate jurisdiction upon the courts of the State. The jurisdiction of such courts is conferred under the constitution and laws of the State. The county courts in the exercise of probate jurisdiction proceed under the jurisdiction conferred by the constitution and laws of the State. Where the Congress has relinquished its superior power over Indians and their property located within a State, such Indians and their property are subject to the laws of the State and the jurisdiction of its courts. (*Dickson* v. *Luck Land Co.*, 242 U. S., 371, 61 L. Ed., 371; *Gowdy* v. *Meath*, 203 U. S., 146; *In re Estate of Pageon*, 81 Okla., 180.)

The powers invested in the Secretary of the Interior under the provisions of section 6 to appoint local representatives within the State, and who are

commonly designated as probate attorneys, to inquire into and investigate the conduct of guardians for the purpose of prosecuting any civil or criminal remedies in behalf of such Indian minors in no way qualifies the provisions of section 1 of said Act removing restrictions from the allotments of such Indian minors. The same right may be exercised by the next friend of such minor, and it would appear that it was only intended that the Secretary should provide for a representative to protect the rights of such minors by invoking proper civil and criminal remedies in their behalf. By the provisions of section 2 of the Act the term "minor" or "minors," as used in this Act, shall include all males under the age of 21 years and all females under the age of 18 years. By this section Congress only exercised its paramount power in qualifying the laws of the State that would become operative and applicable to such minor allottees. Under the laws of the State marriage of a minor had the effect of removing minority, and the courts of the State might remove the disability of minority. No doubt it was the intention of the Congress to so qualify the operation and effect of the laws of the State as to not make them applicable to such Indians. It prescribed a limitation as to the time the disability of minority should continue, which could not be affected by the law of the State. (*Jefferson* v. *Winkler*, 26 Okla., 653, 110 Pac., 755; *Rogers* v. *Rogers*, 263 Fed., 160; *McKee* v. *Whitehead*, 253 Fed., 546.)

Section 4 of the Act approved May 27, 1908, supra, provides: "Lands from which restrictions have been removed shall be subject to taxation, and all other civil burdens, as though it was the property of other persons than allottees of the Five Civilized Tribes." And the proviso to section 4 prohibits allotted lands from being subjected or held liable to any form of personal claim or demand against the allottee arising or existing prior to removal or restrictions other than contracts theretofore expressly permitted by (Federal) law. It is apparent that the proviso designates the civil burdens to which such lands shall not be subjected, and it appears reasonable that such civil burdens as are not included within the exceptions found in the proviso can not be included therein by interpretation.

It is my conclusion that the income derived from the surplus allotment of the plaintiff was subject to the income taxes collected for the year 1918. The demurrer should be sustained. The plaintiff having indicated that she desires to stand upon the petition as filed, without leave to plead further, the action may be dismissed at the cost of the plaintiff.

ARTICLE 31: What included in gross income.

REVENUE ACT OF 1921.

Modification of I. T. 2352 (C. B. VI-1, 32), relating to income of husband and wife in California. (See I. T. 2616, page 161.)

ARTICLE 31: What included in gross income.

REVENUE ACT OF 1918.

Award to railroad to make good guaranty of "minimum operating income," provided in Transportation Act of 1920; books on the accrual basis. (See Ct. D. 494, page 260.)

ARTICLE 31: What included in gross income.

REVENUE ACT OF 1918.

Award to railroad to make good guaranty of "minimum operating income," provided in Transportation Act of 1920. (See Ct. D. 495, page 263.)

ARTICLE 32: Compensation for personal services.

REVENUE ACT OF 1921 AND PRIOR REVENUE ACTS.

Commission allowed insurance agent on policy taken out on own life. (See G. C. M. 10486, page 14.)

ARTICLE 51: When included in gross income.

REVENUE ACT OF 1916.

Income derived from sales made in 1916, impounded until paid to taxpayer in 1917, ownership being determined by Supreme Court in 1922. (See Ct. D. 499, page 293.)

ARTICLE 53: Examples of constructive receipt.

XI-22-5495
Ct. D. 489

INCOME TAX—REVENUE ACTS OF 1918 AND 1928—DECISION OF COURT.

1. INCOME—ASSIGNMENT OF FUTURE INCOME.

An instrument by which A assigns and transfers to B certain bonuses and commissions thereafter becoming payable by an insurance company to A by virtue of his contract with the company is ineffective to avoid the taxation of such earnings as A's income, notwithstanding the fact that B actually and beneficially receives such earnings.

2. SUIT—COLLECTION—LIMITATION—CLAIM FOR ABATEMENT.

Section 611 of the Revenue Act of 1928 withdraws the statute of limitations upon collection as a ground for the recovery of a tax paid under the conditions therein stated, even though the tax is paid involuntarily and after the effective date of that section.

UNITED STATES CIRCUIT COURT OF APPEALS, SIXTH CIRCUIT.

Camille M. Parker, Administratrix of the Estate of John J. Parker, Deceased, appellant, v. *C. F. Routzahn, Collector of Internal Revenue, appellee.*

Appeal from United States District Court for the Northern District of Ohio, Eastern Division.

[March 8, 1932.]

OPINION.

TUTTLE, District Judge: This is an appeal by the plaintiff below from a judgment of the district court, after written waiver of a jury, which dismissed an action brought against the defendant collector of internal revenue to recover certain income taxes, hereinafter mentioned, paid to the defendant under protest. The action was commenced by John J. Parker, but upon his death the administratrix of his estate was substituted as plaintiff herein. He, however, for convenience, will be hereinafter designated as plaintiff.

The material facts, all of which are undisputed, are as follows:

On January 22, 1906, the plaintiff, then in the employ of the New York Life Insurance Co. as an insurance agent, executed and delivered to his wife, without any valuable consideration, a written instrument containing the following provisions material here:

"In consideration of natural love and affection, I, John J. Parker, do hereby sell, assign, transfer and set over unto my wife, Camille M. Parker, all my right, title and interest in and to the funds of Nylic, said Nylic being an

organization of agents in the New York Life Insurance Co., and all benefits and advantages whatsoever therein subject to my Nylic agreement and the rules and regulations of said company.

"And I hereby further direct said company to pay to my said wife all my benefits in said Nylic as they accrue whether under my present Nylic agreement or under any further modification thereof, or any future Nylic arrangement.

"For the same consideration, I further hereby sell, assign and transfer unto my said wife all renewal commissions hereafter accruing to me, whether under my present contract with said New York Life Insurance Co. or any future contract with said company, and I order and direct said company to pay said renewals to my said wife as they accrue."

The funds and commissions mentioned in this instrument consisted of certain bonuses and commissions thereafter becoming payable by the insurance company to the plaintiff under the terms of his employment by it, the amount of which compensation was dependent on the length of his service and the amount of premiums to be received by the company under its insurance policies sold by plaintiff in previous and in future years.

During the taxable year 1918 the insurance company paid to the said wife of the plaintiff the sum of $3,000, representing the bonus accruing to the plaintiff in that year based on the length of his service and the amount of insurance written by him, and the further sum of $6,671.71, representing commissions accruing to him during such year on renewal premiums paid to it under insurance policies negotiated by him.

On March 14, 1919, plaintiff filed with the defendant collector his income tax return for the taxable year 1918 without reporting, or paying any tax with respect to, the said sums paid by the insurance company to his wife in that year. In February, 1923, the Commissioner of Internal Revenue assessed an additional income tax against the plaintiff based upon the ground that the aforementioned sums so paid to his wife constituted part of the taxable income of the plaintiff for the year 1918. On February 26, 1923, plaintiff filed with the defendant a claim in abatement of such assessment, as a result of which the collection of this additional tax was deferred by the defendant pending a decision thereon. On December 17, 1923, this claim in abatement was rejected by the Commissioner of Internal Revenue. On March 14, 1924, the 5-year period within which collection of this tax was, by section 250(d) of the Revenue Act of 1921 (chapter 136, 42 Statutes at Large, 227, 265), limited, expired. On November 22, 1928, after a threat of distraint by the defendant, this tax was paid by the plaintiff to the defendant under protest. Thereafter a claim for refund was duly made and rejected, and thereupon this action was commenced for the recovery of such tax.

Section 210 of the Revenue Act of 1918 (chapter 18, 40 Statutes at Large, 1057, 1062), applicable to the income here involved, imposed an income tax upon net incomes, including "income derived from salaries, wages, or compensation for personal service * * * of whatever kind and in whatever form paid."

Section 607 of the Revenue Act of 1928 (chapter 852, 45 Statutes at Large, 874), being section 2607 of Title 26 of the United States Code, provides as follows:

"Any tax (or any interest, penalty, additional amount, or addition to such tax) assessed or paid (whether before or after May 29, 1928) after the expiration of the period of limitation properly applicable thereto shall be considered an overpayment and shall be credited or refunded to the taxpayer if claim therefor is filed within the period of limitation for filing such claim."

Section 611 of the same statute (45 Statutes at Large, 875), being section 2611 of Title 26 of the United States Code, provides as follows:

"If any internal-revenue tax (or any interest, penalty, additional amount, or addition to such tax) was, within the period of limitation properly applicable thereto, assessed prior to June 2, 1924, and if a claim in abatement was filed, with or without bond, and if the collection of any part was stayed, then the payment of such part (made before or within one year after May 29, 1928) shall not be considered as an overpayment under the provisions of section 2607, relating to payments made after the expiration of the period of limitation on assessment and collection."

It is urged by the plaintiff (1) that the instrument of assignment in question was a valid, legal assignment of the future earnings of the plaintiff therein mentioned, the effect of which was to transfer to the assignee a vested interest in such earnings prior to the time of their accrual to him and receipt by her

in 1918, so that they did not constitute any part of his taxable income for that year; and (2) that, in any event, as the collection of the tax here involved had been barred by the applicable statute of limitations prior to the time of such collection, plaintiff is entitled to recover such tax as an "overpayment" under the provisions of section 607 of the Revenue Act of 1928, hereinbefore quoted.

1. It is contended by the defendant that inasmuch as, at the time of the execution of this assignment, the earnings of the plaintiff which it purported to assign were not in existence, this instrument operated, not as a legal assignment conveying a present interest to the assignee, but merely as an equitable assignment, under which such assignee acquired no title or rights in such future earnings until they had been earned and received, in contemplation of law, by the plaintiff, at which time they became part of his taxable income, prior to their receipt by her. There is considerable force in this argument. (*Leydig* v. *Commissioner of Internal Revenue*, 43 F. (2d), 494 (C. C. A. 10); *Seaboard Small Loan Corporation* v. *Ottinger*, 50 F. (2d), 856 (C. C. A. 4).) As was pointed out by the court in the case last cited (at page 857):

"The rule is that an assignment of wages to be earned in the future is not good at law because ineffective to pass legal title, but will be enforced in equity. It is enforced in equity, not as a conveyance in praesenti of what manifestly does not exist, but because it is regarded in equity as a contract to take effect and attach to the wages assigned as soon as they come in esse. Until the wages are earned, it is regarded as an agreement to convey; after that time as a conveyance."

It is further insisted by the defendant that as this equitable assignment was not supported by a valuable consideration and was therefore unenforcible and inoperative, at least until after the time when these future earnings had actually accrued to the plaintiff, prior to which time he could have revoked such assignment, the legal situation is not substantially different from what it would have been if plaintiff had expressly reserved the right to make such revocation, in which case the mere reservation of such right, irrespective of its exercise, would have rendered him liable for this tax. (*Corliss* v. *Bowers*, 281 U. S., 376 [Ct. D. 188, C. B. IX–1, 254].) In that case the court used the following significant language (page 378):

"Taxation is not so much concerned with the refinements of title as it is with actual command over the property taxed—the actual benefit for which the tax is paid. If a man directed his bank to pay over income as received to a servant or friend, until further orders, no one would doubt that he could be taxed upon the amounts so paid. It is answered that in that case he would have a title, whereas here he did not. But from the point of view of taxation there would be no difference. The title would merely mean a right to stop the payment before it took place. The same right existed here, although it is not called a title but is called a power. The acquisition by the wife of the income became complete only when the plaintiff failed to exercise the power that he reserved. * * * Still speaking with reference to taxation, if a man disposes of a fund in such a way that another is allowed to enjoy the income which it is in the power of the first to appropriate, it does not matter whether the permission is given by assent or by failure to express dissent. The income that is subject to a man's unfettered command and that he is free to enjoy at his own option may be taxed to him as his income, whether he sees fit to enjoy it or not."

Substantially the same principle was applied to a somewhat different state of facts by the Circuit Court of Appeals for the Second Circuit in *Mitchell* v. *Bowers* (15 F. (2d), 287 [T. D. 3982, C. B. VI–1, 244]).

It is, however, in our opinion, unnecessary to determine to what, if any, extent the foregoing considerations are applicable here, for the reason that, in any event, we think that this branch of the case at bar is controlled, in principle, by the decision of the Supreme Court in *Lucas* v. *Earl* (281 U. S., 111), where the court held, in effect, that in view of the language of section 213 of the Revenue Act of 1918, imposing a tax upon the net income of every individual including "income derived from salaries, wages or commissions for personal service * * * of whatever kind and in whatever form paid," the statute must be construed as taxing such salaries as income to the persons who earn them regardless of any anticipatory contracts or arrangements designed to prevent such a salary from vesting in the person by whom it is earned. That case presented the question, as stated by the court (at page 113), whether the respondent, Earl, could be taxed for the whole of the salary

and attorneys' fees earned by him in certain years or should be taxed for only a half of them in view of a contract with his wife, made before receipt of such salary and fees, providing that his future earnings should be received and owned by him and his wife as joint tenants.

After referring to the language of the statute just quoted the court proceeds as follows:

"A very forcible argument is presented to the effect that the statute seeks to tax only income beneficially received, and that taking the question more technically the salary and fees became the joint property of Earl and his wife on the very first instant on which they were received. We well might hesitate upon the latter proposition, because however the matter might stand between husband and wife he was the only party to the contracts by which the salary and fees were earned, and it is somewhat hard to say that the last step in the performance of those contracts could be taken by anyone but himself alone. But this case is not to be decided by attenuated subtleties. It turns on the import and reasonable construction of the taxing Act. There is no doubt that the statute could tax salaries to those who earned them and provide that the tax could not be escaped by anticipatory arrangements and contracts however skillfully devised to prevent the salary when paid from vesting even for a second in the man who earned it. That seems to us the import of the statute before us and we think that no distinction can be taken according to the motives leading to the arrangement by which the fruits are attributed to a different tree from that on which they grew."

This language is, we think, in substance equally applicable to the present situation, and requires us to hold, as we do, that the assignment here involved, by which this taxpayer attempted to transfer to his wife the right to receive future earnings of his which would otherwise have been taxable as income to him, was ineffective to avoid the taxation of such earnings as his income, notwithstanding the fact that she, and not he, actually and beneficially received such earnings. (*Leydig* v. *Commissioner*, supra; *Bishop* v. *Commissioner*, 54 F. (2d), 298 (C. C. A. 7) [Ct. D. 477, page 164].)

We do not overlook cases, such as *Iowa Bridge Co.* v. *Commissioner of Internal Revenue* (39 F. (2d), 777 (C. C. A. 8)); *Copland* v. *Commissioner of Internal Revenue* (41 F. (2d), 501 (C. C. A. 7)); *Commissioner of Internal Revenue* v. *Field* (42 F. (2d), 820 (C. C. A. 2)); and *Hall* v. *Burnet* (54 F. (2d), 443 (App. D. C.)), holding, in effect, that income accruing from a contract or other property after an irrevocable assignment, not merely of future income but of the property from which such income afterwards arises, is taxable to the assignee and not to the assignor. Such cases, however, are substantially different, in their facts, from the present case, which involves an attempted assignment only of compensation for personal services of the assignor accruing subsequent to the time of such assignment. We, therefore, need not determine whether the conclusions reached in those cases, at least with respect to the assignment of a contract for such subsequently accruing compensation, are consistent with the decision in *Lucas* v. *Earl*, supra, and its necessary implications.

2. Subsequent to the entry of the judgment below, the Supreme Court, in *Graham* v. *Goodcell* (282 U. S., 409 [Ct. D. 287, C. B. X–1, 191]), fully considered and construed the meaning and effect of sections 607 and 611 of the Revenue Act of 1928, hereinbefore quoted. That decision, in our opinion, decided, either expressly or by necessary implication, adversely to the position of the present plaintiff, the contention that the payment of the taxes involved, after the expiration of the period of limitation applicable thereto, under the circumstances already mentioned, is recoverable as an "overpayment" under the section 607, and that such payment was not excepted from the provisions of section 607 by the qualifying provisions of section 611. As we understand the argument of the plaintiff, it is now confined to the claim that because this payment was made in response to a threat of distraint by the defendant collector it was an involuntary payment, and that section 611 does not apply to involuntary payments, at least if made after the time of the enactment of section 611. We are unable to agree with these contentions. As was pointed out by the Supreme Court in *Graham* v. *Goodcell*, just cited (at page 416), "Section 611 enacts a qualification by providing that in stated circumstances the payment of the tax shall not be considered an overpayment under the provisions of section 607. These circumstances are (a) an assessment of the tax within the time applicable thereto and before June 2, 1924, (b) the filing of a claim in abatement, (c) the stay

of the collection of any part of the tax, and (d) the payment of such part of the tax before, or within one year after the enactment of the Act of 1928." After referring to the contention, there made, to the effect that these sections of the statute "are not applicable to payments made under duress," the court says: "We are also of the opinion that the statute embraces involuntary payments." Although it is true that the particular payments there involved had apparently been made prior to the enactment of these sections and that, therefore, there was no occasion for the court to specifically refer to payments made after such enactment, yet we can not perceive any sound reason for holding these statutory provisions applicable to such prior payments and not to such subsequent payments, especially in view of the clear and positive language of section 611 including within its scope such payments "made before or within one year after the enactment of this Act."

As, therefore, the tax in question was, within the period of limitation applicable thereto, assessed prior to June 2, 1924, a claim in abatement was filed, the collection of such tax was stayed, and payment thereof was made within one year after the enactment of section 611, we think it clear that such section is applicable to the payment of this tax and prevents its refund as an overpayment under the provisions of section 607.

It results that the judgment of the district court must be, and it is, affirmed.

ARTICLE 53: Examples of constructive receipt.

REVENUE ACT OF 1921.

Assignment of portion of renewal commissions due and to become due under insurance contract. (See Ct. D. 477, page 164.)

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

ARTICLE 73: Gifts and bequests. XI–23–5504
(Also Section 213(a), Article 31.) Ct. D. 494

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

1. INCOME—SUBSIDY OR GIFT—RAILWAY COMPANY NOT UNDER FEDERAL CONTROL—OPERATING DEFICIT—AWARD OF INTERSTATE COMMERCE COMMISSION.

A payment to a railway company, pursuant to an award of the Interstate Commerce Commission under the terms of section 204 of the Transportation Act of 1920, by the terms of which payment is to be made to railway companies not under Federal control of a proportion of any operating deficit suffered in the period of such control, is not a subsidy or gift but is income not exempt from taxation under the Revenue Act of 1918.

2. SAME—ACCRUAL BASIS—WHEN INCLUDED IN INCOME.

Where the books of a railway company are kept on the accrual basis, an amount paid to it in 1923 pursuant to an award in that year of the Interstate Commerce Commission under section 204 of the Transportation Act of 1920, by the terms of which payment is to be made to railroads not under Federal control of a proportion of any operating deficit suffered in the period of such control, is income in the year 1920, in which year the right to the payment arose.

SUPREME COURT OF THE UNITED STATES. No. 560.—OCTOBER TERM, 1931.

Continental Tie & Lumber Co., petitioner, v. The United States.

On writ of certiorari to the Court of Claims.

[May 16, 1932.]

OPINION.

Mr. Justice ROBERTS delivered the opinion of the court.

For the year 1920 the petitioner filed a consolidated income tax return for itself and the Cimarron & Northwestern Railway Co. and paid the tax shown as due. Subsequently a claim for refund was prosecuted, whereupon the Commissioner made a reaudit and added to the railway's income some $27,000. The refund granted was diminished by the amount of the additional tax resulting from the increase in income so determined. The petitioner objected to this reduction and brought suit in the Court of Claims to recover the full amount claimed to be refundable. The railway company is a short-line carrier whose road was in possession and control of the United States and operated by the Director General of Railroads from December 28, 1917, to June 3, 1918, when it was relinquished, and thereafter throughout the remainder of the period of Federal control operated by its owner. Approximately $25,000 of the additional income determined by the Commissioner consisted of a payment to the railway pursuant to an award of the Interstate Commerce Commission under the terms of section 204 of the Transportation Act, 1920.[1] This section provided for such an award and payment to a railroad which during any part of the period of Federal control competed for traffic, or connected, with one under Federal control, and sustained a deficit in operating income for that portion of the period during which it operated its own railroad. The Act directed the commission to compare the results of such operation with those of the test period, defined as the three years ending June 30, 1917; and if less favorable during the period of Federal control than during the test period, to award an amount calculated as prescribed by the section. The commission made an award and the Secretary of the Treasury paid the railway.

The petitioner asserted (1) that the sum received was not income within the intent of the sixteenth amendment or section 213 of the Revenue Act of 1918; (2) that if income, it was not taxable for 1920, as held by the Commissioner, but for 1923, the year in which the amount was determined and paid. The Court of Claims denied recovery.

What we have said in *Texas & Pacific Railway Co. v. United States*, No. 634, decided this day [Ct. D. 495, page 263, this Bulletin], is determinative of the first contention. Section 209 of the Transportation Act guaranteed the payment of any deficiency below a fixed minimum of operating income for the six months ensuing the termination of Federal control to railroads which had been taken over by the United States. By the terms of section 204 payment was to be made to railroads not under Federal control of a proportion of any operating deficit suffered in the period of such control. The underlying purpose of Congress was the same in both cases. Railroads falling within section 204 were principally short lines. They were known to have suffered serious losses in income due to routing arrangements and other administrative measures made necessary by Government operation of the larger railroad systems. The Transportation Act did not contemplate that the payments to be made pursuant to section 204 were in any sense just compensation for the taking of property. There was no room for such reimbursement, as the short lines were during the time to which the section applied in the possession and management of their owners. Congress, nevertheless, realized that Federal operation had caused them consequential losses, at least partial redress for which was the purpose of the section where actual deficits in income had resulted. For the reasons set forth in No. 634 we hold that these payments were not subsidies or bonuses, but were income within the intent of the amendment and the statute.

The petitioner kept its accounts upon the accrual basis. The Government insists, and the Court of Claims held, that the right to payment having ripened in 1920 the taxpayer should have returned the estimated award under section 204 as income for that year. The petitioner replies that a determination

[1] Ch. 91, 41 Stat., 456, 460.

whether it would receive any award under the section and, if so, the amount of it depended on so many contingencies that no reasonable estimate could have been made in 1920, and that the sum ultimately ascertained should be deemed income for 1923, the year of the award and payment.

The Transportation Act took effect on February 28, 1920. On June 10 the Interstate Commerce Commission issued general instructions governing the compilation and submission of data by carriers entitled to awards under section 204. The petitioner correctly states that at the date of the Act's adoption no railroad had a vested right in any amount; until the commission made an award nothing could be paid, no proceeding was available to compel an allowance, or to determine the elements which should enter into the calculation. In short, says the petitioner, the carrier had no rights, but was dependent solely upon the commission's exercise of an unrestrained discretion, and until an award was made nothing accrued. But we think that the function of the commission under the Act was ministerial, to ascertain the facts with respect to the carrier's operating income by a comparison of the experience during the test period with that during the term of Federal control. The right to the award was fixed by the passage of the Transportation Act. What remained was mere administrative procedure to ascertain the amount to be paid. Petitioner's right to payment ripened when the Act became law. What sum of money that right represented is, of course, a different matter.

The petitioner says that at the date of the passage of the Act it was impossible to predict that any award would be made to the railway, and, assuming one would eventuate, its amount could not be estimated, for the reason that the principles upon which awards were to be made had to be settled by the commission and were not finally formulated until 1923. The Government insists that while adjustments or settlement of principles by the commission might vary the amount to be awarded, the petitioner's case presented problems not differing from those confronting many business concerns which keep accounts on an accrual basis and have to estimate for the tax year the amount to be received on transactions undoubtedly allocable to such year. Admitting there might be differences and discrepancies between the railway's estimate and the amount awarded by the commission, these, says the Government, could, as in similar cases, have been adjusted by an additional assessment or a claim for refund after final determination of the amount due.

The case does not fall within the principle that where the liability is undetermined in the tax year the taxpayer is not called upon to accrue any sum (*Lucas* v. *American Code Co.*, 280 U. S., 445 [Ct. D. 168, C. B. IX–1, 314]), but presents the problem whether the taxpayer had in its own books and accounts data to which it could apply the calculations required by the statute and ascertain the *quantum* of the award within reasonable limits.

The carriers kept their accounts according to standards prescribed by the commission; and these necessarily were the source of information requisite for ascertainment of the results of operation in the two periods to be compared. In the calculation for two such brief periods allowance had to be made for the fact that certain operating charges entered in the books would not accurately reflect true income. Such, for instance, were maintenance charges and those to reserve accounts. The enormous increase in labor and material costs after the expiration of the test period had also to be considered in comparing charges for costs of repairs and renewals in the two periods. Section 204 incorporated by reference the terms of section 209 applicable to the method of treating such items, and the latter in turn referred to the relevant provisions of section 5(a) of the standard operating contract between the director general and the various railroads. As might have been expected, the general principles thus formulated did not cover in detail questions of fact, the solution of which required in some degree the exercise of opinion and judgment. Thus difference might fairly arise as to when reserve accounts ought to be closed out, as to how much of the sum actually expended for maintenance within a given time was properly allocable to that period, and how much to later years; at what price renewals and replacements should be charged in view of the rapidly mounting cost of material; what factor of difference should be allowed for the efficiency of labor in the pre-war and post-war periods. The petitioner points to the fact that these questions were raised by the railroads under section 209, that the commission gave extended consideration to them, and that, as respects sundry of them, the applicable principles were not settled until 1921, 1922, and 1923. Petitioner might have added that the commission, while attempting as far as possible to formulate general principles applicable to large groups of carriers, found

it necessary in addition to consider the peculiar conditions and special circumstances affecting individual carriers in order in each case to do justice to the carrier and to the United States.[2] But in spite of these inherent difficulties we think it was possible for a carrier to ascertain with reasonable accuracy the amount of the award to be paid by the Government. Subsequent to its order of June 10, 1920, the commission made no amendment or alteration of the rules with respect to the information to be furnished under section 204. Obviously the data had to be obtained from the railway's books and accounts and from entries therein all made prior to March 1, 1920. These accounts contained all the information that could ever be available touching relevant expenditures. Compare *United States* v. *Anderson* (269 U. S., 422 [T. D. 3839, C. B. V-1, 179]). The petitioner was promptly informed by the terms of section 209 as supplemented by the instructions issued by the commission of the method to be followed in allocating charges to operation during periods under inquiry. It does not appear that a proper effort would not have obtained a result approximately in accord with what the commission ultimately found.

Much is made by the petitioner of the fact that as a result of representations by the carriers the commission from time to time during 1921, 1922, and 1923 promulgated rulings respecting the method of adjusting book charges to actual experience, and it is asserted that petitioner could not in 1920 have known what these rulings were to be. But it is not clear that if the taxpayer had acted promptly an award could not have been made during 1920, or at least the principles upon which the commission would adjust the railway's accounts to reflect true income have been settled during that year sufficiently to enable the railway to ascertain with reasonable accuracy the amount of the probable award. The reports of the Interstate Commerce Commission show that it was possible for a carrier whose claim arose under section 209 to obtain a final award early in 1921, prior to the time for preparing its income tax return.[3] From the record it would seem that in spite of the fact that its return was not made until November, 1922, the petitioner made up its claim by taking maintenance charges as appearing in its books without attempt at allocation as between the limited periods in which they were entered and the probable useful life of the installations. Petitioner must have known that the entire amounts charged to maintenance during the respective periods would not be properly allowable in ascertaining true income for each period. The books and accounts fixed the maximum amount of any probable award, and if petitioner had endeavored to make reasonable adjustments of book figures it could have arrived at a figure to be accrued for the year 1920. Any necessary adjustment of its tax could readily have been accomplished by an amended return, claim for refund, or additional assessment, as the final award of the commission might warrant.

For these reasons the Court of Claims correctly held that the amount awarded was taxable income for the year 1920.

Judgment affirmed.

ARTICLE 73: Gifts and bequests. (Also Section 213(a), Article 31.)

XI-23-5505
Ct. D. 495

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

INCOME—SUBSIDY OR GIFT—FEDERAL CONTROL OF RAILWAYS—GUARANTY OF "MINIMUM OPERATING INCOME."

Where a railway company accepts the provisions of section 209 of the Transportation Act of 1920 relative to the compensation payable to railway companies by the United States for the six months "guaranty period" immediately following their release from Government control on March 1, 1920, the amount received by the company, which is awarded to it by the Interstate Commerce Commission to make good the guaranty embodied in that section of a "minimum operating income" for that period, is not a subsidy or gift but is income not exempt from taxation under the Revenue Act of 1918.

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[2] Maintenance expenses under section 209 (70 I. C. C., 115).
[3] Norfolk Southern R. R. Co. (65 I. C. C., 798).

SUPREME COURT OF THE UNITED STATES. No. 634.—OCTOBER TERM, 1931.

The Texas & Pacific Railway Co., petitioner, v. *The United States.*

On writ of certiorari to the Court of Claims.

[May 16, 1932.]

OPINION.

Mr. Justice ROBERTS delivered the opinion of the court.

During Federal control of railways that of petitioner was operated by the director general under the Act of March 21, 1918.[1] Pursuant to the Transportation Act, 1920,[2] the Government relinquished the property March 1, 1920; petitioner accepted the provisions of section 209[3] of the Act, and consequently received for the six months period commencing March 1, 1920, an allowance awarded by the Interstate Commerce Commission to make good the guaranty embodied in that section. The company omitted this sum from taxable income returned for the year 1920. After audit the Commissioner of Internal Revenue added the amount to the petitioner's income and assessed a resulting additional tax, which was paid under protest. Upon rejection of a claim for refund, suit was brought in the Court of Claims to recover the portion of the tax attributable to the inclusion of the guaranty payment, petitioner asserting that the amount received was a subsidy or gift and therefore not income within the sixteenth amendment of the Constitution or section 213 of the Revenue Act of 1918.[4] Recovery was denied. This court granted certiorari.

By the terms of section 209 of the Transportation Act railroad companies which, like petitioner, had made contracts with the director general for annual compensation during Federal control, were guaranteed an operating income for the ensuing six months of not less than one-half the amount of such compensation. A minimum operating revenue was also assured to carriers not having such contracts, which had been under Federal control or adversely affected thereby. Payment was conditioned on the carrier's acceptance of the provisions of the section, one of which was the agreement that if operating revenue for the period should exceed the guaranteed amount the excess should be paid into the Treasury. Petitioner signified its acceptance.

The statute in terms guarantees a "*minimum operating income*" for six months after relinquishment of Federal control. The situation in which the railroads of the country were as a result of war-time Government operation is well described in *United States* v. *Guaranty Trust Co.* (280 U. S., 478, 484). During that period their expenses had risen and there had been no commensurate increase in rates. While the Government had either paid or was obligated to pay just compensation for their requisition, the amount of it was known to be insufficient for rehabilitation of the roads as privately owned and operated organizations. Until rates could be adjusted to meet increased expenses, loans be negotiated, and operating forces realigned and reintegrated, the credit of the carriers must by some means be reestablished. Thus the Government had a real obligation, not readily susceptible of accurate measurement, to assist in the restoration of normal conditions. The purpose of the guaranty provision was to stabilize the credit position of the roads by assuring them a minimum operating income. They were bound to operate their properties in order to avail themselves of the Government's proffer. Under the terms of the statute no sum could be received save as a result of operation. If the fruits of the employment of a road's capital and labor should fall below a fixed minimum then the Government agreed to make up the deficiency, and if the income were to exceed that minimum the carrier bound itself to pay the excess into the Federal Treasury. In the latter event the carrier unquestionably would have been obligated to pay income tax measured by actual earnings; in the former, it ought not to be in a better position than if it had earned the specified minimum. Clearly, then, the amount paid to bring the yield from

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[1] Ch. 25, 40 Stat., 451.
[2] Act of February 28, 1920 (ch. 91, 41 Stat., 456).
[3] 41 Stat., 464; U. S. C., Title 49, section 77.
[4] 40 Stat., 1057, 1065: "That for the purposes of this title * * * the term 'gross income' * * * (b) Does not include * * * (3) The value of property acquired by gift * * *."

operation up to the required minimum was as much income from operation as were the railroad's receipts from fares and charges.

The sums received under the Act were not subsidies or gifts—that is, contributions to the capital of the railroads—and this fact distinguishes cases such as *Edwards* v. *Cuba Railroad Co.* (268 U. S., 628 [T. D. 3728, C. B. IV–2, 122]), where the payments were conditioned upon construction work performed. Here they were to be measured by a deficiency in operating income, and might be used for the payment of dividends, of operating expenses, of capital charges, or for any other purpose within the corporate authority, just as any other operating revenue might be applied. The Government's payments were not in their nature bounties, but an addition to a depleted operating revenue consequent upon a Federal activity.

In a proper sense these payments constituted income to the carrier not exempt from taxation under the sixteenth amendment or the Revenue Act of 1918. The Court of Claims was right in denying the claim and the judgment must be affirmed.

ARTICLE 87: Income of States.

XI–20–5480
Ct. D. 485

INCOME AND EXCESS PROFITS TAXES—REVENUE ACTS OF 1916, 1917, AND 1918—DECISION OF SUPREME COURT.

1. EXEMPTION—STATE INSTRUMENTALITY—OIL AND GAS LEASE OF SCHOOL LANDS OF OKLAHOMA.

A lease to a private corporation by the State of Oklahoma of a part of her public lands valuable for minerals granted to the State by the United States for the benefit of the public schools of the State is an instrumentality of the State in its performance of a governmental function and the income of the lessee derived from the sale of its share of the oil and gas produced by it from such school lands is exempt from income and excess profits taxes imposed by the Revenue Acts of 1916, 1917, and 1918.

2. DECISION DISTINGUISHED.

The decision in *Group No. 1 Oil Corporation* v. *Bass* (283 U. S., 279) distinguished.

3. DECISION FOLLOWED.

The decision in *Gillespie* v. *Oklahoma* (257 U. S., 501) followed.

SUPREME COURT OF THE UNITED STATES. No. 341.—OCTOBER TERM, 1931.

David Burnet, Commissioner of Internal Revenue, petitioner, v. *Coronado Oil & Gas Co.*

On writ of certiorari to the Court of Appeals of the District of Columbia.

[April 11, 1932.]

OPINION.

Mr. Justice MCREYNOLDS delivered the opinion of the court.

By the enabling Act Congress required as a condition precedent to the admission of Oklahoma into the Union that her constitution should make provision for common schools; and for their benefit it granted certain lands to the State with the proviso that those valuable for minerals, gas and oil should not be sold prior to January 1, 1915, but might be leased. (Act of June 16, 1906; 34 Stat., 267, 270, 272, 273.) The State constitution established a common school system and pledged her faith to preserve the lands so conveyed by the United States as a sacred trust, "and to keep the same for the uses and purposes for which they were granted." The legislature prescribed regulations for leasing and directed payment of the proceeds into the school fund. (Oklahoma Comp. Statutes of 1921, sections 9415, 9417, 9423.)

In January, 1914, some of these lands were leased to the Coronado Oil & Gas Co.; renewals followed in 1919. Under the first lease the State received 50 per cent and under the second 12½ per cent of the gross production of oil and

gas. During the years here important the lessee's entire income came from the sale of its portion of such output.

The Commissioner of Internal Revenue assessed income and excess-profits taxes upon the corporation's net income for 1917, 1918 and 1919. The Board of Tax Appeals approved his action; the Court of Appeals, District of Columbia, ruled otherwise. The latter held that the lease to the Coronado company was an instrumentality of the State for the utilization of lands dedicated to the support of public schools and that to tax the fruits of the lease would burden her in the performance of the government function of maintaining such schools. This conclusion, it properly thought, was necessary under *Gillespie* v. *Oklahoma* (257 U. S., 501).

We are disposed to apply the doctrine of *Gillespie* v. *Oklahoma* strictly and only in circumstances closely analogous to those which it disclosed. In principle, however, the present claim of exemption can not be distinguished from the one presented in the earlier cause and we adhere to the rule there approved.

True it is, as stated in *Group No. 1 Oil Corporation* v. *Bass* (283 U. S., 279, 282, 283 [Ct. D. 330, C. B. X–1, 153]), "This court has consistently held that where property or any interest in it has completely passed from the Government to the purchaser, he can claim no immunity from taxation with respect to it, merely because it was once Government-owned, or because the sale of it effected some Government purpose. * * * Property which has thus passed from either the National or a State Government to private ownership becomes a part of the common mass of property and subject to its common burdens." And as there distinctly indicated the exemption claimed by the Oil corporation was denied because under the settled rule applied by the Texas Supreme Court the oil and gas from disposal of which the corporate income arose had been purchased, not obtained under a lease—title had passed out of the State by a present sale. Status of the title was matter for determination under laws of the State as construed and applied by her courts. In the present cause there is no basis for saying that according to the local law, the transaction between the State and the lessee amounted to a sale. The distinction between cases involving sales and those where leases had been made seemed sufficiently apparent when *Group No. 1 Oil Corporation* v. *Bass* was decided, and is not less obvious now.

"Just what instrumentalities of either a State or the Federal Government are exempt from taxation by the other can not be stated in terms of universal application. But this court has repeatedly held that those agencies through which either government immediately and directly exercises its sovereign powers, are immune from the taxing power of the other." (*Metcalf & Eddy* v. *Mitchell*, 269 U. S., 514, 522 [T. D. 3824, C. B. V–1, 218].)

The opinion in *Gillespie* v. *Oklahoma*, supra, has often been referred to as the expression of an accepted principle. (*Metcalf & Eddy* v. *Mitchell*, supra; *Jaybird Milling Co.* v. *Weir*, 271 U. S., 609, 613; *Northwestern Insurance Co.* v. *Wisconsin*, 275 U. S., 136, 140; *Heiner* v. *Colonial Trust Co.*, 275 U. S., 232, 234; *Shaw* v. *Oil Corporation*, 276 U. S., 575, 579; *Panhandle Oil Co.* v. *Knox*, 277 U. S., 218, 221, 222; *Carpenter* v. *Shaw*, 280 U. S., 363, 366; *Willcuts* v. *Bunn*, 282 U. S., 216, 229 [Ct. D. 280, C. B. X–1, 309]; *Group No. 1 Oil Corporation* v. *Bass*, supra; *Indian Motocycle Co.* v. *United States*, 283 U. S., 570, 576 [Ct. D. 354, C. B. X–1, 439]; *Choteau* v. *Burnet*, 283 U. S., 691, 696 [Ct. D. 352, C. B. X–1, 355].)

When Oklahoma undertook to lease her public lands for the benefit of the public schools she exercised a function strictly governmental in character. Consequently, *South Carolina* v. *United States* (199 U. S., 437), much relied upon, is not in point.

The States are essential parts of the plan adopted by the Federal Constitution; and we accept as settled doctrine that the United States can lay no tax upon their governmental instrumentalities. (*Texas* v. *White*, 7 Wall., 700, 725; *Collector* v. *Day*, 11 Wall., 113; *Pollock* v. *Farmers Loan & Trust Co.*, 157 U. S., 429, 584; *Farmers Bank* v. *Minnesota*, 232 U. S., 516, 527.)

"It is an established principle of our constitutional system of dual government that the instrumentalities, means and operations whereby the United States exercises its governmental powers are exempt from taxation by the States, and that the instrumentalities, means and operations whereby the States exert the governmental powers belonging to them are equally exempt from taxation by the United States." (*Indian Motocycle Co.* v. *United States*,

supra.) Each government is supreme in its sphere; and in order to preserve our dual system this fact must be given practical recognition.

Here the lease to the respondent was an instrumentality of the State for the purpose of carrying out her duty in respect of public schools. To tax the income of the lessee arising therefrom would amount to an imposition upon the lease itself.

The challenged judgment must be affirmed.

Affirmed.

SECTION 214(a)4, 5, AND 6.—DEDUCTIONS ALLOWED: LOSSES.

ARTICLE 141: Losses. XI-25-5520
Ct. D. 503

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

1. DEDUCTION—LOSS—PURCHASE OF WORTHLESS STOCK—TRANSACTION NOT ENTERED INTO FOR PROFIT.

Where the evidence establishes that a transaction is not entered into for profit, a loss incurred as a result of the transaction is not deductible from gross income under section 214(a)5 of the Revenue Act of 1918. Accordingly where a person familiar with the affairs and conditions of the business of a corporation purchases its stock at a time when it is worthless and the transaction is not entered into for profit, the amount paid for the stock is not a loss sustained at the time of the purchase and is not deductible as such under that paragraph.

2. DEDUCTION—LOSS—PARTIAL LIQUIDATION OF CORPORATION.

Where a corporation is in process of liquidation and there is no proof with respect to the value or lack of value of undistributed assets on the particular date on which a loss to a stockholder from the liquidation is claimed, the loss is not susceptible of determination and is therefore not deductible from gross income under the Revenue Act of 1918 even if it be assumed that a stockholder is entitled to a deduction when the assets of the corporation have not been disposed of and its liabilities and expenses of liquidation have not been satisfied.

3. SAME.

Where a corporation is in process of liquidation and it is reasonably certain that the stockholders will receive a further liquidating dividend, a loss to a stockholder from the liquidation is not allowable under the Revenue Act of 1918 before there is a distribution of such dividend in property or money.

COURT OF CLAIMS OF THE UNITED STATES. No. H-362.

Robert B. Dresser and Sinclair Richardson, Administrators Cum Testamento Annexo De Bonis Non of the Estate of Frank A. Sayles, Deceased, v. *The United States.*

[January 18, 1932.]

OPINION.

LITTLETON, Judge, delivered the opinion of the court.

There are five issues in this case. The first four are all substantially the same, and are whether the decedent sustained deductible losses in 1918 and 1919 upon the acquisition by him in these years of certain shares of stock of the East Providence Water Co., the Nitrogen Products Co., the Nitrogen Corporation, and the Erie Specialty Co. The fifth question is whether the decedent was entitled to a deduction of $243,579.33, or any other amount, for the calendar year 1919 as a loss on 7,500 shares of common stock of Clarence Whitman & Co., Inc., resulting from the liquidation of that corporation.

The first four issues are rested by plaintiffs upon the proof which establishes that the outstanding and issued capital stock of these corporations prior to January 1, 1918, and January 1, 1919, was worthless and that stock acquired by the decedent during 1918 and 1919 was worthless at the time of its acquisition, and that the amounts paid by him for the stock in 1918 and 1919 were losses sustained by him at the time the stock was acquired and were deductible under section 214(a)5 of the Revenue Act of 1918 (40 Stat., 1057, 1067), which provides "That in computing net income there shall be allowed as deductions: * * * Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit, though not connected with the trade or business; * * *." No deduction is claimed on account of the stock of these corporations acquired by the decedent prior to the years 1918 and 1919 for the reason that such stock was worthless prior to those years. These transactions do not fall under subdivision (4) of section 214(a) as losses "incurred in trade or business," and they are not claimed under that subdivision. Neither did the transactions in question give rise to a deductible loss for tax purposes under subdivision (5) of section 214(a) of the Revenue Act of 1918, inasmuch as the facts establish that the acquisitions of stock of these corporations were not "transactions entered into for profit." Before a deduction can be taken under this subdivision, it must be established that the loss claimed resulted from a transaction entered into for profit. If a taxpayer chooses to pay or contribute money in any transaction, which, under all the circumstances known to him at the time, is a hopeless venture, and from which he has no reasonable expectation of profit, he is not entitled to take the amounts paid or contributed as a deduction from income for tax purposes. A loss, in order to be deductible under the statute, must be an unintentional parting with something of value. The evidence establishes and we have found as a fact that the decedent was familiar with the affairs and conditions of the business of the corporations, the stocks of which are involved in these issues, and that the acquisitions in 1918 and 1919 of the stocks thereof were not transactions entered into for profit. The losses claimed for 1918 of $177,800 on account of 3,232 shares of stock of the East Providence Water Co., $48,500 on account of 485 shares of stock of the Nitrogen Products Co., and $17,500 on account of 175 shares of the Nitrogen Corporation, and the losses claimed for 1919 of $40,950 on account of 615 shares of stock of the Erie Specialty Co., and $22,500 on account of 225 shares of the Nitrogen Corporation are not legal deductions from gross income.

The loss of $177,800 on account of 3,232 shares of the capital stock of the East Providence Water Co. is claimed on the basis that the indebtedness of the corporation to Sayles of $323,200, for the cancellation of which the stock was issued to him, had a value of $176,900 and that in addition to the cancellation of such indebtedness the decedent paid the corporation $900 in cash. The facts establish that the value of the indebtedness of the corporation to Sayles, for the cancellation of which this stock was issued, was $80,800. We find no proof that the decedent paid $900 in cash in this transaction.

The burden is on the plaintiffs who claim a loss under section 214(a)5 to show, in order to be entitled to the loss, that the transaction upon which it is based was one entered into for profit. In this case the estate has not shown this, but the evidence establishes the contrary. In *Worcester Bank & Trust Co. et al., Exrs.* (13 B. T. A., 630), the United States Board of Tax Appeals allowed a deduction as a loss on the cost of stock, which it was stipulated was worthless at the time of acquisition and at the close of the taxable years, upon the sole ground that the parties had stipulated that the stock was acquired as an "investment," stating that in view of this stipulation and the absence of any evidence in the record further to explain the circumstances under which the stock was acquired there was nothing to indicate that the acquisition was not a transaction for profit or to justify a finding to that effect. In *W. H. Dail, jr.* (19 B. T. A., 1036) the Board allowed a loss on a transaction in the year in which it was entered into, but the proof there showed the taxpayer's dealings constituted a transaction entered into for profit. It can not be assumed that every transaction is one that is entered into for profit under section 214(a)5, but this must be determined under the facts in each case and the record must establish that there was a transaction entered into for profit. In *Edgar M. Carnrick* (21 B. T. A., 12) the United States Board of Tax Appeals pointed out this requirement, and one of the grounds for denying the loss there claimed was that there was nothing in the record to indicate that, even if there were

a loss, there was a transaction entered into for profit, and in this connection the Board said: "The statute has always confined deductible losses to certain carefully described classes, and the qualifications of these classes may not be ignored. The reasonable intendment of restricting nonbusiness transactions resulting in losses to such as were entered into for profit is that, since the intended profit would be taxable, the loss suffered instead should be deductible. When there is no intended profit and naturally could be none, there is no just demand for a deduction of a loss. Personal losses, except by theft and other occurrences provided in section 214(a)6, have never been broadly allowed by Congress to be deducted, and the provisions of section 214(a)5 should not be construed so broadly as to override this general legislative purpose. In a case such as this, the taxpayer seeking the deduction must prove in fact that the transaction resulting in the alleged loss was and reasonably might have been entered into for profit." The Board further said: "An unfavorable purchase is not a realized loss." (*E. B. Stephenson* v. *Commissioner of Internal Revenue*, 43 Fed. (2d), 348.) This opinion of the Board is a proper construction of the statute and, as applied to the facts in this case, precludes the allowance of the deductions here claimed as losses on account of the stocks involved in these issues. See, also, *Edward J. Cornish* (22 B. T. A., 474), in which the Board held that where a taxpayer who had sold certain stock in 1922 and reacquired it in 1923 after it had become worthless in exchange for a note, the maker of which was entirely solvent, the taxpayer was not entitled to a deductible loss. The Board held that under the circumstances the transaction was not one entered into for profit and again pointed out that no losses of a character other than those to which the statute specifically refers are provided for as allowable deductions from gross income and that transactions in a taxable year, to which the taxpayer may have been influenced by motives other than profit to himself, do not result in a deductible loss in that or any other year. See, also, *Snider B. Ward* (18 B. T. A., 326), denying a loss on the ground that it was not sustained in trade or business, nor resulted from a transaction entered into for profit.

The last item of loss claimed is $243,579.33 for 1919 on 7,500 shares of common capital stock of Clarence Whitman & Co., Inc., the charter of which expired March 31, 1918, at which time the corporation passed into the hands of its directors as trustees in liquidation. The theory upon which this loss is claimed is that the difference between the cost of this stock to the decedent of $46.15 a share or $346,125 and $102,545.67, representing $90,000 paid to and received by the decedent as a dividend during 1919 on his common stock and $12,545.67, which it is alleged was the maximum amount that he could receive at December 31, 1919, from the liquidation of the remaining tangible assets of the corporation, or $243,579.33, was the loss sustained by him upon the stock of this corporation.

The facts establish that the partnership of Clarence Whitman & Co. had a valuable good will, trade name, and trade-marks, and that these intangibles were acquired by the corporation at the time of its organization on April 1, 1913. These intangibles are in addition to all intangibles in the form of good will, trade name, and trade-marks of the Whitman Textile Co., which were also acquired by Clarence Whitman & Co., Inc.

The facts also establish that the corporation of Clarence Whitman & Co., Inc., at all times had a valuable good will, trade name, and trade-marks. It further appears that at December 31, 1919, the date on which this loss is claimed, no disposition had been made of the good will or intangible assets of the corporation. It is clear from the evidence in this case that intangible assets of this character were very valuable in a business of the kind carried on by this corporation; and where there is no proof with respect to the value or lack of value on the particular date on which the loss is claimed, a loss through the liquidation of the corporation is not susceptible of determination even if it might be said that a stockholder may claim as a deduction from gross income a loss on liquidation of the corporation when the assets of the corporation have not been disposed of and its liabilities and expenses of liquidation have not been satisfied. For the reasons just stated, the loss of $243,579.33 for 1919 on account of 7,500 shares of common stock of Clarence Whitman & Co., Inc., must be denied. But we are of opinion that when it appears, as here, that it is reasonably certain that the stockholders will receive a further liquidating dividend, a loss may not be allowed under the taxing Act until there is a distribution of such dividend in property or money. Until this is done the stock has a value to its owner and the mere fact that because the corporation is in

process of liquidation its value has declined in a particular taxable year to a figure which is less than cost does not entitle the stockholder to elect in which year he will take his loss. It often happens, as here, that the liquidation of a corporation extends over a period of years and a decision that a loss may be taken upon the basis of a valuation of the unliquidated assets and an estimate of the remaining liabilities and expenses would enable the taxing authorities to place the loss in a taxable year in which the taxpayer might have a very small income and would enable the taxpayer to select a taxable year in which to take the loss in which he might have a large income and thereby obtain a greater benefit from the loss.

Losses are sustained within the meaning of the taxing Act when the events definitely occur which give rise thereto. (*Lewellyn, Collector*, v. *Electric Reduction Co.*, 275 U. S., 243; *Lucas* v. *American Code Co.*, 280 U. S., 445 [Ct. D. 168, C. B. IX–1, 314].) If a loss is to be determined on the basis of a valuation or an estimate of the assets and liabilities of a corporation in liquidation, we fail to see why it should not be held that the loss is sustained in the taxable year in which the liquidation of the corporation begins rather than in some future year when a partial disposition of assets has been made. The statute allows the deduction of a loss when it has been sustained, and we think it is the clear purpose of the Act to allow the deduction in the year in which it may appear that the taxpayer has received from the property all that it is possible for him to receive. A stock loss is no different from a loss on any other property and if a taxpayer acquires property at a certain cost which has not been disposed of he may not take a deduction from gross income as a loss of any amount merely because it may appear that when the property is finally disposed of he will receive less than what he paid for it. (Cf. *New York Life Insurance Co.* v. *Edwards*, 271 U. S., 109 [T. D. 3872, C. B. V–1, 305]; *Corn Exchange Bank*, 6 B. T. A., 158.) Partial losses are not allowable as deductions from gross income so long as the stock has a value and has not been disposed of. Of course where a corporation is in process of liquidation and there are assets of substantial value upon which large amounts may be realized by the liquidating trustees, a loss may be taken by the stockholder upon definite proof that outstanding liabilities and claims superior to those of the stockholder will more than absorb the maximum amount that can be received from the disposition of the assets, thereby leaving nothing for the stockholder. (*George C. Jones*, 6 B. T. A., 451; *W. W. Hanly*, 6 B. T. A., 613.) But such a situation is just the reverse of the claim presented by the plaintiffs in this case. The liquidation of Clarence Whitman & Co., Inc., was not completed until some time in 1923 or 1924, and the proof shows that upon final disposition of the assets and payment of the liabilities and expenses, the decedent's estate received a substantial amount although less than the amount with which the executor seeks to charge the decedent on December 31, 1919. It is true that this difference was not large, but we think the question whether the stockholder has sustained a deductible loss on his stock may not be made to depend upon an estimate by the liquidating trustees through a valuation of the assets and liabilities. The stockholder does not own the assets in the hands of the liquidating trustees, and a valuation thereof does no more than to fix the value of the stock. The petition is dismissed. It is so ordered.

SECTION 214(a)8.—DEDUCTIONS ALLOWED: DEPRECIATION.

ARTICLE 167: Depreciation of patent or copyright.

REVENUE ACT OF 1921.

A secret plan or copyright thereof. (See Ct. D. 459, page 219.)

SECTION 214(a)10.—DEDUCTIONS ALLOWED: DEPLETION.

ARTICLE 223: Charges to capital and to expense in the case of oil and gas wells.

REVENUE ACT OF 1921 AND PRIOR ACTS.

Restatement of article 223, Regulations 62 and 45. (See T. D. 4333, page 31.)

SECTION 215.—ITEMS NOT DEDUCTIBLE.

ARTICLE 291: Personal and family expenses.

REVENUE ACTS OF 1918 AND 1921.

Payments from trust provided in consideration of release of all claims for alimony, dower, maintenance, and support. (See I. T. 2628, page 34.)

SECTION 216.—CREDITS ALLOWED INDIVIDUALS.

ARTICLE 302: Personal exemption of head of family.

REVENUE ACTS OF 1918 AND 1921.

Child adopted without legal proceedings. (See I. T. 2611, page 36.)

PART III.—CORPORATIONS.

SECTION 230.—TAX ON CORPORATIONS.

ARTICLE 503: Corporations liable to tax. XI–6–5381
(Also Sections 1318, 1319, and 1320, Article 1050.) Ct. D. 447

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

1. DE FACTO CORPORATION.

Where the business of a partnership is incorporated in March, 1920, and before that date nothing is done in transacting the business that could not also have been done by a partnership or an association or which would inform the public or parties with whom dealings were had of any claim that the business was carried on by a corporation and none of the proceedings which the law requires in order to create a corporation were had or taken, a de facto corporation beginning with January 1, 1920, does not exist and the corporation is not entitled to have its tax computed on the basis of the entire calendar year 1920 and may not use as its opening inventory the market value of the merchandise of the predecessor partnership on hand at December 31, 1919.

2. CLAIM FOR REFUND—SUFFICIENCY.

A claim for refund based solely on the ground that the taxpayer is entitled to an increased value for its inventory at January 1, 1920, is not a sufficient claim, under section 3226 of the Revised Statutes as amended, to entitle the taxpayer to sue on the ground that the income of the business from January, 1920, to March 20, 1920, should be eliminated and that the opening inventory should be valued at March 20, 1920.

COURT OF CLAIMS OF THE UNITED STATES. No. K–471.

H. Lissner Co., Inc., v. *The United States.*

[October 20, 1931.]

OPINION.

LITTLETON, Judge, delivered the opinion of the court.

This suit was instituted to recover $150,000, but in the brief plaintiff claims that if it is entitled to value its inventory at January 1, 1920, at actual market value, it is entitled to judgment for $99,155.76 with interest. In the alternative it is claimed that for the period March 20, 1920, to December 31, 1920, it overpaid its tax in the amount of $76,241.31.

The controversy arises over the fact that although it is claimed that the business was carried on and conducted in all respects as if it had been a corporation on and after January 1, 1920, the corporation charter was not, in fact, issued and the plaintiff corporation did not exist and was not organized until March 20 of that year, and, although it made a tax return to the Commissioner in 1921 for the entire calendar year 1920 and paid the tax as shown thereon, the Commissioner refused to allow any portion of the claim for refund of taxes for 1920 on the ground that the plaintiff was not a corporation during the period January 1 to March 20 of that year. No defense is interposed on behalf of the defendant to the proposition that if the case is to be treated the same as if the plaintiff had been incorporated on the 1st day of January, 1920, it is entitled to have its income and tax recomputed for that year on the basis of actual market value of the inventory on January 1, 1920, which the facts clearly establish to have been $1,054,277.10. The result of such computation would show an overassessment and overpayment of tax for that year in an amount substantially as claimed by the plaintiff. (*Munising Motor Co.*, 1 B. T. A., 286; *The Walker-Crim Co., Inc.*, 1 B. T. A., 599; *Rouse, Hempstone & Co., Inc.*, 7 B. T. A., 1018.)

It is contended on behalf of plaintiff by reason of matters shown by the facts that it was a *de facto* corporation from January 1, 1920, and that defendant by reason of having assessed and collected the tax for the whole of the year is now estopped from claiming that the corporation did not exist on January 1, 1920. It further contends that even if the corporation was not in existence until March 20 of that year, the facts show that it was an association which would have paid the same rate of tax, and that it would be entitled to the same recovery.

On behalf of the defendant it is contended that the doctrine of estoppel can not be applied to the Government and that the plaintiff, not having been in existence on January 1, 1920, could not have acquired the inventory on that date and could not have issued its stock therefor at that time.

The question whether the plaintiff was a *de facto* corporation beginning with January 1, 1920, depends upon how the interested parties conducted the business and upon what was done, if anything, in the way of complying with the requirements of the law for the creation of a corporation. The former partners, as between themselves from and after January 1, 1920, seem to have regarded themselves as doing business as a corporation, and opened books in corporate form. Whatever sums they withdrew were charged to their individual accounts and the amounts paid for their services were designated as salaries and were paid as though they were corporate officers. The facts do not show that the books designated them as corporate officers. But all of this could have been done as a partnership or association; and it should also be observed that there is nothing in the record to show that the business was so conducted as to advise the public or outside persons with whom business was being done that the parties carrying on the business considered it to be incorporated and were transacting it on that basis, nor is there any evidence that any officers were elected, any meetings held, or any resolutions adopted.

Under such circumstances it can not be said that they were in fact doing business as a corporation. Moreover, nothing was actually done in the way of performing any of the acts required by law to obtain a charter until long after January 1, 1920. The date on which the charter was applied for is not shown but it was near the date on which the charter was issued. It is evident that none of the legal steps necessary to create a corporation was taken until a considerable time after January 1. Where nothing is done

in transacting the business that could not also have been done by a partnership or an association, or which would inform the public or parties with whom dealings were had of any claim that the business was being carried on as by a corporation, and none of the proceedings which the law required in order to create a corporation was had or taken, we think a *de facto* corporation can not be said to exist. Whether plaintiff was a *de facto* corporation at any time prior to the date on which its charter was granted it is not necessary to determine. (See *Niles Fire Brick Co.*, 6 B. T. A., 8; Treasury Department rulings O. D. 1016, C. B. 5, p. 231; O. D. 1078, C. B. 5, p. 232; O. D. 1121, C. B. 5, p. 233.) It is urged by plaintiff that if it was not a *de facto* corporation from January 1 to March 20, 1920, it must have been an association and that its return of taxation would be the same as for a corporation. It may be that it was an association during that period and taxable under the same statutory provision as a corporation, but the conclusion that the total amount of the tax for the calendar year 1920 of the two taxable entities would be the same does not follow. There were different inventories and very different amounts of profit. The total amount of tax that might be due by the different taxable entities in existence from January 1 to March 20, 1920, and from the latter date to December 31, 1920, is immaterial to the decision in this case since we are here concerned only with the plaintiff corporation which was in existence only from and after March 20, 1920. Had the plaintiff filed a claim for refund on the basis that its tax should be determined for the period March 20, 1920, to the end of the year, its rights would have been altogether different from what they are under the refund claim filed.

Plaintiff is not entitled to have its tax computed on the basis of the calendar year beginning January 1, 1920, and may not use as its opening inventory the actual market value of the merchandise on hand by the predecessor partnership at December 31, 1919, since it was not in existence until March 20, 1920. (*Younker Bros., Inc.*, 8 B. T. A., 333; *Isidor Hellman* v. *United States*, 70 C. Cls., 498 [T. D. 4042, C. B. VI-2, 227].)

The second ground upon which plaintiff sues is that the income of the business from January 1 to March 20, 1920, should be eliminated and a refund of $76,241.31 should be made. In other words, that the opening inventory should be valued at March 20, 1920, and that it should be relieved of any tax which it paid upon any income for the period January 1 to March 20, 1920.

The defendant insists that plaintiff is not entitled to maintain this suit upon this ground for the reason that the claim for refund filed, the rejection of which forms the basis of this suit, made no mention of this ground and was based entirely upon the ground that the plaintiff was entitled to an increased value for its inventory at January 1, 1920. We are of opinion that the position of the defendant is correct. No mention whatever was made in the claim for refund, or in any of the hearings before the Commissioner of Internal Revenue, that the merchandise inventory should be valued at March 20, 1920, or that the tax liability of the corporation should be determined for the period March 20 to December 31, 1920. It appears that notwithstanding the fact that during the consideration of plaintiff's claim for refund the Commissioner's office called its attention to the fact that it was not incorporated until March 20, 1920, the plaintiff took no steps to amend its claim for refund so as to claim an overpayment on any ground other than the valuation of its inventory on January 1, 1920. It submitted no facts whatever to the Commissioner as to the value of the merchandise inventory on hand on March 20, 1920, or with reference to its net income from March 20 to December 31, 1920, and claimed no refund on that ground.

No claim for refund upon the ground upon which plaintiff's second cause of action is based was filed with the Commissioner of Internal Revenue, as required by the statutes and the regulations, and there was nothing in the claim for refund filed or in the facts submitted to the Commissioner, or the papers and documents filed or presented to him in connection therewith, to inform the Commissioner that plaintiff was claiming a refund on the ground upon which it bases its second claim for recovery here, namely, that it was taxable for the period March 20 to December 31, 1920, and that its inventory should be valued and its net income determined accordingly. The claim of March 29, 1927, was not sufficient to entitle the plaintiff to sue upon its second claim. One of the principal objects of the requirements of the statute with reference to the filing of a claim for refund is to advise the appropriate officials of the demands or claims intended to be asserted so as to insure an orderly administration of the revenue, and a claim which gives no notice of the amount or nature of the claim for

which the suit is brought and refers to no facts upon which it may be founded does not satisfy the requirements of the statute. (*United States* v. *Felt & Tarrant Mfg. Co.*, 283 U. S., 269 [Ct. D. 336, C. B. X–1, 431].) "Meticulous compliance by the taxpayer with the prescribed conditions must appear before he can recover." (*Maas & Waldstein Co.* v. *United States*, 283 U. S., 583 [Ct. D. 150, C. B. IX–1, 348]; *Wausau Sulphite Fibre Co.* v. *United States*, J–618, decided by this court May 4, 1931 [Ct. D. 384, C. B. X–2, 274].)

Plaintiff is not entitled to recover on the first ground stated in the petition, and it can not maintain the suit on the second ground alleged. The petition is therefore dismissed, and it is so ordered.

SECTION 233.—GROSS INCOME OF CORPORATIONS DEFINED.

ARTICLE 545: Sale and retirement of corporate bonds. XI–11–5412 Ct. D. 456

(Also Section 234, Article 564.)

INCOME TAX—REVENUE ACT OF 1921—DECISION OF SUPREME COURT.

INCOME—DEDUCTION—INTEREST—BOND PREMIUMS.

Premiums received by a corporation on bonds issued before March 1, 1913, and outstanding at the close of the taxable year became capital prior to that date and are in no part taxable income subsequent thereto. The interest paid on such bonds in the taxable year is deductible under section 234(a)2 of the Revenue Act of 1921 without reduction of the year's proportion of amortization of the bond premiums.

SUPREME COURT OF THE UNITED STATES. No. 349.—OCTOBER TERM, 1931.

Old Colony Railroad Co., petitioner, v. *Commissioner of Internal Revenue.*

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

[February 15, 1932.]

Mr. Justice ROBERTS delivered the opinion of the court.

The Revenue Act of 1921 defines gross income as including gains, profits and income derived by the taxpayer from any source whatever, and provides that in computing net income of a corporation "all interest paid or accrued within the taxable year on its indebtedness" is deductible from such gross income. Treasury regulations promulgated under authority of the statute state that if bonds are issued by a corporation at a premium the net amount of such premium is gain or income which should be amortized over the life of the bonds.[1]

In making return for 1921 the Old Colony Railroad Co. deducted from gross income the full amount paid during the year as interest to holders of its bonds. These had been issued at various dates between 1895 and 1904 and the subscribers had taken them at prices in excess of par. The total of the premiums thus paid the company was $199,528.08. At the dates of issuance of the bonds, and until 1914, the company kept its accounts on a cash basis and credited the sums so received in an account designated "Premium on bonds." In the last-named year the Interstate Commerce Commission ordered that they should be amortized over the periods of the respective lives of the bonds. The company complied under protest, extinguished by appropriate entries the ratable proportion of the premiums for the years prior to 1914, and thereafter reported to the commission as income a yearly ratable proportion of the remainder of the premiums, but entered the same on its books in the profit and loss account (a surplus account) and not as income. The proportion of the premiums attributable to 1921 and reported to the commission as income for that year was $6,960.64, but the company did not in its tax return include this figure in

[1] Act of November 3, 1921 (ch. 136, sections 213, 234; 42 Stat., 227, 237, 254). Treasury Regulations 62, article 545.

gross income or deduct it from the amount of interest paid on its bonds.[2] The Commissioner, in his audit of the return, made no adjustment in the item of interest paid, but added the sum of $6,960.64 to the company's gross income for 1921 and found a resulting deficiency in the amount of tax. Upon a petition for redetermination the Board of Tax Appeals held that the Commissioner erred in treating this amount as taxable income of the year in question.[3]

The Commissioner asked reconsideration, asserting that the mere form of the calculation by which he arrived at a redetermination of the tax was immaterial and that the result was correct since the year's proportion of amortization of bond premiums was in reality a deduction from the stipulated interest paid the bondholders. The Board adhered to its ruling.[4] The Circuit Court of Appeals adopted the Commissioner's view and reversed the Board.[5] The court distinguished its earlier decision in *Commissioner* v. *Old Colony R. R. Co.*, supra, note 3, stating that its attention had not been called to the fact that the profit made in the years prior to 1913 was not being taxed, but was used only to determine the expense of the payment of interest on the bonds for the year 1921. We granted certiorari.

The regulations state that the net amount of premium is gain or income. Necessarily, then, the premium is gain or income of the year in which it is received. The provisions of the Revenue Acts of 1918, 1921, 1924, and 1926 are the same as respects gross income of corporations and deductions therefrom. The regulations under the relevant sections of the Acts of 1918, 1924, and 1926 employ substantially the same phraseology as that found in those issued under the 1921 Act.[6] The repeated reenactment of a statute without substantial change may amount to an implied legislative approval of a construction placed upon it by executive officers. (*National Lead Co.* v. *United States*, 252 U. S., 140; *United States* v. *Farrar*, 281 U. S., 624; *Poe* v. *Seaborn*, 282 U. S., 101, 116 [Ct. D. 259, C. B. IX–2, 202].)

There is no ambiguity in the language of the regulation, which defines a bond premium as income. As a corollary from this definition it follows that the petitioner received the income represented by the premiums here involved prior to the adoption of the sixteenth amendment, for these premiums could not be income for any other year than that in which they were received. That income had become capital prior to the adoption of the amendment and could not be reached by a subsequent income tax Act. This conclusion is not affected by the provision of the regulation which allows the proration or amortization of this item over the life of the bonds, and extends to the taxpayer the privilege of treating the premium as income received in installments instead of in a lump sum in the year of its receipt.

Nor does the fact that the regulation thus ameliorates the burden of the taxpayer authorize the use of the grant to convert income of years prior to the effective date of the sixteenth amendment into income assumed to have been received thereafter. The amortization requirement may properly be applied to premiums paid subsequent to March 1, 1913, but can not operate to contradict the definition of a premium as gain or income.

The Government, however, insists that notwithstanding the regulation's designation of a premium paid by the subscriber to corporate bonds as income

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[2] By lease dated February 15, 1893, still in force, petitioner leased all its property to The New York, New Haven & Hartford Railroad Co., the lessee agreeing to operate and maintain petitioner's railroad, to assume the payment of the principal of and interest upon its bonded indebtedness and other obligations, and to pay a certain additional sum as rental. Although the bonds in question were issued after the effective date of the lease they were the direct obligation of petitioner and it remained liable for the payment of interest. Petitioner bases certain arguments upon the fact that in the tax year under review it charged itself with bond interest received from the lessee and took credit for the same amount as interest paid to bondholders. These facts are unimportant in the view we take of the case. We shall treat it as if the lease were nonexistent and the bonds had been issued by a company operating its own property.

[3] 18 B. T. A., 267. In reaching this conclusion the Board followed its earlier decision in *Old Colony Railroad Co.* v. *Commissioner* (6 B. T. A., 1025), wherein it had held that under similar provisions of the Revenue Act of 1918 and a like Treasury regulation the premiums were income in the year in which they were received, thus becoming a part of the company's capital prior to the adoption of the sixteenth amendment and not taxable. (See *Doyle* v. *Mitchell Bros. Co.*, 247 U. S., 179; *Lynch* v. *Turrish*, 247 U. S., 221; *Southern Pacific Co.* v. *Lowe*, 247 U. S., 330; *Goodrich* v. *Edwards*, 255 U. S., 527 [T. D. 3174, C. B. 4, 40].) The Board's holding was affirmed in *Commissioner* v. *Old Colony R. R. Co.* (26 F. (2d), 408). (See also *Chicago, R. I. & P. R. R. Co.* v. *Commissioner* (47 F. (2d), 990).)

[4] 18 B. T. A., 267.

[5] 50 F. (2d), 896.

[6] Regulations 45, article 544; Regulations 62, article 545; Regulations 69, article 545; Regulations 74, article 68.

it is not such to the corporation, but is in the nature of capital loaned which must be returned to the lender during the life of the bonds. Reference is made to the practice of bond buyers in determining the amount they will bid. It is said that a purchaser, in arriving at the price he is willing to pay for a bond, has regard to the current rate of interest for money, and if the bond bears a stipulated rate in excess of the ruling rate he will pay a premium. He does this although he knows that at maturity he can only receive the par of the bond, but considers that he will be repaid the premium by the excess of the agreed rate of interest over the rate he is content to receive. On the other hand, where the stipulated interest is less than the going rate bond buyers will bid less than the par of the bond by such amount as is necessary to redress the difference between the agreed rate of interest and the going rate which the subscriber demands. The conclusion is that the actual return to one who pays a premium is less than the nominal interest carried by the bond, and to one who buys at a discount is greater than such nominal rate. The argument is that although the regulations are inaptly phrased and are susceptible of the construction petitioner places upon them their real intent was to adjust the nominal interest paid on a corporation's indebtedness to the actual amount it is paying for the use of the money represented by the par of the bond—that is, to what accountants have called the "effective rate" of interest. In this view the Government says that each time the debtor pays an installment of stipulated interest what it in fact does is to pay interest at a lesser rate on the par of the bond and return a ratable proportion of the premium, which really constitutes a loan by the investor to the debtor. Thus that portion of the installment paid at each interest date which is a return of the loaned capital represented by the premium must be deducted from the nominal interest in order to arrive at the "effective rate" of interest the debtor is really paying. It is said the regulation is intended to afford a method of adjusting the taxpayer's income in the light of these facts, and that it is immaterial whether, as provided, the pro rata yearly return of capital loaned in excess of the face of the bond is added to gross income or deducted from interest paid, for in either case the result in dollars will be exactly the same.

Doubtless the premium received by the corporation is acquired capital rather than income. But if this be admitted the concession does not answer the question whether a premium paid prior to 1913 is taxable. Obviously, therefore, it is not enough for the Government's purpose to disregard the regulation which designates this item as income or gain. The Commissioner must and does go further and contend that the receipt of such a premium reduces the item of interest paid and renders the sum nominated as such in the bond something different from the "interest * * * on its indebtedness" mentioned in section 234 of the Revenue Act of 1921 as a permissible deduction from gross income.

In other words, the contention is that by the use of the quoted phrase the statute did not intend to allow the deduction of the amount agreed to be paid, which the contract denominates "interest," but of a different sum to be ascertained by a calculation which will allocate the payment between the partial and ratable return of the premium and "effective" interest on the par of the security.

Is this the reasonable construction of the language of the Act—"all interest * * * on its indebtedness"? The rule which should be applied is established by many decisions. "The legislature must be presumed to use words in their known and ordinary signification." (*Levy's Lessee* v. *McCartee*, 6 Pet., 102, 110.) "The popular or received import of words furnishes the general rule for the interpretation of public laws." (*Maillard* v. *Lawrence*, 16 How., 251, 261.) And see *United States* v. *Buffalo Gas Co.* (172 U. S., 339, 341); *United States* v. *First Nat. Bank* (234 U. S., 245, 258); *Caminetti* v. *United States* (242 U. S., 470, 485). As was said in *Lynch* v. *Alworth-Stephens Co.* (267 U. S., 364, 370 [T. D. 3690, C. B. IV-1, 162]), "the plain, obvious and rational meaning of a statute is always to be preferred to any curious, narrow-minded sense that nothing but the exigency of a hard case and the ingenuity and study of an acute and powerful intellect would discover." This rule is applied to taxing Acts. (*DeGanay* v. *Lederer*, 250 U. S., 376, 381.)

Applying the accepted tests to the language of the statute, we are of opinion that the construction contended for by the Commissioner is inadmissible. In common parlance the bonded indebtedness of a corporation imports the total face of its outstanding bonds—the amount which must be paid at their maturity. The phrase is not generally used to connote par plus an unreturned proportion of premium.

And as respects "interest," the usual import of the term is the amount which one has contracted to pay for the use of borrowed money. He who pays and he who receives payment of the stipulated amount conceives that the whole is interest. In the ordinary affairs of life no one stops for refined analysis of the nature of a premium or considers that the periodic payment universally called "interest" is in part something wholly distinct—that is, a return of borrowed capital. It has remained for the theory of accounting to point out this refinement. We can not believe that Congress used the word having in mind any concept other than the usual, ordinary and everyday meaning of the term, or that it was acquainted with the accountants' phrase "effective rate" of interest and intended that as the measure of the permitted deduction.

In the present case, as with corporate obligations generally, the bond has a par value and each coupon stipulates that on a date therein mentioned the company will pay a named sum as interest on the bond. Until the present contention was put forward no one supposed that the taxpayer was not entitled to deduct the entire amount specified in the coupon and actually paid during the taxable year as interest. The person who receives this sum certainly considers it interest and so, apparently, does the Government, which requires him to return it all as such and does not permit him, if he or his predecessor holder paid more than par for the bond, to treat part of the sum received as a return of capital loaned and the remainder as interest received.

In short, we think that in the common understanding "interest" means what is usually called interest by those who pay and those who receive the amount so denominated in bond and coupon, and that the words of the statute permit the deduction of that sum, and do not refer to some esoteric concept derived from subtle and theoretic analysis.

If there were doubt as to the connotation of the term, and another meaning might be adopted, the fact of its use in a tax statute would incline the scale to the construction most favorable to the taxpayer. (*Gould* v. *Gould*, 245 U. S., 151; *United States* v. *Merriam*, 263 U. S., 179 [T. D. 3535, C. B. II–2, 87]; *Bowers* v. *New York & Albany Lighterage Co.*, 273 U. S., 346 [T. D. 4009, C. B. VI–1, 268]; *United States* v. *Updike*, 281 U. S., 489 [Ct. D. 192, C. B. IX–1, 228]; *Burnet* v. *Niagara Falls B. Co.*, 282 U. S., 648 [Ct. D. 315, C. B. X–1, 403].)

A further contention is advanced that inasmuch as by the ruling of the Interstate Commerce Commission the company was compelled to designate the annual amount of premium amortization as income, and under protest did so treat it in reporting to the commission, the ruling of the Commissioner of Internal Revenue is in conformity with the method of bookkeeping adopted by the petitioner and hence is justified by section 212(b) of the Revenue Act of 1921,[7] which provides that the net income of a corporation shall be computed in accordance with the method of accounting regularly employed in keeping the books of the taxpayer, and by section 213(a) of the same Act, which authorizes the accrual method of reporting income. This position is inconsistent with the other arguments advanced. If the amortized premium is to be deducted from interest paid by the taxpayer it is not income. If it is income, then by hypothesis it is income received prior to the date of the sixteenth amendment and not income which accrues to the taxpayer from year to year. Moreover, the rules of accounting enforced upon a carrier by the Interstate Commerce Commission are not binding upon the Commissioner, nor may he resort to the rules of that body, made for other purposes, for the determination of tax liability under the Revenue Acts. (*Kansas City Southern Ry. Co.* v. *Commissioner*, 52 F. (2d), 872, certiorari denied November 30, 1931, No. 495, October Term, 1931.) (Compare *Chicago, R. I. & P. Ry. Co.* v. *Commissioner*, 13 B. T. A., 988, 1027; *Fall River Electric Light Co.* v. *Commissioner*, 23 B. T. A., 168.)

We conclude that the yearly pro rata amortization of bond interest is not income received in the year to which it is applicable; and that so far as the deduction of interest on indebtedness is concerned the fact that a premium was paid does not operate to reduce interest paid on bonded indebtedness within the meaning of the Revenue Acts.

The judgment is reversed.

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[7] Note 1, supra.

SECTION 234.—DEDUCTIONS ALLOWED CORPORATIONS.

ARTICLE 561: Allowable deductions. XI-2-5351
(Also Section 235, Article 582.) Ct. D. 439

INCOME TAX—REVENUE ACT OF 1921—DECISION OF COURT.

1. CAPITAL EXPENDITURES—BUSINESS EXPENSES—LOSS—BRANCH LINE OF RAILROAD—COMPROMISE PAYMENTS.

Payments made by corporations, owners of coal properties, to a railroad company in compromise of suits brought by the latter, involving the amount they should pay for the construction of a branch line of railroad to connect the properties owned by them with the line of a railroad company and to be owned by the railroad company when built, are capital expenditures amortizable over the estimated productive life of the coal properties and are not deductible under section 234 of the Revenue Act of 1921 as business expenses in the year the payments were made or as a loss.

2. DECISION AFFIRMED.

The decision of the Board of Tax Appeals (20 B. T. A., 326) affirmed.

UNITED STATES CIRCUIT COURT OF APPEALS, FOURTH CIRCUIT.

No. 3169. *Colony Coal & Coke Corporation, petitioner*, v. *Commissioner of Internal Revenue, respondent.*

No. 3170. *Hazard Coal Corporation, petitioner*, v. *Commissioner of Internal Revenue, respondent.*

On petitions to review the decisions of the United States Board of Tax Appeals.

Before PARKER, NORTHCOTT, and SOPER, Circuit Judges.

[October 12, 1931.]

OPINION.

These are petitions to review decisions of the United States Board of Tax Appeals, which decisions are reported in 20 B. T. A., 326.

Both petitioners were corporations engaged in the business of owning and leasing coal properties in Perry County, Ky. In the year 1917, they, with another corporation, entered into an arrangement with the Louisville & Nashville Railroad Co. to build a branch line of railroad to connect the properties owned by them with the line of that railroad.

The railroad line was built, and a controversy arose as to the amount the coal companies should pay the railroad company for its construction.

Suit was brought and as a compromise the three companies paid the railroad company $22,666.67 each in settlement. The suit was dismissed by the railroad company.

Petitioners, in making their income tax returns for the year in which the payments were made (1923), claimed the sums paid as a business expense or loss not otherwise accounted for under the Revenue Act of 1921 (ch. 136, 42 Stat., 227). With such deduction the year 1923 still showed a loss in petitioner's operation, and the balance was claimed as a deduction in the year 1924.

The Commissioner of Internal Revenue disallowed the claimed deductions, and held that the payments were capital outlays, amortizable over a period of 40 years, that being the estimated productive life of petitioners' coal properties, and allowed deductions therefor on that basis.

From this action of the Commissioner petitioners appealed to the Board of Tax Appeals, which Board approved the deficiencies as determined by Commissioner. The coal companies then filed these petitions to review the decisions of the Board.

The sole question involved is whether the payments made by petitioners to the railroad company were capital or business expenditures.

This case comes clearly under the rule laid down by this court in *Gauley Mountain Coal Co.* v. *Commissioner* (23 Fed. (2d), 574), where under a like state of facts the expenditure was held to be a capital one. In that case Judge Parker said:

"* * * we do not think that what was acquired * * * was a mere transitory service, nor a mere intangible increase in the value of property, * * * but was a right of permanent value to the company operating the mining property, and one which added greatly to the value of the property itself. Before the branch line was built, the mines of the taxpayer were 4 miles away from a line of railroad, and for that reason could not be operated profitably. As a result of its construction, and the railroad connection thereby acquired, the facilities of a great railway system have been brought to the mines of the company, and this has done away with the necessity of transporting the coal to the line of the railroad.

"The taxpayer has acquired property of permanent value in the same sense as does a manufacturing corporation which pays a railroad company to build an industrial siding to its plant, or a land development company which pays a bonus to a street railway company to build a line through its property. Whether the rights acquired as a result of the railroad connection obtained are to be defined as tangible or intangible property, it is not necessary to inquire. Intangible property, which enables a taxpayer to save or earn money, is as legitimate a form of capital investment as tangible property. Thus money spent in building up the circulation of a newspaper has been held to be capital invested, within the meaning of the taxing Acts. * * * The railroad connection itself is quite tangible, the rights flowing therefrom are intangible; but, whether tangible or intangible, the connection and the rights incident thereto are of great value to the taxpayer, and save it many thousands of dollars annually in marketing its coal.

* * * * * * *

"It is said that, because the track of the branch line is the property of the railroad, and no time is specified by the contract during which the railroad shall continue furnishing service over same, the taxpayer has received no property, tangible or intangible, for the expenditure it has made. But the important thing to the taxpayer is, not the ownership of the track, but the fact that by means of it is furnished the railroad connection desired. In the case of industrial sidings, just adverted to, the track is generally the property of the railroad.

"Nor is it important, we think, that the contract specifies no time during which the connection and the service incident thereto shall be maintained. As a practical matter, now that the branch line has been built, the connection will be maintained and the service furnished without reference to the contract. The railroad is in the business of hauling coal, and may be relied upon from motives of self-interest to continue to haul the coal from taxpayer's mines so long as it is profitable to do so. * * *

"It is clear that, although the track does not belong to the taxpayer, and the contract does not provide a specific period during which the service over it shall be continued, nevertheless the laying of the track and the railroad connection resulting therefrom established for the taxpayer a relationship with the railroad of mutual advantage and of great and continuing value to the taxpayer."

This reasoning so clearly fits the question to be decided here that we can add nothing to it.

It is contended on behalf of the petitioners that because any liability on the part of the coal companies to the railroad was denied, and the payments only made by way of compromise to avoid litigation, they constituted expense and not capital expenditures. We think not. The fact that a payment is made voluntarily or involuntarily, in the course of legal proceedings or as a result of a compromise settlement does not change the nature of the transaction. The real test is the character of the transaction that occasions the payment.

The action of the Board of Tax Appeals is affirmed.

ARTICLE 561: Allowable deductions.

XI-8-5396
Ct. D. 451

INCOME TAX—REVENUE ACT OF 1921—DECISION OF COURT.

1. DEDUCTION—LOSS—DISTRIBUTION OF CORPORATE ASSETS.

Where a going corporation owning stock in another corporation, which stock represents in part earnings and surplus accumulated since February 28, 1913, does not sell such stock but distributes the same in kind to its stockholders without the payment of any consideration therefor and without the prior declaration of any cash dividend in payment of which the distribution is made, there is no "sale or other disposition of property" within the meaning of section 202(a) of the Revenue Act of 1921 and no deductible loss under section 234(a)4 of that Act is sustained, although the market value of such stock at the date of distribution is less than it cost the owning corporation.

2. DECISION AFFIRMED.

The decision of the Board of Tax Appeals (17 B. T. A., 804) is affirmed.

COURT OF APPEALS OF THE DISTRICT OF COLUMBIA.

First Savings Bank of Ogden (formerly First Utah Savings Bank), appellant, v. *David Burnet, Commissioner of Internal Revenue.*

Appeal from the United States Board of Tax Appeals.

Before MARTIN, Chief Justice, and ROBB, VAN ORSDEL, HITZ, and GRONER, Associate Justices.

[November 9, 1931.]

OPINION.

MARTIN, C. J.: Appeal from a decision of the Board involving income and profits taxes for the calendar years 1922 and 1923, reported in 17 B. T. A., 804.

The appellant is a Utah banking corporation. In September, 1922, it had among its assets 9,526 shares of common stock of the Amalgamated Sugar Co. This had been acquired at various times subsequent to 1913, at a total cost of $108,501.14, but at the times now in question its total market value was only $36,196.80.

On September 30, 1922, the bank delivered the stock to certain trustees with authority to sell the same and divide the proceeds ratably among the bank's stockholders. But on October 17, 1922, no such sale having been made, the bank authorized and directed the trustees to deliver 9,000 shares of the stock in kind as a dividend pro rata to the bank's stockholders. No cash dividend had been declared by the bank as part of this transaction.

On November 11, 1922, in accordance with this authorization, the trustees transferred and delivered 9,000 shares of the stock to the bank's stockholders pro rata. At these times the earned surplus and undivided profits of the bank were greater than the book value or original cost of the shares thus transferred, and the bank charged off against that fund the sum of $72,304.34, entering the cost of the transferred stock at $108,501.14, and the market value thereof at $36,196.80.

The bank claims that when it transferred the stock to its stockholders it suffered a loss of $72,304.34, as the difference between the cost of the stock and its market value when so transferred, and that it is entitled to a deduction of that amount in its income tax returns for the appropriate years.

This claim was disallowed by the Commissioner, and corresponding delinquencies were assessed against the bank. On appeal, the Board of Tax Appeals sustained the Commissioner.

The conclusion of the Board is stated by it in the following terms:

"Where the evidence shows that a going corporation, owning stock in another corporation, which stock represents in part earnings and surplus accumulated since February 28, 1913, does not sell such stock, but distributes the same in

kind to its stockholders, no deductible loss is sustained, although the market value of such stock at date of distribution is less than it cost the owning corporation."

We agree with the Board's decision. The following provisions of the Revenue Act of 1921 (42 Stat., 227) are controlling:

"SEC. 234. (a) That in computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions: * * *.

"(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise; * * *.

"SEC. 202. (a) That the basis for ascertaining the gain derived or loss sustained from a sale or other disposition of property, real, personal, or mixed, acquired after February 28, 1913, shall be the cost of such property; * * *."

Accordingly in order to prove a deductible loss in this instance the appellant must show that the loss was sustained either from "a sale or other disposition" of the stock which was transferred. It is plain that no actual sale was made of the stock, for there was no price agreed upon or paid for it, and the transaction was no more than a distribution of the stock in kind as a dividend to the bank's stockholders.

The question remains whether the transfer, even if not a sale, responds to the description of "other disposition of property," as employed in the statute. This question is not free from doubt, but we feel constrained to hold that the rule of ejusdem generis is applicable in construing the phrase, and that it relates only to such dispositions of property as are like sales. The transfer in question was not of this kind, for the stockholders of the bank paid no consideration for the stock received by them, nor was it received in payment of any cash dividend previously declared by the bank. This conclusion is consistent with the prior decisions of the Board in similar cases, and with all of the regulations promulgated by the Treasury Department since the year 1918.

In the Revenue Act of 1918, section 202(a) (40 Stat., 1057), it is enacted that "for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, the basis shall be * * *." This language is identical with the corresponding provisions in the Revenue Acts of 1921, 1924, 1926, and 1928, respectively. Article 547 of Treasury Regulations 45, promulgated under the Revenue Act of 1918, reads in part as follows: "No gain or loss is realized by a corporation from the mere distribution of its assets in kind upon dissolution, however they may have appreciated or depreciated in value since their acquisition." The same provision occurs in article 548 of Regulations 62, Revenue Act of 1921; in article 548 of Regulations 65, Revenue Act of 1924; and in article 548 of Regulations 69, Revenue Act of 1926. No difference exists in principle between mere distributions of assets by corporations in dissolution and by those not in dissolution. In both instances alike such assets are merely distributed among the stockholders of the corporation without the payment of any consideration therefor, and without the prior declaration of any cash dividend in payment of which the distribution is made. The regulations of the Treasury Department, accordingly, have been consistently opposed to the claim advanced by the appellant. "It is the settled rule that the practical interpretation of an ambiguous or doubtful statute that has been acted upon by officials charged with its administration will not be disturbed except for weighty reasons." (*Brewster* v. *Gage*, 280 U. S., 327, 336 [Ct. D. 148, C. B. IX–1, 274].)

It is true that the rule hereby adopted leads to an anomalous result, inasmuch as appellant at the time of transferring the stock had suffered an actual loss of value measured by the difference between the cost of the transferred stock and its then market price, for which no deduction is allowed. But on the other hand according to the same rule if the transferred stock had enhanced in value between its purchase and transfer no taxable gain would have been charged against the corporation because of that fact. Moreover, the income tax laws do not profess to embody perfect economic theory. They have their own criteria which at times look to certain rather severe tests of liability and exemption. (*Weiss* v. *Weiner*, 279 U. S., 333, 337 [Ct. D. 60, C. B. VIII–1, 257].)

For prior Board opinions consistent with our conclusion herein see *Hollenberg Music Co.* v. *Commissioner* (6 B. T. A., 421); *Callanan Road Imp. Co.* v. *Commissioner* (12 B. T. A., 1109); *McMillan Veneer Co.* v. *Commissioner* (20 B. T. A., 556).

The decision of the Board is affirmed.

ARTICLE 561: Allowable deductions. XI-12-5421
(Also Section 203, Article 1582.) Ct. D. 460

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

1. DEDUCTION—OBSOLESCENCE—BUILDINGS ERECTED ON LEASED LAND FOR MANUFACTURE OF WAR AMMUNITION.

Where a manufacturer of commercial ammunition constructed before 1917 at its own cost on leased land buildings for the purpose of making war ammunition while the World War should last, which buildings became part of the realty and under the terms of the lease were to become the property of the lessor at the termination of the period of the lease in 1924, under section 234(a)7 of the Revenue Act of 1918 a deduction in 1918 is allowable for obsolescence of such buildings due to the armistice in November, 1918, although subsequent to that event the buildings were utilized to the end of the lease for the manufacture of commercial ammunition and for other purposes not related to the manufacture of war ammunition.

2. INVENTORIES—VALUATION—MATERIALS INTENDED FOR USES UNDER GOVERNMENT CONTRACT.

Where a taxpayer, using cost or market, whichever is lower, as the basis of valuation of inventories, enters into a contract with the United States for the production of war ammunition and in December, 1918, ceased production under the contract in compliance with the request of the Chief of Ordnance made with a view to the negotiation of a supplementary contract providing for the cancellation, settlement, and adjustment of the existing contract, inventories of material, intended for use under the contract, on hand at the end of 1918, when no negotiations for adjustment or settlement had been made and when the contract provisions as to payments by the United States to the taxpayer of cost were superseded by compliance with the request, may be valued at market which was less than cost and less than the amounts eventually realized for such material in 1920, 1921, and 1922 under contracts of settlement.

SUPREME COURT OF THE UNITED STATES.

United States Cartridge Co., petitioner, v. *The United States.*

On writ of certiorari to the Court of Claims.

[February 15, 1932.]

OPINION.

Mr. Justice BUTLER delivered the opinion of the court.

Petitioner sued to recover an alleged overpayment of income and profits taxes for 1918. The court made findings of fact, ruled in favor of petitioner as to a part of the amount and gave it judgment for $160,978.83 which is not here challenged. The court dismissed petitioner's complaint as to two other claims which this writ (284 U. S., 610) brings up for consideration. One is on account of buildings erected by it for war purposes on leased land. The other involves the valuation of petitioner's inventories relating to Government contracts. There is printed in the margin [1] a statement showing the net income and taxes as determined by the Commissioner, the reduction made by the judgment and the deductions claimed by petitioner and denied by the court.

The substance of the findings as to the buildings may be stated as follows:

Petitioner, for some years before the war, had been a manufacturer of ammunition for small arms used in times of peace. It carried on at Lowell, Mass.,

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[1]

Net income	$1,792,432.58	Taxes	$1,152,123.53
Reduction by court	195,362.67	Taxes	160,978.83
Leaving income	1,597,069.91	Taxes	991,144.70
Deduction claimed on account of buildings	327,937.35	Taxes	270,220.38
Deduction on account of inventories	500,473.19	Taxes	412,389.91

principally in buildings rented from a power company. During the years 1911 to 1914, inclusive, its business was relatively small and not profitable. In 1914 it commenced making ammunition for use in the war and, for the purpose of continuing that business while the war should last, it constructed new buildings upon the power company's land at a cost of $802,499.49 pursuant to an agreement that it should have the right to use them rent free until December 31, 1924, and then hand them over to the power company. Until the armistice, at first for foreign governments and later for our own, it had orders, and used all the buildings, up to their capacity in the manufacture of war ammunition. There was no way of knowing when this demand would cease.

Petitioner did not expect to make military ammunition after conflict ended and in fact received no orders after the armistice. It continued the commercial ammunition business but made no profit in any year from 1918 to the end of the lease. The buildings could not be rented. Those belonging to the power company had been incorporated into the new ones. The space so made was much greater than required for its commercial ammunition business. Petitioner, for the purpose of utilizing the excess, undertook the manufacture of some other things, but that business was small and resulted in loss each year. There was a garage used during the war production but not needed afterwards. Petitioner attempted to operate the building as a public garage but, realizing no net return, rented it to others from October, 1923, until the end of the lease.

The Commissioner allowed deductions on account of the cost of the buildings for the years from 1914 to 1917, inclusive, amounting in all to $197,107.74, leaving as of the end of 1917, cost less depreciation $605,391.75. In the settlement of its 1918 taxes petitioner claimed that, as of the end of that year, the value of its right to use the new buildings during the remainder of the term was $190,969.86, and the Court of Claims found it not in excess of that amount. Petitioner claimed a deduction of the difference between the depreciated cost and such residual value. The Commissioner disallowed the claim on the ground that it had not abandoned the use of the buildings or permanently devoted them to a radically different use. He allowed $86,484.54, arrived at by distributing the cost of each building ratably over the period ending with the term of the lease. The difference between the deduction claimed and that allowed is $327,937.35. In its tax returns for the remaining years of the lease, petitioner claimed deductions on account of the buildings amounting in all to $190,969.86, but the Commissioner added to such deductions $327,937.35.

The Revenue Act of 1918 (40 Stat., 1077) controls and its pertinent provisions are printed in the margin.[2] The Government maintains that subsection (8) excludes the allowance claimed. The contention is without merit. The argument is that, by authorizing amortization in respect of buildings erected for war production after April 6, 1917, Congress denied allowances for obsolescence as to like buildings constructed before the war. But obsolescence and amortization are not synonymous. While in some connections like meaning may be attributed to them, they do not necessarily or generally refer to the same thing. Obsolescence may arise from changes in the art, shifting of business centers, loss of trade, inadequacy, supersession, prohibitory laws and other things which, apart from physical deterioration, operate to cause plant elements or the plant as a whole to suffer diminution in value. (*Burnet* v. *Niagara Falls Brewing Co.*, 282 U. S., 646, 654 [Ct. D. 315, C. B. X–1, 403]; *Gambrinus Brewery Co.* v. *Anderson*, 282 U. S., 638 [Ct. D. 314, C. B. X–1, 400].) Amortization as used

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[2] SEC. 234. (a) That in computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:

* * * * * * *

(7) A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence;

(8) In the case of buildings * * * or other facilities, constructed * * * or acquired, on or after April 6, 1917, for the production of articles contributing to the prosecution of the present war, and in the case of vessels constructed or acquired on or after such date for the transportation of articles or men * * * there shall be allowed a reasonable deduction for the amortization of such part of the cost of such facilities or vessels as has been borne by the taxpayer, but not again including any amount otherwise allowed under this title or previous Acts of Congress as a deduction in computing net income. At any time within three years after the termination of the present war the Commissioner may, and at the request of the taxpayer shall, reexamine the return, and if he then finds as a result of an appraisal or from other evidence that the deduction originally allowed was incorrect, the taxes imposed by this title and by Title III [war-profits and excess-profits tax] for the year or years affected shall be redetermined and the amount of tax due upon such redetermination, if any, shall be paid upon notice and demand by the collector, or the amount of tax overpaid, if any, shall be credited or refunded to the taxpayer in accordance with the provisions of section 252; * * *.

in the Act is not so broad; it refers to deductions on account of such part of the costs of certain facilities as has been borne by the taxpayer, "but not again including any amount otherwise allowed." This safeguard against duplication of allowances on account of the same diminution in value shows that deductions for amortization were not intended to exclude obsolescence, but rather were to be made in addition or having regard to allowances deducted on account of obsolescence and the like.

The legislative history of the Act negatives the contention. In explanation of the deduction for amortization the Committee on Ways and Means, having charge of the measure, reported that many facilities provided for war purposes would be of little value after termination of the conflict; that, under the law then existing, it was impossible to allow deductions other than for the "ordinary exhaustion, wear and tear, and depletion of such property" and that the purpose was "to allow special amounts for amortization, according to the peculiar condition in each case * * *."[3] When that report was made, and as the draft of the Act was originally passed by the House and amended and passed by the Senate, it contained no provision expressly authorizing allowances for obsolescence. Subsection (7) in the form in which it was finally adopted was formulated in conference much later than the committee report, and after the provision for amortization as finally enacted had been agreed to. (See *Gambrinus Brewery Co.* v. *Anderson*, supra, 643.) Manifestly Congress intended by subsection (7) to establish a general rule and by subsection (8) to authorize, in a limited class of cases and under special circumstances, the amortization of certain costs by deductions not duplicating any other allowed by that or previous Acts of Congress.

Under the circumstances disclosed by the findings, the buildings erected by petitioner are not to be distinguished from equipment designed, constructed and suitable only for the performance of a single job or from brewery plants put out of use by prohibitory laws. The Government does not suggest that any part of the allowance claimed should have been deducted in petitioner's returns for years prior to 1918. It was impossible to know when the conflict would cease but it was certain that, when demand for war materials ended, there necessarily would be great diminution in the value of the buildings. That remaining after the armistice, November 11, 1918, was properly to be regarded as in the nature of salvage. The depreciated cost less the value of petitioner's right to use the buildings after 1918 must be taken into account for the proper determination of petitioner's 1918 income and profits taxes. (*Gambrinus Brewery Co.* v. *Anderson*, supra; *Burnet* v. *Niagara Falls Brewing Co.*, supra.)

The findings as to inventories may be stated as follows:

At the end of 1918, petitioner had large quantities of material acquired for the production of war ammunition to be supplied by it under four contracts with the Government. The contracts provided that the Chief of Ordnance, upon termination or limitation of the war, might notify petitioner that any part of the articles then remaining undelivered should not be manufactured or delivered, and that: "In the event of such complete or partial termination [of performance of the contract] the United States shall inspect all completed articles then on hand and such as may be completed within thirty (30) days after such notice and shall pay to the contractor the price herein fixed for all articles accepted * * *. The United States shall also pay to the contractor the cost of materials and component parts purchased by the contractor for the performance of this contract and then on hand * * *" together with other allowances mentioned.[4]

In December, 1918, the Chief of Ordnance caused letters to be sent petitioner in respect of each of its contracts stating: "You are requested in the public interest immediately to suspend further operations under your contract * * * and incur no further expenses in connection with the performance of said contract. This request is made with a view to the negotiation of a supplemental contract providing for the cancellation, settlement and adjustment of your existing contract, in a manner which will permit of a more prompt

[3] House Report 767, Sixty-fifth Congress, second session, page 10. Senate Report 617, Sixty-fifth Congress, third session, page 7.

[4] Each of the contracts contained a provision substantially the same as that quoted. One of them, GA-126, did not give petitioner a right to continue production for 30 days after termination.

settlement and payment than will be practicable under the terms of said existing contract. Please acknowledge receipt of this notice immediately, and indicate your decision as to compliance with or rejection of this request. Upon notice of your compliance, a representative of the Ordnance Department will forthwith take up with you the proposed negotiation."[6] Before the end of the year petitioner complied with these requests and ceased production under the contracts.

At the end of that year there was no market for the materials in the inventories; they were not salable at any price approaching cost; it was wholly uncertain what amounts might be obtained in settlement, and no negotiations for adjustments or settlement had been made.

After negotiations involving much time and expense, partial settlements were reached in 1920 under which the Government took over and paid petitioner's cost for most of the raw material and work in process, except labor and overhead items chargeable to the latter. In final settlements in 1921 and 1922 there were compromises under which the Government paid a portion of the cost of some items and made no allowance for others.

Petitioner kept its books on the accrual basis and elected to price its inventories at cost or market whichever was lower. The difference between petitioner and the Commissioner as to 1918 taxes was whether inventories of material on hand at that date should be taken at $231,615.43, the then market value, or at $732,088.62 which was made up of amounts eventually realized by petitioner under the contracts of settlement. The latter was used by the Commissioner.

Mere inspection of the suspension requests disclose that they were not intended to be the notices provided for in the clauses authorizing the Government to terminate manufacture or deliveries. (*College Point Boat Co.* v. *United States*, 267 U. S., 12, 15.) And upon petitioner's compliance with such requests the contract provisions as to payments by the Government to petitioner of cost were superseded. At the end of 1918, the Government was not bound to take or to pay petitioner for any property covered by the inventories. Petitioner had no assurance as to what settlements finally would be made or that it ever would receive more than the then market value of the inventories. Up to the time of the partial settlements in 1920, petitioner had no agreement that it would be paid the cost of any part of the property. (Cf. *Lucas* v. *American Code Co.*, 280 U. S., 445, 449 [Ct. D. 168, C. B. IX–1, 314].)

Petitioner's position was not different from that of a merchant whose stock on hand at the end of the tax year and not covered by contracts of sale had declined in value and was inventoried below cost. In such case amounts in excess of inventory value realized from sales in subsequent years are attributable to such years. Gains or losses must be accounted for in the year in which they are realized. The purpose of the inventories is to assign to each period its profits and losses. (*Lucas* v. *Kansas City Structural Steel Co.*, 281 U. S., 264, 268 [Ct. D. 223, C. B. IX–2, 299].) The tax laws are calculated to produce revenue ascertainable and payable at regular intervals. Otherwise it would not be practicable to devise methods of accounting, assessment or collection capable of operation. (*Burnet* v. *Sanford & Brooks Co.*, 282 U. S., 359, 365 [Ct. D. 277, C. B. X–1, 363].) The taking of petitioner's inventories at market value was essential to a proper disclosure of its financial position. Regulations in force at the time of the Commissioner's determination declare that items such as claims for compensation under canceled Government contracts constitute income for the year in which they are allowed or their value is otherwise definitely determined. (Regulations 65, article 50.) And see Regulations 45, articles 1582–1584, as amended by Treasury Decision 3296 [C. B. I–1, 40]. On the facts found there was no warrant for including in petitioner's 1918 taxable income on account of such inventories any amount in excess of market value at the end of that year.

The lower court's dismissal of petitioner's claims for deduction of $327,937.35 on account of buildings and $500,473.19 on account of inventories can not be sustained.

Reversed.

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[6] The suspension requests were not in identical words, but in substance all were the same.

ARTICLE 564: Interest.

REVENUE ACT OF 1921.

Deduction of interest paid on bonds issued at a premium prior to March 1, 1913, without reduction by the year's proportion of amortization of the bond premium. (See Ct. D. 456, page 274.)

SECTION 235.—ITEMS NOT DEDUCTIBLE BY CORPORATIONS.

ARTICLE 582: Capital expenditures.

REVENUE ACT OF 1921.

Payments by owners of coal properties to a railroad company in compromise of suits involving cost of construction of branch railroad. (See Ct. D. 439, page 278.)

SECTION 238.—CREDIT FOR TAXES IN CASE OF CORPORATIONS.

ARTICLE 612: Domestic corporation owning a majority of the stock of foreign corporation. XI–13–5428 Ct. D. 463

INCOME TAX—REVENUE ACT OF 1921—DECISION OF SUPREME COURT.

CREDIT FOR TAXES—CORPORATION—FOREIGN COUNTRY—NEW SOUTH WALES.

New South Wales is a foreign country within the meaning of section 238(e) of the Revenue Act of 1921.

SUPREME COURT OF THE UNITED STATES. No. 378.—OCTOBER TERM, 1931.

David Burnet, Commissioner of Internal Revenue, petitioner, v. *Chicago Portrait Co.*

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

[February 23, 1932.]

OPINION.

Mr. Chief Justice HUGHES delivered the opinion of the court.

This proceeding was brought for the redetermination of a deficiency in income tax for the year 1923. The respondent, Chicago Portrait Co., is an Illinois corporation with its principal place of business at Chicago. It owned 51 per cent of the capital stock of the International Art Co. of Sydney, Australia, a foreign corporation. Respondent received dividends from the International Art Co. and sought credit for a proportionate part of the income taxes paid by that corporation to the Commonwealth of Australia, to the State of New South Wales, and to the Dominion of New Zealand. Section 238(e) of the Revenue Act of 1921 (42 Stat., 227, 258, 259) permitted credit in the case of such taxes paid "to any foreign country." Credit was allowed on account of the income taxes paid to the Commonwealth of Australia and to the Dominion of New Zealand but was refused as to those paid to the State of New South Wales. The Board of Tax Appeals held that the respondent was entitled to the credit with respect to the last mentioned taxes also, and the Circuit Court of Appeals affirmed that decision. (16 B. T. A., 1129; 50 Fed. (2d), 683.) This court granted a writ of certiorari.

The sole question is whether New South Wales is a "foreign country" within the meaning of the applicable statute.[1]

The word "country," in the expression "foreign country," is ambiguous. It may be taken to mean foreign territory or a foreign government. In the sense of territory, it may embrace all the territory subject to a foreign sovereign power. When referring more particularly to a foreign government, it may describe a foreign state in the international sense; that is, one that has the status of an international person with the rights and responsibilities under international law of a member of the family of nations;[2] or it may mean a foreign government which has authority over a particular area or subject matter, although not an international person but only a component part, or a political subdivision, of the larger international unit.[3] The term "foreign country" is not a technical or artificial one, and the sense in which it is used in a statute must be determined by reference to the purpose of the particular legislation.[4]

In the case of tariff Acts, this court said in *Stairs* v. *Peaslee* (18 How., 521, 526) that the word "country" has always been construed "to embrace all the possessions of a foreign state, however widely separated, which are subject to the same supreme executive and legislative control." See, also, *United States* v. *The Ship Recorder* (1 Blatchf., 218, 225–227); *Campbell* v. *Barney* (5 Blatchf., 221). Accordingly, in construing the Act of March 3, 1851 (9 Stat., 629, 630), providing that imported merchandise should be appraised at its market value "at the principal markets of the country" from which it had been imported, the court held that a commodity shipped from Halifax, Nova Scotia, should be appraised according to the value in the principal markets under the British rule, and these were found, in fact, to be London and Liverpool. After the ratification of the treaty of peace between the United States and Spain, Porto Rico and the Philippines ceased to be "foreign country" under the tariff laws. (*De Lima* v. *Bidwell*, 182 U. S., 1; *Fourteen Diamond Rings* v. *United States*, 183 U. S., 176, 179.) It followed that the term "other countries" in the Commercial Convention with Cuba of 1903 (33 Stat., 2136, 2140) did not include the Philippine Islands. (*Faber* v. *United States*, 221 U. S., 649, 658.) Under the provisions of the Platt amendment and the constitution of Cuba, the Isle of Pines was *de facto* under the jurisdiction of Cuba and hence remained "foreign country" within the meaning of the Tariff Act of 1897 (30 Stat., 151). (*Pearcy* v. *Stranahan*, 205 U. S., 257, 265.)

In construing legislation providing for the deportation of aliens "to the country whence they came," the place of emigration affords the dominant consideration. Thus, under the Immigration Act of 1917 (39 Stat., 874, 890), the court held that an alien emigrating from Grodno, then a part of Russia, was

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[1] The provisions of section 238 (a) and (e) of the Revenue Act of 1921 are as follows:

"SEC. 238. (a) That in the case of a domestic corporation the tax imposed by this title, plus the war-profits and excess-profits taxes, if any, shall be credited with the amount of any income, war-profits, and excess-profits taxes paid during the same taxable year to any foreign country, or to any possession of the United States: *Provided*, That the amount of credit taken under this subdivision shall in no case exceed the same proportion of the taxes, against which such credit is taken, which the taxpayer's net income (computed without deduction for any income, war-profits, and excess-profits taxes imposed by any foreign country or possession of the United States) from sources without the United States bears to its entire net income (computed without such deduction) for the same taxable year. * * *

* * * * * * *

"(e) For the purposes of this section a domestic corporation which owns a majority of the voting stock of a foreign corporation from which it receives dividends (not deductible under section 234) in any taxable year shall be deemed to have paid the same proportion of any income, war-profits, or excess-profits taxes paid by such foreign corporation to any foreign country or to any possession of the United States, upon or with respect to the accumulated profits of such foreign corporation from which such dividends were paid, which the amount of such dividends bears to the amount of such accumulated profits: *Provided*, That the credit allowed to any domestic corporation under this subdivision shall in no case exceed the same proportion of the taxes against which it is credited, which the amount of such dividends bears to the amount of the entire net income of the domestic corporation in which such dividends are included. The term 'accumulated profits' when used in this subdivision in reference to a foreign corporation, means the amount of its gains, profits, or income in excess of the income, war-profits, and excess-profits taxes imposed upon or with respect to such profits or income. * * *"

[2] Oppenheim, International Law, 4th ed., Volume I, sections 63, 64, pages 133–135; Hyde, International Law, volume 1, sections 6–8, pages 15–18; Moore's International Law Digest, Volume I, pages 14–18.

[3] See Dicey, Conflict of Laws, 4th ed., pages 59, 60.

[4] *Wayman* v. *Southard* (10 Wheat., 1, 29); *Marriott* v. *Brune* (9 How., 619, 635, 636); *American Tobacco Co.* v. *Werckmeister* (207 U. S., 284, 293); *United States* v. *Louisville & Nashville R. R. Co.* (236 U. S., 318, 333); *Inter-Island Steam Navigation Co.* v. *Ward* (242 U. S., 1, 4); *Porto Rico Railway, Light & Power Co.* v. *Mor* (253 U. S., 345, 348).

properly deported to Poland, because at that time Grodno was a part of Poland. "The term country," said the court, was used in the statute "to designate, in general terms, the state which, at the time of deportation, includes the place from which the alien came." (*Mensevich* v. *Tod*, 264 U. S., 134, 136, 137.) The evident purpose of the statute determined the significance to be attached to the expression.

In the instant case, the question is one of credit for income taxes "paid to any foreign country." The word "country" is manifestly used in the sense of government. And to decide what government fits the description, whether only that of a foreign power which may be considered an international person, or that of a political entity which, although not an international person, levies and collects income taxes which may be the subject of the intended credit, it is necessary to consider the object of the enactment and to construe the expression "foreign country" so as to achieve, and not defeat, its aim. We think that the purpose of the statute is clear. The fact that the provision is for a credit to the domestic corporation, against income taxes payable here, of income taxes "paid during the same taxable year to any foreign country," itself demonstrates that the primary design of the provision was to mitigate the evil of double taxation. Cognate provisions in the case of individuals disclose a similar intent. Section 222(a)[5] of the same Revenue Act (1921) provides that the income tax, in the case of a citizen of the United States, should be credited with the amount of any income taxes "paid during the taxable year to any foreign country or to any possession of the United States." In the case of an alien resident of the United States, the credit is conditioned upon reciprocal treatment. The resident alien is to be credited with "the amount of any such taxes paid during the taxable year to any foreign country, if the foreign country of which such alien resident is a citizen or subject, in imposing such taxes, allows a similar credit to citizens of the United States residing in such country." (42 Stat., 249.)[6]

In the case of domestic corporations, the purpose is also disclosed to facilitate their foreign enterprises. The provision of section 238(e) of the Revenue Act of 1921 indicates appreciation of the practical exigencies which lead to the foreign incorporation of subsidiaries for the extension by domestic corporations of their business abroad. This clearly appears to be the reason for the allowance by that Act of a credit to a domestic corporation, against its income tax here

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[5] Sec. 222. (a) That the tax computed under Part II of this title shall be credited with:
(1) In the case of a citizen of the United States, the amount of any income, war-profits, and excess-profits taxes paid during the taxable year to any foreign country or to any possession of the United States; and
(2) In the case of a resident of the United States, the amount of any such taxes paid during the taxable year to any possession of the United States; and
(3) In the case of an alien resident of the United States, the amount of any such taxes paid during the taxable year to any foreign country, if the foreign country of which such alien resident is a citizen or subject, in imposing such taxes, allows a similar credit to citizens of the United States residing in such country; * * *.

[6] With respect to the allowance of such credits, as distinguished from deductions from gross income in computing net income, the Committee on Ways and Means of the House of Representatives in its report on the revenue bill of 1918 (H. R. Rep. No. 767, Sixty-fifth Congress, second session, page 11), said: "Under existing law a citizen of the United States can only deduct income, war or excess profits taxes paid to a foreign country from gross income in computing net income. With the corresponding high rates imposed by certain foreign countries the taxes levied in such countries in addition to the taxes levied in the United States upon citizens of the United States place a very severe burden upon such citizens. The bill provides that a credit against the income tax imposed in the United States be allowed a citizen of the United States subject to income and war or excess profits taxes in a foreign country of an amount equal to the tax paid in such country upon income that is received from sources within such country. The bill further provides that, in the case of an alien resident of the United States who is a citizen or subject of a country which imposes income, war profits, or excess profits taxes, a like credit shall be allowed if such country allows a similar credit to citizens of the United States resident in such country."

The conference report on the revenue bill of 1918 (H. R. Rep. No. 1037, Sixty-fifth Congress, third session, page 53) contains the following statement: "Amendment No. 118: The House bill provided that a citizen of the United States might credit against his income tax the amount of any income, war-profits, and excess-profits taxes paid to any foreign country, Porto Rico, or the Philippine Islands, upon income derived from sources therein, and allowed a similar credit to an alien resident if his country makes reciprocal provisions. The Senate amendment entirely rewrites the section and broadens it to include a credit for taxes paid to any possession of the United States, which is also to be given to an alien resident of the United States. The House recedes with an amendment providing that if any deduction is allowed for taxes accrued in any possession or foreign country, the Commissioner may require the taxpayer to give a surety bond providing for the payment of any tax found to be due the Government in case too great a deduction shall be allowed for accrued taxes in our possessions or any foreign country. * * *."

upon dividends received from its foreign subsidiary, of a proportionate part, as defined, of the income taxes paid by that subsidiary to "any foreign country."[7] The same provision applies to subsidiaries with respect to income taxes paid "to any possession of the United States."

In effectuating these purposes, it is manifest that the controlling consideration was the fact that the income tax was paid to a foreign government competent to lay the tax, and not the international status of that government. The burden upon the domestic corporation was the same whether the foreign government had international standing or was a lesser political entity which nevertheless had authority to impose the exaction upon the corporation or its subsidiary. And if credit was to be allowed here by reason of the payment of the income tax abroad, it made no difference to the Government of the United States whether the payment abroad was made to the one sort of foreign government or the other. The reasons underlying the allowance of the credit were applicable in either case.

An examination of the provisions of earlier income tax Acts in which the expression "foreign country" is found, does not support, but rather negatives, the conclusion that the term was used in the restricted sense for which the petitioner contends. In the Corporation Tax Act of 1909 (36 Stat., 113) deduction from gross income was allowed to the corporation for all sums paid by it within the year for taxes "imposed by the government of any foreign country as a condition to carrying on business therein." That corporation tax was an excise on the privilege of doing business in a corporate capacity. The provision with respect to taxes laid by a foreign government manifestly referred to that government which, as the statute said, imposed a privilege tax. There was no suggestion that the foreign government laying the tax must have an international status; it was enough that it had authority to require the payment "as a condition to carrying on business." In the income tax Act of 1913, paragraph G(b) (38 Stat., 173), deduction was allowed, in computing net income of a corporation, of "all sums paid by it within the year for taxes imposed under the authority of the United States or of any State or Territory thereof, or imposed by the Government of any foreign country." The income tax Act of 1916, sections 5(a), 6(a) and 12(a) (39 Stat., 759, 769), provided for deduction from gross income of "Taxes paid within the year imposed by the authority of the United States, or its Territories, or possessions, or any foreign country, or under the authority of any State, county, school district, or municipality, or other taxing subdivision of any State, not including those assessed against local benefits." The income tax amendments of 1917, sections 1201(1), 1207(1) (40 Stat., 330, 335), continued the provisions for deductions as to taxes imposed "by the authority" of "any foreign country" in obviously the same sense.[8]

There appears to be no room for the conclusion that, under these Acts, the deductions for taxes paid abroad were available only if paid to a foreign government that had an international standing, and not if paid to a foreign government which although not having that standing was still authorized to exact the taxes. The criterion was the fact that the tax was imposed by the authority of a foreign country and not the international status of the particular

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[7] In the report of the Committee on Ways and Means of the House of Representatives in relation to the revenue bill of 1921 (H. R. Rep. No. 350, Sixty-seventh Congress, first session, page 8), the following statement was made with respect to American concerns doing business in foreign countries: "Under existing law an American citizen or domestic corporation is taxed upon his or its entire income even though all of it is derived from business transacted without the United States. This results in double taxation, places American business concerns at a serious disadvantage in the competitive struggle for foreign trade, and encourages American corporations doing business in foreign countries to surrender their American charters and incorporate under the laws of foreign countries." While this statement was made to introduce a remedial proposal, which was not adopted, it discloses the purpose entertained. See, also, report of Committee of Finance of the Senate (S. Rep. No. 275, Sixty-seventh Congress, first session, page 9).

The conference report on the revenue bill of 1921 (H. R. Rep. 486, Sixty-seventh Congress, first session, page 38) contains the following: "Amendment No. 436: The House bill provided for the exclusion from income of all dividends received from a corporation. Senate amendments agreed to by the conferees having provided for the inclusion in gross income of certain dividends received from a foreign corporation, Senate amendment No. 436 provides, under proper safeguards, for the credit by a domestic corporation of taxes paid by its subsidiary foreign corporation with respect to the income or profits of the foreign corporation paid as taxable dividends to the domestic corporation; and the House recedes."

[8] These provisions in the Act of 1917 read: "Taxes paid within the year imposed by the authority of the United States (except income and excess profits taxes), or of its Territories, or possessions, or any foreign country, or by the authority of any State, county, school district, or municipality, or other taxing subdivision of any State, not including those assessed against local benefits."

government to which it was paid. We have not been referred to any opposing administrative construction of these Acts.[9]

The Revenue Act of 1918, with its provisions for credits, against income taxes laid here, of taxes paid "to any foreign country, upon income derived from sources therein" (sections 222(a), 238(a); 40 Stat., 1073, 1080)[10] was enacted with this background and we find no basis whatever for the conclusion that the term "foreign country" was used in that statute in any different sense. In the Act of 1918, the provisions for deductions of taxes from gross income, in computing net income, by citizens or residents, and by domestic corporations, of taxes paid to a foreign country, were continued as in the prior Acts, save that there was excepted from these deductions the amount of the credits now allowed to citizens and residents under section 222 and to domestic corporations under section 238 (40 Stat., 1067).[11] In these provisions for deductions, the expression "foreign country" undoubtedly had the same meaning that it had in the prior income tax Acts.[12] It will be observed that taxes paid to the States of the Union, or to their political subdivisions, were deductible from gross income.[13] But in the provisions introduced in the Act of 1918 for credits against income taxes, such taxes paid to the States of the Union, and to their political subdivisions, were not included.[14] This fact does not affect the present question, for credits were allowed in the case of income taxes paid to foreign countries, and the provision as to such countries was the same in the section relating to credits as in that with respect to deductions. The slight difference in phraseology in sections 222 and 238 as to credits for taxes paid "*to* any foreign country," instead of taxes imposed "*by the authority of* any foreign country,"

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[9] On the contrary, Treasury Regulations No. 33, Revised (issued in January, 1918, applicable to the income tax Acts of 1916 and 1917), had the following provision in article 8 with respect to the deductions allowed to citizens and resident aliens for taxes paid abroad: "Taxes: State or any political subdivision thereof, Federal or foreign (except income and excess profits taxes paid to the United States), and not including taxes assessed against local benefits."

The provision of these regulations as to the taxes deductible in cases of corporations had the same import. This provision was as follows:

"ART. 191. *Taxes deductible.*—Taxes imposed against a corporation by authority of the United States (except income and excess-profits taxes), its Territories or any foreign country, or by authority of any State, county, school district, municipality, or other taxing subdivision of a State (not including those assessed against local benefits) and paid within the year for which the return is made, are deductible from the gross income of a domestic corporation."

[10] These provisions as to individuals were as follows:

"SEC. 222. (a) That the tax computed under Part II of this title shall be credited with:

"(1) In the case of a citizen of the United States, the amount of any income, war-profits and excess-profits taxes paid during the taxable year to any foreign country, upon income derived from sources therein, or to any possession of the United States; and

"(2) In the case of a resident of the United States, the amount of any such taxes paid during the taxable year to any possession of the United States; and

"(3) In the case of an alien resident of the United States who is a citizen or subject of a foreign country, the amount of any such taxes paid during the taxable year to such country, upon income derived from sources therein, if such country, in imposing such taxes, allows a similar credit to citizens of the United States residing in such country; * * *."

And with respect to domestic corporations:

"SEC. 238. (a) That in the case of a domestic corporation the total taxes imposed for the taxable year by this title and by Title III shall be credited with the amount of any income, war-profits and excess-profits taxes paid during the taxable year to any foreign country, upon income derived from sources therein, or to any possession of the United States. * * *"

[11] These provisions for deductions in the Revenue Act of 1918 were:

"SEC. 214. (a) * * * (3) Taxes paid or accrued within the taxable year imposed (a) by the authority of the United States, except income, war-profits and excess-profits taxes; or (b) by the authority of any of its possessions, except the amount of income, war-profits and excess-profits taxes allowed as a credit under section 222; or (c) by the authority of any State or Territory, or any county, school district, municipality, or other taxing subdivision of any State or Territory, not including those assessed against local benefits of a kind tending to increase the value of the property assessed; or (d) in the case of a citizen or resident of the United States, by the authority of any foreign country, except the amount of income, war-profits and excess-profits taxes allowed as a credit under section 222; * * *."

Section 234(a)3(d) provided for a similar deduction of taxes paid by a domestic corporation, excepting from such deductions the credits allowed under section 238.

[12] Treasury Regulations No. 45, under the Revenue Act of 1918, thus described these deductions:

"ART. 131. *Taxes.*—Federal taxes (except income, war-profits and excess-profits taxes), State and local taxes (except taxes assessed against local benefits of a kind tending to increase the value of the property assessed), and taxes imposed by possessions of the United States or by foreign countries (except the amount of income, war-profits, and excess-profits taxes allowed as a credit against the tax), are deductible from gross income. * * *" See, supra, note 9.

[13] Supra, note 11.

[14] Supra, note 10.

as in sections 214(a) and 234(a)[15] is not important. As the context plainly shows, both phrases were intended to convey the same meaning. Thus section 234(a)3(d) provides for deduction, in computing the net income of a domestic corporation, of the taxes imposed "by the authority of any foreign country, except the amount of income, war-profits and excess-profits taxes allowed as a credit under section 238." The distinction made with respect to income taxes paid to the States of the Union, and to their political subdivisions, between deductions from gross income and credits against taxes, simply reflected the economic policy adopted in making allowances for taxes paid within the borders of continental United States and the organized territories. In relation to income taxes paid outside these borders, the provision as to credits was enacted to give greater and not less relief. Not only was the same expression as to foreign countries used in the section as to credits against income taxes as had been employed, and was still continued, as to deductions from gross income, but that the reference was not to a government having an international status was indicated by the provision for similar credits in cases of income taxes paid to "any possession of the United States."[16] And that the dominant thought in the mind of the Congress was to allow a credit for income taxes paid in any foreign country, whenever imposed by the authority of a foreign government, is shown in the reports, above cited, of the committees in connection with the revenue bill of 1918.[17]

No change, or qualification, was made in the use of the term "foreign country" in the Revenue Act of 1928,[18] and we think it must be regarded as having the same significance as it unquestionably had through the series of the prior income tax Acts to which we have referred. The same controlling purpose is manifest, and the credit provision, here in question, in relation to taxable dividends from foreign subsidiaries of domestic corporations was introduced not to narrow that purpose but to carry it out more effectively.[19]

The present controversy has arisen under the Treasury regulations adopted with respect to the Revenue Acts of 1918 and 1921 as to credits.[20] The familiar principle is invoked that great weight is attached to the construction consistently given to a statute by the executive department charged with its administration. (*United States* v. *Jackson*, 280 U. S., 183, 193.) But the qualification of that principle is as well established as the principle itself. The court is not bound by an administrative construction, and if that construction is not uniform and consistent, it will be taken into account only to the extent that it is supported by valid reasons. (*United States* v. *Missouri Pacific R. R. Co.*, 278 U. S., 269, 280.) (See, also, *United States* v. *Dickson*, 15 Pet., 141, 161; *United States* v. *Healey*, 160 U. S., 136, 145; *Chicago, Milwaukee & St. Paul Rwy. Co.* v. *McCaull-Dinsmore Co.*, 253 U. S., 94, 99.) Moreover, ambiguous regulations are of little value in resolving statutory ambiguities. In the "Preliminary Edition" of Treasury Regulations No. 45, under the Act of 1918, article 382, relating to credits stated: "'Foreign country' means any governmental authority, not that of the United States or any part or possession thereof, having power to impose such taxes, and it therefore includes a self-governing colony, such as the Dominion of Canada." But this provision was shortly superseded in the amended Regulations No. 45, promulgated April 17, 1919, by a new article 382 containing the following: "'Foreign country' includes within its meaning any foreign sovereign state or self-governing colony (for example, the Dominion of Canada), but does not include a foreign municipality (for example, Montreal) unless itself a sovereign state (for example, Hamburg). 'Any possession of the United States' includes, among others, Porto Rico, the Philippines, and the Virgin Islands." The Department thus sought to introduce a qualification as to the significance of 'foreign country' not found in the words of the statute, or in those of the preceding income tax Acts, or in departmental regulations under them, and one that was inconsistent with the apparent purpose of the enactment. It was a qualification which not only did not conform to the view that the expression "foreign country" was limited to a foreign state having the status of an international person under international law, but, on the other

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[15] Supra, note 11.
[16] See sections 222(a) and 238(a) of the Revenue Act of 1918; supra, note 10.
[17] Supra, note 6.
[18] Supra, notes 1 and 5.
[19] See reports of committees in relation to the revenue bill of 1921, supra, note 7.
[20] So far as deductions of taxes from gross income, in computing net income, are concerned, the regulation under the Act of 1918 was continued under that of 1921. (Treasury Regulations No. 62, article 131; see, supra, note 12.)

hand, afforded no definite criterion. Its phrase "self-governing colony" had no certain application, as there are colonies with varying degrees of self-government, and if, in view of the aim of the statute, it was important to draw a distinction with respect to self-government, it would appear that the particular phase of autonomy that was relevant to the purpose of the statute was the competency to impose income taxes upon the domestic corporation, or its foreign subsidiary, with respect to which the relief was granted. It is true that certain foreign political divisions which formerly had not had an international status were achieving it, but even that progress, at the time of the adoption of the regulation in 1919,[21] was still uncertain both as to the quality and extent of the international recognition which would be accorded, and, however important in other relations that progress might be, it was not the concern of this statute and its operation can not be deemed to depend upon it. The departmental regulation became the more ambiguous as it proceeded with its illustrations relating to municipalities.

By section 216(e) of the Revenue Act of 1918, a nonresident alien individual was allowed credits for personal exemptions and for dependents if the "country" of which he was a citizen or subject allowed a similar credit to citizens of the United States not residing in "such country." Article 307 of Regulations No. 45 gave a list of "countries" which satisfied the credit requirements of this provision. This list was amended in later editions of these regulations, applicable to the Revenue Act of 1918, and embraced a great variety of "countries," including, for example, British Honduras, Ceylon, Cyprus, Fiji Islands, Gibraltar, Gold Coast, Malay States, Mauritius, St. Kitt-Nevis, etc.[22] As already noted, the expression "foreign country" was used in section 222(a)3 of the Revenue Act of 1918 in relation to credits allowed to an alien resident of the United States for taxes upon income derived from sources in such "country" if the latter allowed a similar credit to citizens of the United States.[23] Article 385 of Regulations No. 45 set forth the list of "countries" which did or did not satisfy this reciprocal credit requirement. This article further illustrates the ambiguity of the regulations.[24]

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[21] See Oppenheim, International Law (4th ed., volume 1, sections 63, 94*a*, 94*b*).

[22] See article 307, Treasury Decisions, volume 21, page 245; volume 23, page 444; volume 24, page 118. As finally amended, the article was as follows:

"ART. 307. *When nonresident alien individual entitled to personal exemption.*—(a) The following is an incomplete list of countries which either impose no income tax or in imposing an income tax allow both a personal exemption and a credit for dependents which satisfy the similar credit requirement of the statute: Argentina, Bahama, Barbados, Basutoland, Bechuanaland Protectorate, Belgium, Bermuda, Bolivia, Bosnia, Brazil, British Guiana, British Honduras, Bukowina, Bulgaria, Canada, Carniola, Ceylon, Chile, China, Colombia, Cuba, Cyprus, Czechoslovakia, including Bohemia, Moravia, and Slovakia, Dalmatia, Denmark, Ecuador, Egypt, Falkland Islands, Fiji Islands, France, Galicia, Gambia, Germany, Gibraltar, Gold Coast, Goritz, Gradisca, Greece, Grenada, Guatemala, Herzegovina, Hongkong, Istria, Jamaica, Kenya, Luxemburg, Malay States, Malta, Mauritius, Mexico, Montenegro, Montserrat, Morocco, Newfoundland, Nicaragua, Nigeria, Northern Rhodesia, Norway, Nyasaland Protectorate, Panama, Paraguay, Persia, Peru, Porto Rico, Portugal, Rumania, St. Kitt-Nevis, St. Helena, Santo Domingo, Serbia, Siam, Sierra Leone, Silesia, Somaliland Protectorate, Spain, Swaziland, Switzerland, Trieste, Uganda Protectorate, Union of South Africa, Venezuela, Virgin Islands (British), Weihaiwei, Western Pacific Islands, Zanzibar Protectorate. (b) The following is an incomplete list of countries which in imposing an income tax allow a personal exemption which satisfies the similar credit requirement of the statute, but do not allow a credit for dependents: Bachka, Banat of Temesvar, Croatia, Finland, India, Italy, Salvador, Slavonia, Transylvania. (c) The following is an incomplete list of countries which in imposing an income tax do not allow to citizens of the United States not residing in such country either a personal exemption or a credit for dependents and therefore fail entirely to satisfy the similar credit requirements of the statute: Australia, Austria, including Carinthia, Lower Austria, Salzberg, Styria, Tyrol, Upper Austria and Vienna, Costa Rica, Dutch Guiana, Great Britain and Ireland, Japan, the Netherlands, New Zealand, Trinidad, Sweden. The former names of certain of these territories are here used for convenience, in spite of an actual or possible change in name or sovereignty. A nonresident alien individual who is a citizen or subject of any country in the first list is entitled for the purpose of the normal tax to such credit for personal exemption and for dependents as his family status may warrant. If he is a citizen or subject of any country in the second list he is entitled to a credit for personal exemption, but to none for dependents. If he is a citizen or subject of any country in the third list he is not entitled to credit for either personal exemption or for dependents. If he is a citizen or subject of a country which is in none of the lists, then to secure credit for either a personal exemption or for dependents he must prove to the satisfaction of the Commissioner that his country does not impose an income tax or that in imposing an income tax it grants the similar credit required by the statute."

[23] Supra, note 10.

[24] Article 385 of Regulations No. 45 is as follows (Treasury Decisions, volume 3, page 473):

"ART. 385. *Countries which do or do not satisfy the similar credit requirement.*—(a) The following is an incomplete list of the countries which satisfy the similar credit

It is urged that the Revenue Act of 1921 must be deemed to have been adopted with the meaning attributed to the term "foreign country" by the regulations under the Act of 1918. But regulations of such an ambiguous character supplying no definite criterion can not be deemed to determine satisfactorily the interpretation of the statute. The Revenue Act of 1918 had continued the expression "foreign country" precisely as it had been used in the preceding income tax Acts without any such restricting gloss, and the Act of 1921 continued the expression as used in the Act of 1918. In these circumstances, we are of the opinion that the expression "foreign country" in the Act of 1921 should be deemed to have the same significance in that Act that it had in the prior Acts and was not limited by the regulations adopted under the Act of 1918. The regulations under the Act of 1921 were of the same equivocal sort as those to which we have referred under the Act of 1918, and can be deemed to have no greater effect.[28] The decisions of the Treasury Department[29] applying these regulations have no more force than the reasons given to sustain them and these, in our opinion, furnish no adequate ground for denying effect to the credit provisions of the statute in accordance with their manifest purpose.

In this view, we find it unnecessary to consider the arguments that have been adduced with respect to the status of New South Wales in its relation to the Commonwealth of Australia. There is no question that New South Wales levied the income taxes for which credit is sought and that its government had adequate authority to impose them.

We conclude that the Board of Tax Appeals and the Circuit Court of Appeals were right in holding that these income taxes fell within the statutory provision as to credits, and the judgment is affirmed.

Judgment affirmed.

SECTION 239.—CORPORATION RETURNS.

ARTICLE 622: Returns by receivers. XI-24-5514
(Also Section 213(a), Article 51.) Ct. D. 499

INCOME TAX—REVENUE ACT OF 1916—DECISION OF COURT.

1. RETURNS—RECEIVER.

Section 13(c) of the Revenue Act of 1916, providing that receivers make returns of net income as and for corporations the property or business of which they are operating, is inapplicable to a receiver holding only a part of the property of a corporation, who is neither required nor permitted to make such return.

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requirement of section 222(a)3 of the Revenue Act of 1918, either by allowing to citizens of the United States residing in such countries a credit for the amount of income, war profits, or excess profits taxes paid to the United States upon incomes derived from sources therein, or in imposing such taxes, by exempting from taxation the incomes received from sources within the United States by citizens of the United States residing in such countries: Bulgaria, Canada, Italy, Newfoundland, Salvador. (b) The following is an incomplete list of the countries which do not satisfy the similar credit requirement of section 222(a)3 of the Revenue Act of 1918, either by allowing no credit to citizens of the United States residing in such countries, for the amount of income, war profits, or excess profits taxes paid to the United States upon incomes derived from sources therein, or because such countries do not impose any income, war profits, or excess profits taxes: Argentina, Bahama, Belgium, Bermuda, Bolivia, Bosnia, Brazil, Chile, China, Costa Rica, Ecuador, Egypt, Finland, France, Great Britain and Ireland, Guatemala, Herzegovina, India, Jamaica, Japan, Montenegro, Morocco, New Zealand, Nicaragua, Panama, Paraguay, Persia, Peru, Portugal, Roumania, Santo Domingo, Serbia, Siam, Sweden, Switzerland, Venezuela. The former names of certain of these territories are here used for convenience in spite of the actual or possible change in the name or sovereignty. A resident of the United States who is a citizen or subject of any country in the first list is entitled, for the purpose of the total tax due the United States for 1918 and subsequent years, to a credit for the amount of any income, war profits, and excess profits taxes paid or accrued during the taxable year to such country upon income from sources therein. If he is a citizen or subject of any country in the second list, he is not entitled to such credit. If he is a citizen or subject of a country which is in neither list, then to secure the desired credit he must prove to the satisfaction of the Commissioner that his country satisfies the similar credit requirement of the statute."

[28] Regulations No. 62, articles 382, 385.

[29] Solicitor's Memorandum No. 1187, October 18, 1919; Office Decision No. 1050 (C. B. 5, 194); Solicitor's Memorandum No. 1614 (C. B. III-1, 227).

2. INCOME—WHEN TAXABLE—INCOME IMPOUNDED DURING LITIGATION.

Income, derived in 1916 from the sale of oil, which is impounded in that year in the hands of a receiver appointed by the Federal court for that purpose and retained by him until 1917, when under order of court, it is paid to the taxpayer, the right to which is litigated until the final decision of the Supreme Court in 1922 and the return of which the taxpayer and not the receiver is required to make, is taxable in the year 1917, even if the taxpayer's returns are made on the accrual basis.

SUPREME COURT OF THE UNITED STATES. No. 575.—OCTOBER TERM, 1931.

North American Oil Consolidated, petitioner, v. *David Burnet, Commissioner of Internal Revenue.*

On certiorari to the United States Circuit Court of Appeals for the Ninth Circuit.

[May 23, 1932.]

OPINION.

Mr. Justice BRANDEIS delivered the opinion of the court.

The question for decision is whether the sum of $171,979.22 received by the North American Oil Consolidated in 1917, was taxable to it as income of that year.

The money was paid to the company under the following circumstances. Among many properties operated by it in 1916 was a section of oil land, the legal title to which stood in the name of the United States. Prior to that year, the Government, claiming also the beneficial ownership, had instituted a suit to oust the company from possession; and on February 2, 1916, it secured the appointment of a receiver to operate the property, or supervise its operations, and to hold the net income thereof. The money paid to the company in 1917 represented the net profits which had been earned from that property in 1916 during the receivership. The money was paid to the receiver as earned. After entry by the district court in 1917 of the final decree dismissing the bill, the money was paid, in that year, by the receiver to the company. (*United States* v. *North American Oil Consolidated,* 242 Fed., 722.) The Government took an appeal (without supersedeas) to the Circuit Court of Appeals. In 1920, that court affirmed the decree. (264 Fed., 336.) In 1922, a further appeal to this court was dismissed by stipulation. (258 U. S., 633.)

The income earned from the property in 1916 had been entered on the books of the company as its income. It had not been included in its original return of income for 1916; but it was included in an amended return for that year which was filed in 1918. Upon auditing the company's income and profits tax returns for 1917, the Commissioner of Internal Revenue determined a deficiency based on other items. The company appealed to the Board of Tax Appeals. There, in 1927 the Commissioner prayed that the deficiency already claimed should be increased so as to include a tax on the amount paid by the receiver to the company in 1917. The Board held that the profits were taxable to the receiver as income of 1916; and hence made no finding whether the company's accounts were kept on the cash receipts and disbursements basis or on the accrual basis. (12 B. T. A., 68.) The Circuit Court of Appeals held that the profits were taxable to the company as income of 1917, regardless of whether the company's returns were made on the cash or on the accrual basis. (50 F. (2d), 725.) This court granted a writ of certiorari. (284 U. S., 614.)

It is conceded that the net profits earned by the property during the receivership constituted income. The company contends that they should have been reported by the receiver for taxation in 1916; that if not returnable by him, they should have been returned by the company for 1916, because they constitute income of the company accrued in that year; and that if not taxable as income of the company for 1916, they were taxable to it as income for 1922, since the litigation was not finally terminated in its favor until 1922.

First. The income earned in 1916 and impounded by the receiver in that year was not taxable to him, because he was the receiver of only a part of the properties operated by the company. Under section 13(c) of the Revenue Act of 1916,[1] receivers who "are operating the property or business of corporations" were obliged to make returns "of net income as and for such corporations," and "any income tax due" was to be "assessed and collected in the same manner as if assessed directly against the organization of whose business or properties they have custody and control." The phraseology of this section was adopted without change in the Revenue Act of 1918. (40 Stat., 1057, 1081, ch. 18, section 239.) The regulations of the Treasury Department have consistently construed these statutes as applying only to receivers in charge of the entire property or business of a corporation; and in all other cases have required the corporations themselves to report their income. (Treasury Regulations 33, articles 26, 209; Treasury Regulations 45, articles 424, 622.) That construction is clearly correct. The language of the section contemplates a substitution of the receiver for the corporation; and there can be such substitution only when the receiver is in complete control of the properties and business of the corporation. Moreover, there is no provision for the consolidation of the return of a receiver of part of a corporation's property or business with the return of the corporation itself. It may not be assumed that Congress intended to require the filing of two separate returns for the same year, each covering only a part of the corporate income, without making provision for consolidation so that the tax could be based upon the income as a whole.

Second. The net profits were not taxable to the company as income of 1916. For the company was not required in 1916 to report as income an amount which it might never receive. (See *Burnet* v. *Logan*, 283 U. S., 404, 413. Compare *Lucas* v. *American Code Co.*, 280 U. S., 445, 452 [Ct. D. 168, C. B. IX–1, 314]; *Burnet* v. *Sanford & Brooks Co.*, 282 U. S., 359, 363 [Ct. D. 277, C. B. X–1, 363].) There was no constructive receipt of the profits by the company in that year, because at no time during the year was there a right in the company to demand that the receiver pay over the money. Throughout 1916 it was uncertain who would be declared entitled to the profits. It was not until 1917, when the district court entered a final decree vacating the receivership and dismissing the bill, that the company became entitled to receive the money. Nor is it material, for the purposes of this case, whether the company's return was filed on the cash receipts and disbursements basis, or on the accrual basis. In neither event was it taxable in 1916 on account of income which it had not yet received and which it might never receive.

Third. The net profits earned by the property in 1916 were not income of the year 1922—the year in which the litigation with the Government was finally terminated. They became income of the company in 1917, when it first became entitled to them and when it actually received them. If a taxpayer receives earnings under a claim of right and without restriction as to its disposition, he has received income which he is required to return, even though it may still be claimed that he is not entitled to retain the money, and even though he may still be adjudged liable to restore its equivalent. (See *Board* v. *Commissioner of Internal Revenue*, 51 F. (2d), 73, 75, 76. Compare *United States* v. *S. S. White Dental Manufacturing Co.*, 274 U. S., 398, 403 [T. D. 4059, C. B. VI–2, 198].) If in 1922 the Government had prevailed, and the company had been obliged to refund the profits received in 1917, it would have been entitled to a deduction from the profits of 1922, not from those of any earlier year. (Compare *Lucas* v. *American Code Co.*, supra.)

Affirmed.

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[1] Act of September 8, 1916 (39 Stat., 756, 771, ch. 463): "In cases wherein receivers, trustees in bankruptcy, or assignees are operating the property or business of corporations * * *, subject to the tax imposed by this title, such receivers, trustees, or assignees shall make returns of net income as and for such corporations * * *, in the same manner and form as such organizations are hereinbefore required to make returns, and any income tax due on the basis of such returns made by receivers, trustees, or assignees shall be assessed and collected in the same manner as if assessed directly against the organizations of whose business or properties they have custody and control."

SECTION 240.—CONSOLIDATED RETURNS OF CORPORATIONS.

ARTICLE 633: When corporations are affiliated.

REVENUE ACT OF 1918.

Substantial equality of losses or profits, as between stockholders, based upon contract between two corporations. (See Ct. D. 487, page 322.)

SECTION 245.

ARTICLE 681: Reserve funds. XI–26–5521
Ct. D. 502

INCOME TAX—REVENUE ACT OF 1921—DECISION OF COURT.

GROSS INCOME—DEDUCTION—"RESERVE FUNDS REQUIRED BY LAW"—LIFE INSURANCE COMPANY.

The following items, even if reserves required to be maintained by a life insurance company under State laws, are not a part of "the reserve funds required by law" within the meaning of section 245(a)2 of the Revenue Act of 1921 and may not be included in determining the amount of the deduction from the gross income of a life insurance company specified in that paragraph:

1. Dividends left with the company to accumulate at interest, and accrued interest thereon.
2. Dividends or other profits due policyholders, including those contingent on payment of outstanding and deferred premiums.
3. Dividends declared on or apportioned to annual dividend policies payable to policyholders.
4. Policy claims.

COURT OF CLAIMS OF THE UNITED STATES. No. J–119.

Massachusetts Mutual Life Insurance Co. v. *The United States.*

[March 7, 1932.]

OPINION.

LITTLETON, Judge, delivered the opinion of the court.

The Commissioner of Internal Revenue refused to allow the additional reserves claimed by plaintiff on the ground that they were not reserves required by law within the meaning of section 245(a)2 of the Revenue Act of 1921 and article 681 of Regulations 62. The pertinent provisions of the Revenue Act of 1921 (42 Stat., 227, 261) are as follows:

"SEC. 243. That in lieu of the taxes imposed by sections 230 and 1000 and by Title III, there shall be levied, collected, and paid for the calendar year 1921 and for each taxable year thereafter upon the net income of every life insurance company a tax as follows:

"(1) In the case of a domestic life insurance company, the same percentage of its net income as is imposed upon other corporations by section 230.

"SEC. 244. (a) That in the case of a life insurance company the term 'gross income' means the gross amount of income received during the taxable year from interest, dividends, and rents.

"SEC. 245. (a) That in the case of a life insurance company the term 'net income' means the gross income less—

* * * * * * *

"(2) An amount equal to the excess, if any, over the deduction specified in paragraph (1) of this subdivision, of 4 per centum of the mean of the reserve

funds required by law and held at the beginning and end of the taxable year. * * *.

* * * * * * *

"(8) All interest paid or accrued within the taxable year on its indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from taxation under this title."

Plaintiff is a mutual life insurance company organized under the laws of the Commonwealth of Massachusetts, and transacted its business on the level-premium plan. It complied with the insurance laws of Massachusetts and Connecticut. The laws in the Commonwealth of Massachusetts contained the same provisions, in effect, as the laws of Connecticut, but in more general terms. The reserves maintained by plaintiff, in compliance with the laws of the strictest State inured to the benefit of policyholders in the State and every other State in which it did business. Under the level-premium plan the insured pays during his early years a sum in excess of the cost of his insurance. The excess is devoted to the creation of a reserve fund which enables the insurance to be maintained in later years when the stipulated level premium would be insufficient to meet the current costs of insurance on the mutual-premium plan.

The table rate of premiums provided for in life insurance on the mutual level-premium plan is calculated, first, by adopting an accepted table of mortality showing the death rate for every age of life, and second, by adopting an assumed rate of interest, such as the company may safely expect to realize upon the investment of the amounts of such premiums for the duration of all of its policies. With these two factors, a calculation is made of the sum each insured must pay in advance so as to put the company in funds with which to pay all outstanding policies as they become claims, providing deaths occur exactly in accordance with the table of mortality, and also providing the rate of interest earned on the company's invested funds is exactly the same as the rate assumed in calculating its premiums. The sum ascertained in this way is called the net or mathematical premium.

The calculation of the reserve is thus an actuarial function, and being the amount theoretically necessary for reinsuring the risks, is sometimes called the reinsurance fund or reinsurance reserve. As applied to a policy, the term means value or valuation, but that part of the assets of the company which, according to a specified table of mortality, with interest at the assumed rate, must be set apart to meet or mature the company's obligation to the insured on his death or upon the surrender or cancellation of his policy.

Under the laws of the State of Connecticut (ch. 213, sections 4110, 4111, and 4112 of the Laws of the State of Connecticut, Revision of 1918, and ch. 76, 1919. Laws of the State of Connecticut) this reinsurance reserve is the minimum standard valuation for contracts issued before January 1, 1921, based upon the actuaries' or combined experience table of mortality, with interest at 4 per cent per annum, and on policies issued after that date based upon the American experience table of mortality, with interest at 3½ per cent per annum. As thus calculated, this reinsurance reserve is, we think the reserve which has a technical and special meaning in the law of insurance and is the reserve required by law within the meaning of the Federal statutes in so far as the question here involved is concerned. None of the reserves here claimed is calculated upon the basis above set forth, and possess none of the characteristics of the legal reserve required by law, as above described. (*McCoach* v. *Insurance Co. of North America*, 244 U. S., 585; *Maryland Casualty Co.* v. *United States*, 251 U. S., 342; *United States* v. *Boston Insurance Co.*, 269 U. S., 197 [T. D. 3792, C. B. V–1, 300]; *New York Life Insurance Co.* v. *Edwards*, 271 U. S., 109 [T. D. 3872, C. B. V–1, 305]; and *Minnesota Mutual Life Insurance Co.* v. *United States*, 66 C. Cls., 481; cert. denied 279 U. S., 856.)

It may be conceded that the reserves here in question are required to be maintained by plaintiff under the laws of the Commonwealth of Massachusetts and the State of Connecticut as a condition to the continued transaction by plaintiff of its business as a life insurance company. But all reserves required by State statutes or State officials are not reserves required by law within the meaning of the Federal statutes and only those may be considered reserves required by law which aid in determining what portion of the gross income constitutes the net income of a life insurance company for the purpose of the Federal statutes. (*McCoach* v. *Insurance Co. of North America*, supra; *United*

States v. *Boston Insurance Co.*, supra; and *Minnesota Mutual Life Insurance Co.* v. *United States*, supra.)

The plaintiff argues that the cases above cited are not in point, since they arose under the Revenue Acts prior to 1921, and the Revenue Act of 1921 changed the method of taxing life insurance companies. We are of opinion, however, that the legal reserve required by law within the meaning of the Federal statute was not changed by the Revenue Act of 1921. Under all of the Revenue Acts prior to that of 1921, beginning with the Corporation Excise Tax Act of August 5, 1909, a special excise tax measured by net income was imposed upon life insurance companies by the United States, although, under the various Acts, the items to be included in gross income and the items subject to deductions have varied. Until the enactment of the Revenue Act of 1921, however, the gross income of such companies included their premium receipts.[1]

Under all of these Acts such companies were permitted to deduct the amounts paid on policies, except as dividends, and the amount required by law to be added to their legal reserve, i. e., the net additions to the legal reserve required by law.

The inclusion of premium receipts with the deductions specified gave rise to much litigation, and was generally unsatisfactory.[2] In the Revenue Act of 1921, Congress adopted a new basis of computing the net taxable income of such companies and therein provided that the gross income of such companies should consist of investment income, that is, income from interest, dividends, and rents, and, in order to ascertain the net taxable income, provided for nine classes of deductions, one of which is the deduction permitted by section 245(a)2 here under consideration.

In the report of the Committee on Ways and Means, revenue bill of 1921, No. 350, page 14, Sixty-seventh Congress, first session, it was said:

"The provisions of the present law applicable to life insurance companies are imperfect and productive of constant litigation. Moreover, the taxes paid by life insurance companies under the income tax are inadequate. It is accordingly proposed in lieu of all other taxes to tax life insurance companies on the basis of their investment income from interest, dividends, and rents, with suitable deduction for expenses fairly chargeable against such investment income. * * *"

The Act made a material change in the basis of computing the net income of life insurance companies. Since underwriting income, that is, premium receipts were not to be included in gross income under the Revenue Act of 1921, the deduction of the mortality content in the net or mathematical premium could no longer be permitted, the deduction of the net addition to the reserves required by law was therefore eliminated. There still remained, however, the interest content in the net or mathematical premium, since a portion of the interest, dividends, and rents received by a life insurance company must be used each year in maintaining the legal reserve; that is, adding to it on the basis of a certain interest rate varying from 3 to 4 per cent, according to the requirements of the statutes of the several States. Since gross income includes all interest, dividends, and rent received, it was proper to permit a deduction of that portion of the same included in the gross income which was required to mature the policy of a life risk. Congress thereupon provided for the deduction of 4 per centum of the mean of the reserve, the highest per cent required to be credited thereto by any of the State laws, and based the deduction upon the mean of the reserve held at the beginning and end of the taxable year. The deduction permitted by section 245(a)2 was therefore consistent with the deduction permitted by prior Revenue Acts, namely, the net addition to reserves required by law.

Congress has not, in any of the Revenue Acts, defined the meaning of the term "reserve required by law." It had, however, knowledge of the meaning of that term as defined by the courts when it enacted the Revenue Act of 1921, and had it intended to change the meaning of the term it would have done so in the 1921 and later Acts. Section 245(a)2 of the 1921 Act was reenacted by the Revenue Act of 1924 (43 Stat., 253, 289); the Revenue Act of 1926

[1] Act of August 5, 1909 (36 Stat., 11, 112); Act of October 3, 1913 (38 Stat., 114, 172, 173); Act of September 8, 1916 (39 Stat., 756, 765–768); Act of February 24, 1919 (40 Stat., 1057, 1075–1079).

[2] Hearings before the Committee on Ways and Means, H. R., Part I, Sixty-fifth Congress, second session; Senate Report No. 617, page 9, Sixty-fifth Congress, third session. Proceedings of the fourteenth annual meeting of life insurance presidents, December, 1920, pages 140–145.

(44 Stat., 9, 47); and by section 203 of the Revenue Act of 1928 (45 Stat., 791, 843). By this action it would seem that Congress accepted the definition of that term as established by repeated court decisions. (*Midland Lead Co.* v. *United States*, 252 U. S., 140.)

In *Old Line Insurance Co.* (13 B. T. A., 758) the United States Board of Tax Appeals held that a contingency reserve for anticipated excessive mortality losses and possible losses in reserve invested, which was maintained by petitioner in addition to a reserve of the net value of the oustanding policies, is not a reserve required by law within the meaning of section 245(a)2 of the Revenue Act of 1921. And in *Standard Life Insurance Co. of America* (13 B. T. A.. 13) the Board held, in considering the Revenue Acts of 1921 and 1924, that the term "reserve funds" has the same meaning under all Acts. In *Midland Mutual Life Insurance Co.* (19 B. T. A., 765) the Board held that reserves maintained by a mutual life insurance company for 1922 and subsequent years on account of dividends declared upon participating policies and left with the company to accumulate are not reserve funds required by law within the meaning of the Revenue Acts.

From the foregoing, we are of opinion that the technical insurance reserve of a life insurance company, under the 1921 and subsequent Acts, is the same reserve as that under the 1918 and prior Revenue Acts. The items claimed by plaintiff as a part of its reserve funds required by law represented claims that had accrued under plaintiff's policy contracts on account of the very contingencies insured against. They constituted pure liabilities and, as stated by this court in *Minnesota Mutual Life Insurance Co.* v. *United States*, supra, "the statutory requirement as to a reserve against the liability is, it seems to us, no more than a wholesome provision that the stated annual financial condition of the company in this respect shall be maintained."

We think the Commissioner properly rejected the claim for refund. The petition must be dismissed, and it is so ordered.

PART IV.—ADMINISTRATIVE PROVISIONS.

SECTION 250.—PAYMENT OF TAXES.

ARTICLE 1011: Compromise of tax cases. XI–25–5523
Ct. D. 504

FEDERAL TAXES—COMPROMISE—DECISION OF COURT.

1. SUIT—COMPROMISE—ESTOPPEL.

An executed agreement in writing entered into, pursuant to section 3229 of the Revised Statutes, by the authorized representatives of a taxpayer and the authorized officers of the United States to compromise and settle all matters affecting the tax liability of the taxpayer before the Board of Tax Appeals for the years involved in the taxpayer's petitions to the Board precludes a recovery of any part of the amount paid in accordance with the terms of the compromise. The binding effect of the agreement is not destroyed by the failure to file the opinion of the Solicitor of Internal Revenue with a statement as provided in that section.

2. SAME.

Where a taxpayer receives and retains the benefits flowing to it from a compromise of its tax liability, the taxpayer, after the statutory period for the collection of the tax has expired, is estopped from repudiating such part thereof as it contends to have been less favorable to it than the facts or the law warranted.

3. SAME—CONSENT DECREE.

Where a petition filed with the Board of Tax Appeals is pending without a hearing thereon at the date of the approval of the Revenue Act of 1926 a consent decree thereafter entered by the Board fixing and determining the petitioner's tax liability is a bar to a suit to recover any part of the amount paid pursuant to the decree.

COURT OF CLAIMS OF THE UNITED STATES. No. J-204.

E. W. Backus, E. W. Decker, and Charles Fowler, Receivers of the Minnesota & Ontario Paper Co., v. *The United States.*

[May 31, 1932.]

Plaintiff instituted this suit April 18, 1928, to recover income, war-profits, and excess-profits taxes and penalties for the calendar years 1917 to 1920, inclusive, aggregating $2,489,119.50, with interest thereon from the date of payment, March 22, 1926. It is alleged that the amount sued for was wrongfully and illegally collected and was paid involuntarily and under duress.

The aggregate amount of the tax and penalty claimed in this suit was paid voluntarily and without question pursuant to a consent decree for the amount entered by the United States Board of Tax Appeals of March 6, 1926, and pursuant to an agreement reached by the plaintiff, its representatives, and counsel, and the United States by its proper officers after negotiations and conferences extending over a period of two months.

The defendant by special answer and plea to jurisdiction contends that the plaintiff finally and conclusively settled and disposed of all questions affecting its tax liability and that of its affiliated corporations for the years 1917 to 1920, inclusive, by an executed settlement and compromise agreement which the Commissioner of Internal Revenue was authorized by section 3229 of the Revised Statutes to make, and that by reason of plaintiff's previous action in relation to the settlement, the compromise agreement, and the consent decree of the United States Board of Tax Appeals, the payment of the amount adjudicated by the Board of Tax Appeals and the prejudicial effect upon the defendant resulting therefrom, the plaintiff is estopped from maintaining this action to recover the full amount in question or any portion thereof.

OPINION.

LITTLETON, Judge, delivered the opinion of the court.

Plaintiff sues to recover $2,489,119.50, income and profits tax and penalties adjudicated by the Board of Tax Appeals for 1917 to 1920, inclusive, in consent judgments entered pursuant to a settlement agreement with reference to all matters affecting the tax liability of plaintiff and its affiliated corporations, petitioners before the Board, for these years, and stipulations duly executed by the authorized officers of the United States and the duly authorized representatives of the plaintiff and its affiliated corporations and filed with the Board.

The defendant has filed a special answer to the petition and a plea to jurisdiction asking a dismissal of the petition on the ground that the matters upon which the suit is predicated were compromised and settled by a fully executed agreement and that the plaintiff is estopped from maintaining a suit with reference thereto. The plea of the defendant states that more than two years prior to the presentation of its claim by the petition filed herein, the plaintiff "had finally and conclusively settled and disposed of the same by an executed contract as provided in Revised Statutes, section 3229, and/or that by reason of its previous action in relation thereto and the now resultant prejudicial effect therefrom upon the defendant the plaintiff is estopped from maintaining this action."

Present counsel for the plaintiff deny that the tax liability for the years 1917 to 1920, inclusive, was compromised and settled in the various conferences held between January and March, 1926, and the agreements and stipulations executed pursuant thereto and filed with the Board of Tax Appeals, and deny that plaintiff is estopped by reason of such agreements and stipulations from maintaining this action. It is insisted on behalf of the plaintiff that the settlement agreements and stipulations entered into between the taxpayers, petitioners before the Board of Tax Appeals, and the Treasury officials of the United States were confined solely to the items specifically placed in issue before the Board, and that plaintiff, having filed claims for refund within four years after the payment of taxes and penalties adjudicated by the Board, is entitled to maintain this suit. Plaintiff further insists that the settlement agreements and stipulations are not effective as a compromise under section 3229. Revised Statutes, for reason that the record herein does not show that an opinion of the Solicitor of Internal Revenue was placed on file in the office of the Commissioner as required by section 3229.

Upon the facts in this case we are of opinion that all matters affecting the tax liability of the plaintiff and its affiliated corporations for the taxable years 1917 to 1920, inclusive, were finally and conclusively settled by the agreements and stipulations executed and filed with the Board of Tax Appeals and by the consent judgments entered by the Board. The facts have been fully stated in the findings and need not be here repeated in detail. The compromise and settlement agreement and the stipulations with which we are here concerned were agreed upon and executed after the Commissioner of Internal Revenue had made his final determinations with reference to the tax liabilities for the years involved and after proceedings with reference thereto had been instituted before the Board of Tax Appeals. The case should not therefore be considered as the usual case of an audit of returns in the Bureau of Internal Revenue. The audits in these cases had been finally made and the Commissioner had mailed to plaintiff and its affiliated corporations notices of his final determinations. The corporations instituted proceedings before the Board of Tax Appeals. After the Board had definitely placed the cases upon its calendar for trial, the plaintiff and its affiliated corporations, petitioners before the Board, requested the Commissioner of Internal Revenue and his counsel to agree to a continuance of the trial of the cases and to enter into negotiations with the duly authorized representatives of the taxpayers, with reference to the various questions in the case with a view to arriving at a settlement of the whole case. The board of directors of the plaintiff and its affiliated corporations had duly adopted resolutions requesting Mr. E. W. Decker, president of the Northwestern National Bank, of Minneapolis, Minn., who was well known to all of the corporations and their officers, to accept the responsibility of settling the case, involving the tax liabilities of the corporations for the years 1917 to 1920, inclusive, with the Government. On December 24, 1925, the board of directors of the Minnesota & Ontario Paper Co., the principal and parent corporation, and the plaintiff herein, adopted a resolution "That E. W. Decker (president of the Northwestern National Bank, Minneapolis) be, and he hereby is, authorized and empowered to agree and stipulate on behalf of this company and its affiliated or subsidiary companies with the Commissioner of Internal Revenue or any other representative of the United States Government, in the controversies now pending before the Board of Tax Appeals with respect to any facts therein or to compromise and settle such controversies or any part thereof, any agreement as to facts or compromise of such controversies being hereby ratified and confirmed."

After said preliminary agreements the Commissioner of Internal Revenue and other officials of the Treasury Department agreed to enter upon a consideration and discussion of the matter of the tax liabilities of the plaintiff and its affiliated corporations for the years involved then pending before the Board of Tax Appeals with a view to a final settlement of the cases. At the outset of the negotiations it was made clear to all that unless an agreement could be reached upon all matters and items about which there was any controversy, it would be necessary to proceed with the trial of the case before the Board of Tax Appeals. It was with this understanding that the Commissioner of Internal Revenue and the duly authorized representatives of the plaintiff and its affiliated corporations entered into negotiations. More than 300 separate items affecting the tax liabilities for the years involved were in question, many of which were specifically in issue before the Board of Tax Appeals while others were not, particularly the matter of penalties against the plaintiff and its affiliated corporations for negligent understatements of their tax in the returns filed. Each item about which there was any dispute or as to which any question arose during the conferences between the Commissioner and the taxpayers was taken up and considered separately and finally agreed upon. The final result arrived at was a compromise settlement of the entire case in each instance.

During the course of the conferences for a settlement of all matters about which there was any dispute, the Commissioner frequently discussed the questions under consideration with the Secretary of the Treasury. February 26, 1926, a stipulation embodying the results of the agreement was reached for all of the years involved which was reduced to writing and signed by the parties. The Commissioner took up in person the terms of the compromise settlement of the case with the Secretary of the Treasury, who verbally approved the same.

In our opinion the resolution under which the representative of the plaintiff and its affiliated corporations acted fully authorized him finally to compromise

and settle the entire case and it was with this intent and purpose that the resolution was adopted, the negotiations entered upon and the agreements and the stipulations were entered into. The facts establish that it was the understanding and purpose of the officials of the Treasury Department finally to compromise and settle all matters affecting the tax liability of the petitioners before the Board of Tax Appeals for the years involved. The facts further establish that this was also the understanding of the representatives of the taxpayers. All matters and questions touching the tax and penalty liabilities for the years involved were removed from further dispute by a fully executed contract, compromise, and settlement, and by consent judgments entered by the Board of Tax Appeals. The compromise and settlement agreement, together with the judgments of the Board, became effective as a bar to a subsequent suit. (*Zemurray* v. *United States*, 64 C. Cls., 657; *DuPuy* v. *United States*, 67 C. Cls., 348; 68 C. Cls., 574 [Ct. D. 99, C. B. VIII–2, 337].)

The binding effect of the compromise and settlement agreement is not destroyed by the failure of the record to contain the opinion of the Solicitor of Internal Revenue with a statement of the amount of additional tax and penalty imposed by law and the amount paid in accordance with the terms of the compromise. This provision in section 3229, Revised Statutes, provides for the filing of such an opinion after the compromise has become complete. It is addressed alone to the officer and is directory, and a failure to comply therewith would not affect the compromise itself or its validity. (*Henderson* v. *United States*, 4 C. Cls., 75; *Clark* v. *United States*, 95 U. S., 539; 25 R. C. L., 767; Lewis' Sutherland on Statutory Construction (2d ed.), section 611; *McIlhenny et al.* v. *Commissioner of Internal Revenue*, 13 B. T. A., 288; 39 Fed. (2d), 356.)

Finally it is contended on behalf of the plaintiff that this case was not finally settled by a closing agreement, as provided by section 1006, Revenue Act of 1924, first enacted in the Revenue Act of 1921, and the case of *Botany Worsted Mills* v. *United States* (278 U. S., 282 [Ct. D. 39, C. B. VIII–1, 279]), is cited.

The provisions of section 1006 of the 1924 Act and section 1106(b) of the 1926 Act, have no effect upon the question here involved. Those provisions were not designed to confer authority to compromise already existing, but made possible the accomplishment of that which was not authorized by the compromise section of the Revised Statutes and, therefore, covered a different field. A compromise may enter into or be a part of a closing agreement, but that has no bearing upon the main purpose of the new enactment which was not to repeal section 3229 but to provide a means whereby tax liabilities may be determined and finally settled in the Bureau of Internal Revenue prior to the running of the statute of limitation for filing a claim, making assessments and bringing suits. There is no warrant for the assumption that section 3229 of the Revised Statutes was repealed by implication. An affirmative Act which gives a new right does not destroy an existing statutory right, unless the intention be apparent that the two rights should not coexist; and where two Acts are merely affirmative, and the substance such that both may stand together, the latter does not repeal the earlier, but they both have concurrent efficacy.

In our opinion the case of *Botany Worsted Mills* v. *United States*, supra, is not in point here. In that case the court pointed out that an informal agreement, not assented to by the Secretary of the Treasury, made during the course of an audit in the Bureau of Internal Revenue did not constitute a settlement which, in itself, was binding upon the Government or the taxpayer, and stated that "without determining whether such an agreement, though not binding in itself, may when executed become, under some circumstances, binding on the parties by estoppel, it suffices to say that here the findings disclose no adequate ground for any claim of estoppel by the United States."

The plaintiff has received and retained the benefits flowing to it from the compromise and in our opinion is estopped from repudiating such part thereof as it contends to have been less favorable to it than was warranted by the facts or the law. It had an election either to pursue its remedy through the Board of Tax Appeals and the courts or to compromise and settle its differences with the Government and become a party to a consent decree by the Board. It elected the latter course and received therein, and has ever since retained numerous concessions and benefits. Estoppels of this character are to be distinguished from estoppels by misrepresentation. When the plaintiff and its affiliated corporations and the Commissioner entered upon negotiations to settle all matters affecting the tax liability for the years involved in the proceeding

pending before the Board of Tax Appeals, the Commissioner had finally determined that the additional tax due was $3,661,188.86. In his answer to the petitions before the Board he had made certain affirmative claims for an increase in this amount. In addition to this the petitioners before the Board were liable for negligence penalties which, upon the tax determined and claimed by the United States, amounted to approximately $2,682,000. This item had not been made an issue before the Board. When the parties entered upon their negotiations, therefore, the Commissioner, acting for the United States, was claiming as the result of his final determinations, that the plaintiff and its affiliated corporations owed the United States more than $6,344,000.

In arriving at the compromise and settlement agreement of the tax and penalty liabilities for the years involved to be included by the Board in the consent decree, the parties before the Board made concessions in order to arrive at a final agreement. Each relied upon the good faith of the other to abide by the agreement. Admittedly the United States, after an agreement had been reached as to the amount of taxes to be paid by the taxpayers, conceded more than $811,126 of a valid claim as to the item of penalties. The foregoing constitutes the very foundation of a rule generally applied by the courts that neither party to a compromise agreement or consent decree will be permitted to repudiate it. We think the full force of the rule is applicable here. The Government was ready and desirous of proceeding with the trial of the cases before the Board. It had expended large sums of money in preparing for trial and it was only at the urgent solicitation of the plaintiff and its affiliated corporations that the Government entered into conferences for the purpose of settling the entire case. The United States, by its reliance upon the plaintiff's agreement and its consent to the judgments entered by the Board of Tax Appeals lost its right both prior to the filing of plaintiff's claim for refund and the institution of this action to assert by counterclaim or otherwise any claim for the recovery of any tax or penalty in excess of the amounts agreed upon and adjudicated by the Board of Tax Appeals. The defendant's right in this case would be purely defensive in character. In *Dickerson* v. *Colgrove* (100 U. S., 578) the court said "The vital principle is that he who by his language or conduct leads another to do what he would not otherwise have done, shall not subject such person to loss or injury by disappointing the expectations upon which he acted. Such a change of position is sternly forbidden. * * * There is no rule more necessary to enforce good faith than that which compels a person to abstain from asserting claims which he has induced others to suppose he would not rely on. The rule does not rest on the assumption that he has obtained any personal gain or advantage, but on the fact that he has induced others to act in such a manner that they will be seriously prejudiced if he is allowed to fail in carrying out what he has encouraged them to expect."

In addition to the foregoing we are of opinion that plaintiff and its affiliated corporations are bound by the consent decree entered by the Board of Tax Appeals. The Revenue Act of 1926 is the charter of the powers and duties of the Board of Tax Appeals and the rights and privileges of the taxpayer and the Government in cases instituted before the Board, both before and after the enactment of that Act.

Upon the approval of this Act the jurisdiction of the Board in cases then pending and thereafter instituted included the question whether the tax had been overpaid.

The proceedings instituted by the plaintiff and its affiliated corporations had not been heard at the date of the enactment of the Revenue Act of 1926. The petitioners and the United States were permitted by proper pleadings prior to the hearing of the case to raise any questions they might have with reference to the tax liability for the taxable years involved, or any overpayment that had been made with respect thereto. (*The Peruna Co.*, 11 B. T. A., 1180; *Peerless Woolen Mills*, 13 B. T. A., 1119.) The Revenue Act of 1926 permitted either party to a proceeding before the Board of Tax Appeals dissatisfied with the decision of the Board in a case heard and decided after the enactment of that Act, to petition for review thereof in the appropriate appellate court. In proceedings instituted before the Board prior to the Revenue Act of 1926 which were heard and decided by the Board after the enactment of that Act, the statute, as construed by the court in *Old Colony Trust Co.* v. *Commissioner* (279 U. S., 716 [Ct. D. 80, C. B. VIII–2, 222]), permitted both the filing of a petition for review in the appropriate appellate court and the institution of suit. In our opinion, however, the statute did not and was not intended

to confer any greater right to institute a suit in a trial court than was given to petition for a review of a decision of the Board. It is manifest that the statute did not give either party before the Board of Tax Appeals a right to a review of a compromise or a consent decree by the Board as to which no issue or question remained. The functions of the Board of Tax Appeals are judicial, and since its jurisdictions in the proceedings instituted by the plaintiff and its affiliated corporations included all matters affecting the correct tax and penalty liability of the petitioners for the years involved, the consent decrees entered by the Board in the case of plaintiff and its affiliated corporations definitely and finally concluded the rights of the parties, fixed the tax and penalty liability of the petitioners and they are now estopped to question the decision to which they specifically agreed. In *Commissioner* v. *Liberty Bank & Trust Co.* (C. C. A., Sixth Circuit, decided May 12, 1932, C. C. H., para. 9273, Vol. III, 1932), the court pointed out that "In passing upon matters such as are involved in this case, the Board exercises functions similar to those exercised by a trial court in a law case without a jury. * * * When the taxpayer seeks a review before the Board of a deficiency assessment, the controversy is between the taxpayer and the Government, as represented by the Commissioner, and the Commissioner by designation of Congress continues thereafter as the Government's representative to prosecute its claim from adverse decisions of the Board. * * * It is not charged with the duty of assessing or collecting taxes, but with deciding controversies between the taxpayer and the authorized representative of the Government. * * * And in *Old Colony Trust Co.* v. *Commissioner* (279 U. S., 716), the court stated that "In the case we have here, there are adverse parties. The United States or its authorized official asserts its right to the payment by a taxpayer of a tax due from him to the Government, and the taxpayer is resisting that payment or is seeking to recover what he has already paid as taxes when, by law, they were not properly due. * * *" A consent judgment in a case of this kind is contractual in its nature. It is largely the act of the parties with respect to the matters involved in the action. Such a decree by consent should only be modified or changed by the same concurring agencies that first gave it form, and whatever has been legitimately and in good faith done in carrying out its provisions should remain undisturbed. The parties to the litigation before the Board entered into an agreement compromising their differences with respect to the tax liabilities for the years involved and voluntarily submitted to a final decision by the Board embodying the agreement. It appears that in order to arrive at the agreement, the plaintiff and its affiliated corporations, through their authorized representatives, and the Government, through its duly authorized officers, renounced what they might otherwise have claimed. In these circumstances, one party to the agreement should not be permitted to repudiate it to the disadvantage of the other. This is the case of the compromise of disputed claims, the parties dealing with each other upon terms of perfect equality, holding no relations of trust or confidence to each other, and having knowledge, or having the opportunity to acquire knowledge, of every fact bearing upon the question of the validity of their respective claims. (*Cleveland* v. *Richardson*, 132 U. S., 318, 319.) "Such a settlement ought not to be overthrown, even if the court should now be of opinion that the party complaining of it surrendered rights that the law, if appealed to, would have sustained." (*Hennessy* v. *Bacon*, 137 U. S., 78.) "The policy of the law has always been to promote and sustain the compromise and settlement of disputed claims. It loves peace, hates broils and dissensions, and discourages the prolongation of litigation and the revival of controversies which have once been closed." (*Chicago & N. W. Ry. Co.* v. *Wilcox*, 116 Fed., 913.)

Counsel for plaintiff has filed a motion to remand this case to the rules generally for proof on all issues of fact raised by the petition and for further proof on defendant's plea in bar. The allegations set forth in the motion contain nothing which, in our opinion, would change our conclusion on the defendant's plea. The motion is therefore denied.

The petition is dismissed. It is so ordered.

WHALEY, Judge; WILLIAMS, Judge; GREEN, Judge; and BOOTH, Chief Justice, concur.

ARTICLE 1012: Assessment of tax. XI-14-5433
Ct. D. 464

FEDERAL TAXES—LIABILITY ON BOND—DECISION OF COURT.

SUIT—BOND—ABATEMENT OF TAX—FINDING OF BOARD OF TAX APPEALS.

Where a bond is executed, to stay the collection, pending disposition of a claim for its abatement, of an additional assessment, conditioned for the payment of "so much of the amount of the claim as is not abated," the finding by the Board of Tax Appeals on a petition for redetermination of the deficiency filed after the Commissioner had rejected the claim for abatement that "there is no deficiency because the statutes of limitation have run against the collection" does not abate the additional assessment within the meaning of the bond, and in a suit upon the bond does not affect the liability of the principal or surety.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT.

Gulf States Steel Co. and National Surety Co., appellants, v. *United States of America, appellee.*

Appeal from the District Court of the United States for the Northern District of Alabama.

[February 19, 1932.]

OPINION.

HUTCHESON, Circuit Judge: This is an appeal from a verdict and judgment that appellants had breached the conditions of and were liable on a bond executed September 9, 1925, to stay the collection, pending disposition of a claim for its abatement, of an additional assessment made by the Commissioner in April, 1921, for the year 1917. This bond, conditioned "that the principal or surety, or both, shall pay to the collector so much of the amount of the claim as is not abated, together with penalties and interest thereon, as provided by law," recited the assessment of the additional tax, the filing of claim for abatement, the prior execution of a bond by the Gulf States Steel Co. securing the payment "of so much of the additional assessment, penalties and interest as is not abated," and the deposit of Liberty loan bonds as security.

The appeal presents the single question whether the finding by the Board of Tax Appeals on a petition for redetermination of deficiency filed after the Commissioner had rejected the taxpayer's claim for abatement, that "there is no deficiency for the year 1917, because the statutes of limitation have run against the collection," abated the additional assessment within the meaning of the bond.

The district judge concluded that it did not. He was of the opinion that the finding of the Board had the effect not at all of abating any part of the tax, but of formally declaring that, because barred, it was not collectible. He was of the opinion that the finding of the Board that limitation had run added nothing to the fact that it had, and that the case was ruled by *United States* v. *John Barth Co.* (279 U. S. 370 [Ct. D. 65, C. B. VIII-1, 189]). We are of the same opinion. That case held "The making of the bond gives the United States a cause of action separate and distinct from an action to collect taxes which it already had. * * * The postponement of the collection of the taxes returned was a waiver of the statutory limitation of five years that would have applied had the voluntary return of the taxpayer stood, and no bond been given" (page 375), and that "the object of the bond was not only to prevent the immediate collection of the tax but also to prevent the running of time against the Government. The taxpayer has obtained his object by the use of the bond, and he should not object to making good the contract by which he obtained the delay he sought." (Page 376.)

Appellants insist that by the different conditions in the bonds there is a great gulf fixed betweeen this and the Barth case. That in the Barth case the agreement, which was to pay "any part of such tax found by the Commissioner to be due," was breached because the Commissioner did find an amount due, and there was no recourse from his finding; that the agreement in this case is to

pay "so much of the amount of the claim as is not abated" and that it was all abated. We think the language of the two bonds is, in legal effect, the same; the only difference is that one speaks affirmatively, the other negatively. The Barth bond was in words an agreement to pay what was found to be due. The bond here was in effect the same, for it was an agreement to pay all but what was found not due. In the Barth case a part only of the tax was found to be due; here it all was.

The Commissioner considered and rejected all claims set up against the assessment. Finding it to have been duly made, he was without power to, and he did not, abate any of it. The Board, under the jurisdiction which is the only one it has under the statutes to redetermine deficiencies asserted by the Commissioner (*Appeal of Morefield*, 4 B. T. A., 394), was at first petitioned to review the findings of the Commissioner and to determine that the assessment had not, in whole or in part, been duly laid. If it had done so, that determination would have, to the extent the assessment was found invalid, have resulted in an abatement of the tax. It did not, however, do this; instead it confined its attention to and based its finding of no deficiency on the point raised in the amended petition filed March 4, 1927, that "the payment of the alleged deficiency had been extinguished by the running of the statutes of limitation, and that collection of such deficiency was barred." This is not a finding that the tax or any part of it should be abated. It does not abate any part of it. It is but a formal judgment that the tax, as tax, is, because the bar of limitation has fallen, not collectible. Since it is this and no more, it has the effect upon the suit on the bond here and no more, that the fact found in the Barth case and the legal conclusion there announced, that time had run against the tax and that it was therefore uncollectible, had on the suit on the bond there.

A brief statement of the facts of this case which are undisputed, and as brief a consideration of the meaning of "abated" used in the bond, will, we think, suffice to show the correctness of these conclusions.

The Gulf States Steel Co., hereafter called "the company," made its return of assessment for 1917 on March 22, 1918. In April, 1921, the Commissioner made the additional assessment of $153,815.30 which furnishes the spring of the controversy here. On May 6, 1921, the company on Form 47, revised April, 1918, filed claim for abatement taxes erroneously and illegally assessed. This claim demanded the abatement of the additional assessment on the ground "that said additional assessment is unwarranted and illegal" in the respects that it incorrectly computed invested capital, allowed a deduction of only 7 per cent instead of 8 per cent, and disallowed as invested capital, certain interest paid. On March 13, nine days before the five years after the return was made had run, upon demand of the tax collector for payment, the company and the American Surety Co. executed a bond in favor of the collector in the sum of $175,350 conditioned that the contractors "will indemnify the collector against all loss, costs, damage and expense to which he may be put by reason of having allowed the Gulf States Steel Co. to withhold the payment to him of the sum of $153,815.30 claimed due by it under the War Revenue Act of 1917 pending the filing of additional facts and information in support of claim for abatement of said amount heretofore filed by it." On April 23, 1925, the company executed an agreement which after reciting that it and the American Surety Co. had executed the bond above in support "of a claim for abatement of assessment, penalties and interest" and that it was desirous of relieving the above-bound surety and further securing the payment of any amount due, pledged with the collector $200,000 of Liberty bonds, and obligated the undersigned "to pay to the collector such amount of the claim as is not abated, together with all costs, damages, penalties and interest." On September 9, 1925, appellants executed the bond sued on here, which after reciting the assessment of the additional income tax for the year 1917, that a claim for the abatement of the additional tax was filed with the collector, the execution of the bond of April 3, 1925, and the deposit in lieu of surety of Liberty bonds, obligated the collector to release and surrender the Liberty bonds to the company, and the appellants to "pay to the collector so much of the amount of the claim as is not abated, together with penalties and interest thereon."

On May 12, 1926, the claim for abatement was rejected by the Commissioner. The company, notified that it had 60 days within which to file a petition with the Board of Tax Appeals for a redetermination of the deficiency assessment, filed its petition attacking the assessment as not duly laid. In July, 1928, the Board disposed of the matter on the plea of limitation set up in the amended petition. It found that "the collection of the deficiency, if any, in income and

excess profits taxes for the year 1917 is barred by the statutes of limitation, and there is no deficiency for that year."

Appellants, taking their definition of "abate" from Webster, "7 Law. (a) To bring entirely down or demolish; to put an end to; to do away with, as to abate a nuisance; to abate an action. (b) To nullify; to make void" declare that that is what has occurred here. The Board has demolished and done away with the tax, therefore it has abated it.

We think appellants' erroneous view of this case springs from the error into which they have fallen here, of giving to the word "abate" the meaning generally attached to it in legal proceedings of a *quashal*, a meaning which in its context and as applied to the subject matter dealt with here, it does not have. Carrying always the general meaning of "To reduce; lessen, diminish" the word "abate" has many shades of meaning, both in general usage and in law. It is a technical word applicable to and used in many relations, and like all such words, it takes its color and content from the context of the subject matter with which it deals. (Webster's International Dictionary; Bouvier Rawles 3d Revision, Volume 1.) As applied to taxation, the subject with which this bond is precisely concerned, it has and has long had, a clear and definite meaning.

"An abatement supposes the assessment not duly made. If the tax be wholly abated, it is as if no assessment had been made, and if the tax be partially abated, and the residue paid, then all that has been duly assessed has been paid (*Billerica* v. *Chelmsford*, 10 Mass., 296).

"It presupposes some error or mistake in the assessment, and is to be made on application of the party aggrieved who has been assessed beyond his due proportion. * * * It is an authority to the assessor to amend an erroneous assessment, and when such assessment is made, it is the diminished and collectible tax, and not the erroneous one, which the law considers to be the tax duly assessed." (19 Pickering, 390.)

This is the nature and position of proceedings in abatement of internal revenue taxes. They assume, indeed the forms used declare, that the taxes claimed have been illegally and erroneously assessed. They seek in advance of compulsory payment to have this determined and the assessment amended. They seek, they expect, no relief, except that which flows from a finding that the assessment has in whole or in part, not been duly made. They are not appropriate to, they do not present, matters of defense to the collection of the tax. They have no force in themselves to defend or stay it. They do go, however, to the very root of the assessment, denying that it has been duly made, and seeking its amendment. The filing of such claims though diminishing under Revenue Acts of 1921 and 1924, and practically nonexistent under those of 1926 and 1928, has long been a familiar practice in connection with the collection of income taxes. (Montgomery on Income Tax Procedure, page 268 et seq.; Holmes, Federal Taxes, 6 Ed., sections 806–816–817, 907, and 908.) It has had no function, no effect, except to stay collection while the correctness of the assessment is being reexamined, in order to save the Government and taxpayer alike from the nuisance of having to pay a tax, erroneously assessed, only to recover it back again by suit. In jeopardy cases and in many others where abatement claims like the one in question here have been filed, bonds have been given. (Holmes, Federal Taxes, 6 Ed., section 801.) Neither the filing of the claim nor the giving of the bond prevents time from running against the collection of the tax as such, nor do they preserve any remedy which but for the bar might be available to collect the tax. (*Bowers* v. *N. Y. & Albany Lighterage Co.*, 273 U. S., 346 [T. D. 4009, C. B. VI–1, 268]; *Russell* v. *U. S.*, 278 U. S., 181 [T. D. 4260, C. B. VIII–1, 206].) The pendency of such claim did not prevent the collector from proceeding with the collection of the tax, or the taxpayer from paying the tax and thereafter in a suit for its return, raising the question not only as to the amount of tax due, but as to the bar of time. (*Graham* v. *Dupont*, 262 U. S., 257.) The giving of the bond, however, did create a new right in the Government upon which, wholly apart from the tax, it may sue. (*U. S.* v. *John Barth Co.*, supra.) It is upon this contract right, and not for the tax, that the Government now sues.

The record shows not only no finding that the assessment referred to in the bond was illegal or erroneously laid, but an affirmative finding by the Commissioner not reversed by the Board, that it was not. Defendants are liable on their bond.

The judgment is affirmed.

ARTICLE 1012: Assessment of tax.

REVENUE ACT OF 1921 AND PRIOR ACTS.

Waiver effective to extend the statutory period for collection of tax assessed before filing of waiver. (See Ct. D. 469, page 187.)

ARTICLE 1012: Assessment of tax. XI-16-5452
Ct. D. 471

INCOME TAX—REVENUE ACTS OF 1921 AND 1926—DECISION OF COURT.

1. WAIVER—VALIDITY.

The secretary-treasurer of a corporation, its manager in large part generally, and of its fiscal affairs completely, who makes, without specific authority, a tax return for the corporation, has the authority to execute a consent in writing for the corporation of the statutory period for assessment of the tax, and such consent executed by him which bears the seal of the corporation and is received and acted upon by the Commissioner is valid and effective to toll the statute.

2. REMANDING CASE TO BOARD OF TAX APPEALS.

Where a taxpayer petitions for a review by the Circuit Court of Appeals of a decision of the Board of Tax Appeals and while the case is pending in that court the Supreme Court in another case decided, contrary to the decision of the Board, that a reasonable amount of additional compensation paid in one year for services performed in previous years, the legal obligation to pay for which is not incurred until the year of payment, is deductible in the latter year, the Circuit Court of Appeals should reverse and remand the cause to the Board for rehearing and finding of fact as to the reasonableness of the salaries paid as bearing on the correctness of the deduction where the Board did not find affirmatively that the salaries were reasonable or unreasonable and made no finding of fact as to the character of the personal services actually rendered for which the salaries were paid.

3. DECISION REVERSED AND REMANDED.

The decision of the Board of Tax Appeals (15 B. T. A., 52) is reversed and remanded.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT.

Independent Ice & Cold Storage Co., petitioner, v. *Commissioner of Internal Revenue, respondent.*

Petition for review of decision of the United States Board of Tax Appeals (District of Louisiana).

Before BRYAN, SIBLEY, and HUTCHESON, Circuit Judges.

[May 27, 1931.]

OPINION.

HUTCHESON, Circuit Judge: From the determination of the Commissioner that there was a deficiency in the sum of $7,067.52 in respect of petitioner's tax for the year 1921, petitioner took its appeal to the Board of Tax Appeals, contending (1) that the assessment and collection of the tax for the year in question was barred by the statute of limitation, because though a purported waiver of the statute had been signed by its secretary and treasurer for the corporation, it was unauthorized by and not binding upon it, and (2) that the respondent had erred in disallowing as excessive salaries paid to the corporate executives for that, as petitioner contends, they were reasonable salaries, and paid for services actually rendered.

The Board considered and directly overruled the first contention, finding that Farley, the secretary-treasurer, was one of the two active executive officers of the corporation from 1912 to 1925, inclusive, and was in charge of the office during the times when the president, who interested in many other businesses did not devote his entire time to petitioner, was absent. That the waiver which operated to extend the time was signed as the act and deed of the corporation, bore its corporate seal, and was duly accepted by the Commissioner. That it was effective to extend the time for making the assessment, and to prevent the statute of limitation from running.

Upon the second point the Board did not find affirmatively that the salaries were reasonable or unreasonable, and made no findings of fact as to the character of the personal services actually rendered for which the salaries were paid. In its opinion it said "the president of the corporation unqualifiedly stated that these amounts were designed to compensate the officers for services performed prior to the taxable year. The petitioner's books were kept and its income tax return was made on the basis of accruals, and under the scheme of the taxing statute each taxable year stands by itself. A corporation may not deduct from its profits of one year the expenses that logically belong to a prior year." Upon this view alone the disallowance as deductions of salaries paid in 1921 for prior years services was sustained.

Petitioner seeks a review here of the finding and order of the Board, assigning under four assignments, two errors. Assignments 1, 2 and 3 challenge the action of the Board in holding the waiver valid. Assignment No. 4 is—

"The Board erred in deciding that petitioner was not entitled to take a deduction of $13,800 for 1921 representing additional compensation authorized and paid by the petitioner to its president and directors in 1921 for services rendered prior to 1921."

The original record was filed in this court on July 15, 1929; on November 19 of the same year, upon joint motion of counsel, reciting:

"In support of said motion the petitioner and respondent respectfully represent to this honorable court that the issue raised in the instant case in assignment of error No. 4 is identical with the issues involved in said cause of *Lucas* v. *Ox Fibre Brush Co.* [Ct. D. 265, C. B. IX–2, 384] in which case the Supreme Court of the United States granted a writ of certiorari on October 1, 1929, and which case is now pending before said court"—

this court entered its order continuing the hearing in the cause. The Supreme Court, in the Ox Fibre Brush Co. case (281 U. S., 115), having decided contrary to the position taken here by the Board, that "salaries paid in one year to compensate for services rendered in prior years constitute an allowable deduction in the year in which their payment became a binding obligation or were paid" petitioner now insists that it should have judgment here in its favor. Respondent, conceding that it can not stand upon the Board's opinion, insists that it can stand upon the finding of the Commissioner not reversed by the Board that the salaries are excessive and unreasonable. Citing *Wickwire* v. *Reinecke* (275 U. S., 101 [T. D. 4126, C. B. VII–1, 316]), *Reinecke* v. *Spalding* (280 U. S., 233 [Ct. D. 154, C. B. IX–1, 305]), *Am. Plus Storage* v. *Commissioner* (35 Fed. (2d), 187), *General Water Heater Co.* v. *Comr.* (42 Fed. (2d), 419), *Austin Co.* v. *Commissioner* (35 Fed. (2d), 910 [Ct. D. 189, C. B. IX–1, 332]) to the point that the determination of the Commissioner that the salaries were in fact unreasonable was prima facie correct and the burden of proving it erroneous before the Board rested upon petitioner, respondent insists that that determination not having been by the Board affirmatively disapproved, stands approved and that the decision denying petitioner relief must be affirmed upon the principle that if the Board reached the correct conclusion it is wholly immaterial that it based its decision upon an untenable ground. (*Hurwitz* v. *Commissioner*, 45 Fed. (2d), 780.)

Petitioner replying contends first, that the effect of the Board's finding is not to approve, but to disapprove the finding of the Commissioner that the salaries were unreasonable. It says that this is not at all a case where the Board having reached a right result, its decision must be affirmed even though the ground upon which it was put is erroneous. It argues that the cases cited by respondent sustaining the ultimate finding of the Board, despite the statement of an erroneous ground for its ruling, requires the reversal, not the affirmance of its ruling here. That it in effect has a finding of the Board in its favor that the sums in dispute were paid as compensation for services ren-

dered; that they were reasonable, and as such were deductible but for the fact of their payment in one year to compensate for services in the prior years. It says that resort to the Board presents the whole matter as an original proceeding that the Board may investigate anew the issues between the Government and the taxpayer, and upon the determination of the appeal it may affirm, set aside or modify the finding and the decision of the Commissioner. (*Blair* v. *Osterlein Co.*, 275 U. S., 220 [T. D. 4120, C. B. VII–1, 181].) That when a taxpayer brings his suit before the Board he proceeds by trial de novo; the record of the case made in the Internal Revenue Bureau is not before the Board, except in so far as it may be properly placed in evidence by the taxpayer or by the Commissioner. The Board must decide each case upon the record made at the hearing before it, and in order that it may properly do so the taxpayer must be permitted to fully present any question relating to his tax liability which may be necessary to a correct determination of the deficiency. (*E. J. Barry*, 1 B. T. A., 157.) That "the Board was not created for the purpose of reviewing rulings made by the Commissioner but was made for the purpose of correcting deficiencies in the tax found by the Commissioner." (*Gutterman, Straus Co.*, 1 B. T. A., 245.)

Respondent claims that the Board has not so found, but in effect just the contrary, and that petitioner finds itself in the position of complaining before this court of a finding of the Board upon a record wholly bare, except for the allegations of the petition, of facts by which to test the finding, and that since the burden is upon the taxpayer to establish the illegality of the tax assessed, the correctness of the deduction claimed (*Reinecke* v. *Spalding*, 280 U. S., 232), the decision of the Board must be affirmed.

Considering first the question of waiver, we are not at all impressed with petitioner's contention that a waiver, executed by the secretary-treasurer, the manager in large part generally, and of the fiscal affairs of the corporation completely, received and acted upon by the Government, was not valid and effective to toll the statute.

"Taxation, as it many times has been said, is eminently practical." (*Tyler* v. *United States*, 281 U. S., 503 [Ct. D. 190, C. B. IX–1, 383].)

It has to do with matters the great majority of which ought to be and usually are, disposed of informally and where rights are substantially preserved, defects in form may not defeat them (*Florsheim Bros. & Co.* v. *United States*, 280 U. S., 453 [Ct. D. 167, C. B. IX–1, 260]; *Stange* v. *United States*, 282 U. S., 270 [Ct. D. 274, C. B. X–1, 414]), and courts will not permit a "sticking in the back" to defeat a waiver voluntarily executed within the scope of the implied powers of him who executed it, and which was acted upon by the officer of the United States to whom it was addressed (*Florsheim Bros. Co.* v. *United States*, 260 U. S., 453; *Stange* v. *United States*, 282 U. S., 271; *Lucas* v. *Hunt*, 45 Fed. (2d), 781), for a waiver is not a contract; it is just what its name implies, a waiver voluntarily and unilaterally, of a defense by the taxpayer (*Aiken* v. *Burnet*, 282 U. S., 277 [Ct. D. 275, C. B. X–1, 417]; *Brown* v. *Burnet*, 282 U. S., 283 [Ct. D. 279, C. B. X–1, 274]; *Burnet* v. *Chicago Railway Equipment Co.*, 282 U. S., 295 [Ct. D. 276, C. B. X–1, 323]). Here the holding out by the corporation of Farley as secretary-treasurer as having authority to execute the waiver is emphasized by the fact that the return, which was the basis of the deficiency assessment, was without specific authority, made by him. It is certainly not reasonable nor consistent to on the one hand contend that Farley had authority to file the return sufficient to avoid the penalties for failure to file, and yet nothing different appearing, that he did not have the power to sign a waiver of assessment with regard to that same return, which as the act of the corporation, he had made and filed. Besides, we think the primary facts found by the Board support the ultimate finding that Farley was authorized to execute the waiver for the corporation, whether under the Louisiana statutes he be regarded as its manager, or whether, the statutes aside, it be considered that under general principles a person charged as he was, with the management of the corporation's fiscal affairs, particularly with reference to the making and filing of its income tax returns, had implied authority to execute other papers in connection with the collection and handling of such tax returns, including the statutory waivers usual in such cases. (*California Iron Yards* v. *Commissioner*, 47 Fed. (2d), 514; *Hammond* v. *Carthage*, 34 Fed. (2d), 155; *Liberty Baking Co.* v. *Heiner*, 34 Fed. (2d), 513 [Ct. D. 194, C. B. IX–1, 231]; *United States* v. *Kemp*, 12 Fed. (2d), 2 [T. D. 3858, C. B. V–1, 326].)

There is much to be said upon the second point in favor of petitioner's view that the case should be here treated as though the Board did in effect find that the salary allowances were reasonable, and did find them deductible except as the view which they took of the law prevented, and that the law having been otherwise declared petitioner should now have judgment.

We are of the opinion, however, since the Board did not make any affirmative fact findings in the matter of the reasonableness of the salaries, either primarily or ultimately, that this court should follow neither the suggestion of petitioner nor of the respondent, should neither affirm nor reverse finally the Board's decision, but should reverse and remand the cause to the Board for a rehearing and precise finding and determination of these matters which its findings do not definitely dispose of. (*Francisco Sugar Co.* v. *Commissioner*, 47 Fed. (2d), 558; *Avery* v. *Commissioner*, 22 Fed. (2d), 7 [T. D. 4116, C. B. VII-1, 155]; *Blair* v. *Osterlein*, 275 U. S., 225.)

Reversed and remanded for rehearing.

ARTICLE 1012: Assessment of tax. XI-17-5463
Ct. D. 476

INCOME TAX—REVENUE ACT OF 1921—DECISION OF COURT.

1. WAIVER—CONSTRUCTION.

A second consent in writing under section 250(d) of the Revenue Act of 1921 to extend the statutory period for the assessment and collection of a tax "in effect for a period of one year after the expiration of the statutory period of limitation, or the statutory period of limitation as extended by any waiver already on file with the Bureau" not only extends the period for assessment and collection for one year after the statutory period of limitation but for one year after an existing extension of the statutory period by a previous consent on file with the Bureau.

2. WAIVER—VALIDITY—CONSIDERATION—NOTICE BY COMMISSIONER.

An agreement in writing between the Commissioner and the taxpayer that a tax may be assessed or collected after the prescribed statutory period requires only a consent and need not be supported by a consideration in order to be valid. A notice to the taxpayer of the receipt and execution of a waiver by the Commissioner is unnecessary.

3. WAIVER—SIGNATURE OF COMMISSIONER.

A contention that a waiver is not properly signed by the Commissioner is met by the waiver itself which contains the signature "D. H. Blair, Commissioner," and the presumption of the verity of the acts of public officials.

4. WAIVER—BURDEN OF PROOF.

Held, that in the circumstances shown the Commissioner has sustained the burden of showing that the first waiver was on file in the office of the Bureau at the time a second waiver was executed.

5. DECISION AFFIRMED.

The decision of the Board of Tax Appeals (17 B. T. A., 848) affirmed.

UNITED STATES CIRCUIT COURT OF APPEALS, EIGHTH CIRCUIT. MAY TERM, A. D. 1931.

Stern Bros. & Co., petitioner, v. *David Burnet, Commissioner of Internal Revenue, respondent.*

On petition to review decision of the United States Board of Tax Appeals.

Before STONE and GARDNER, Circuit Judges, and MARTINEAU, District Judge.

STONE, Circuit Judge, delivered the opinion of the court.

This is a petition to review a decision of the Board of Tax Appeals affirming a deficiency redetermination of taxes of the petitioner. There is no dispute

that the amount of taxes claimed by the Government is proper. The only controversy is whether the assessment and collection of this deficiency is barred by limitations. It is conceded that it is so barred unless extended by two waivers. Therefore, the real issues are as to the term of extension by these two waivers and as to the validity and binding effect of the waivers themselves.

Petitioner contends that the waivers are invalid for various reasons to be hereinafter noted, but that even if valid, they do not suffice to extend the term to include the assessment and collection. Whether they do so extend the term or not, depends upon the construction of the last sentence of the second waiver. The first waiver is as follows:

"January 9, 1924.
"(Date.)
"Received
"Feb. 19, 1924.
"Special Assessment Section.

"INCOME AND PROFITS TAX WAIVER.

"In pursuance of the provisions of subdivision (d) of section 250 of the Revenue Act of 1921, Stern Bros. & Co., of Kansas City, Mo., and the Commissioner of Internal Revenue, hereby consent to a determination, assessment, and collection of the amount of income, excess-profits, or war-profits taxes due under any return made by or on behalf of the said corporation for the year 1918 under the Revenue Act of 1921, or under prior income, excess-profits, or war-profits tax Acts, or under section 38 of the Act entitled 'An Act to provide revenue, equalize duties, and encourage the industries of the United States, and for other purposes,' approved August 5, 1909. This waiver is in effect from one year from the date it is signed by the taxpayer.

"STERN BROTHERS & COMPANY,
[CORPORATE SEAL.] "*Taxpayer.*
"By SIGMUND STERN, *Pres.*
"By MORRIS STERN, *V. P.*
"D. H. BLAIR, *Commissioner.*

"If this waiver is executed on behalf of a corporation, it must be signed by such officer or officers of the corporation as are empowered under the laws of the State in which the corporation is located to sign for the corporation, in addition to which the seal, if any, of the corporation must be affixed."

The second waiver is as follows:

"January 19, 1924.
"(Date.)
"Received
"Feb. 19, 1924.
"Special Assessment Section.

"INCOME AND PROFITS TAX WAIVER.

"In pursuance of the provisions of subdivision (d) of section 250 of the Revenue Act of 1921, Stern Bros. & Co., of Kansas City, Mo., and the Commissioner of Internal Revenue, hereby consent to a determination, assessment, and collection of the amount of income, excess-profits, or war-profits taxes due under any return by or on behalf of the said Stern Bros. & Co. for the year 1918 under the Revenue Act of 1921, or under prior income, excess-profits, or war-profits tax Acts, or under section 38 of the Act entitled 'An Act to provide revenue, equalize duties, and encourage the industries of the United States, and for other puposes,' approved August 5, 1909. This waiver is in effect from the date it is signed by the taxpayer and will remain in effect for a period of one year after the expiration of the statutory period of limitation, or the statutory period of limitation as extended by any waivers already on file with the Bureau, within which assessments of taxes may be made for the year or years mentioned.

"STERN BROTHERS & COMPANY,
[CORPORATE SEAL.] "*Taxpayer.*
"By SIGMUND STERN, *Pres.*
"By M. STERN, *V. P.*
"D. H. BLAIR, *Commissioner.*
"MB

"Distribution Center.
"Jan. 22, 1924.
"P. U. & P. S. Section.

"If this waiver is executed on behalf of a corporation, it must be signed by such officer or officers of the corporation as are empowered under the laws of the State in which the corporation is located to sign for the corporation, in addition to which, the seal, if any, of the corporation must be affixed."

The controverted question as to the proper construction of the last sentence of the second waiver is whether it served to extend the time for one year after the expiration of the statutory period, as extended by the first waiver. The argument is that the 5-year limitation period had not expired at the time the second waiver was made and, therefore, there was no need nor occasion for a further extension of that period by any previous or existing waiver and that it was not the intention of the parties to make such additional extension but that the sentence should be understood as meaning only that the assessment and collection "may still be made 'within' the period as extended by any waivers then on file." Such a construction as contended for does obvious violence to the language here used and to the application of that language to the situation. Taking the language alone, of the above sentence, it is clearly in the alternative, one of which is that it shall remain in effect "for a period of one year after * * * the statutory period of limitation as extended by any waivers already on file with the Bureau." No other meaning can be given this language except that the above waiver not only extended the period for one year after the statutory period of limitation, but for one year after any existing extension of the statutory period by waiver on file with the Bureau. When the application of this wording to the situation is considered, the meaning of the above sentence is further sustained. This situation is that there was actually on file with the Bureau a waiver which extended the period for one year after the statutory limitation. Not only is it significant that the language of the first and second waivers are different in this particular, but there could be no possible purpose in the second waiver if given the meaning contended for by the petitioner, since it would make the extension only the same as the first waiver had already done.

The petitioner's main contention is that the waivers are not effective, as such, and several grounds are urged in support of this view. The first of these grounds is that the Commissioner never notified the taxpayer that he had signed or accepted the first waiver or even that he had received it. The theory as to this is that the waiver is a bilateral contract and that it is a condition of such contracts that an acceptance of an offer must be communicated. This view is met by decisions of the Supreme Court which hold that such a waiver is not a contract (*Aiken* v. *Burnet*, 282 U. S., 277, 281 [Ct. D. 275, C. B. X–1, 417]; *Florsheim Bros. Co.* v. *United States*, 280 U. S., 453, 466 [Ct. D. 167, C. B. IX–1, 260]), and it has been directly decided by the Court of Appeals for the Second Circuit that no such notice is required in connection with waivers of this character (*Greylock Mills* v. *Commissioner*, 31 Fed. (2d), 655, 657 [Ct. D. 98, C. B. VIII–2, 253]).

Another ground is that the demand of the second waiver operated as an affirmative rejection of the first waiver. The language of the last sentence of the second waiver conclusively meets such a contention.

Another ground is that the waivers were made in consideration of the hearing of an appeal which the Commissioner later refused to hear and, as the consideration for the contract thus failed, therefore, the contract represented by the waiver was ineffective. This contention is met by the above citations to the effect that such waivers are not contracts and, as to the matter of consideration, more particularly, by two decisions of the second circuit directly holding that no consideration is necessary to support such a waiver (*Loewer Realty Co.* v. *Anderson*, 31 Fed. (2d), 268, 270 [Ct. D. 125, C. B. VIII–2, 218]; *Greylock Mills* v. *Commissioner*, 31 Fed. (2d), 655, 657).

A further ground is that whether the first waiver be construed as a bilateral contract, or merely as a one-sided instrument to be signed by the taxpayer alone, it never became effective for the reason that it was conditionally delivered by the taxpayer and the condition upon which it was to take effect, if at all, never happened, the condition being that the Commissioner would hear the taxpayer's first appeal. The evidence clearly shows that no such condition was attached to the waiver. The facts as shown by the evidence and clearly understood by both parties at the time are shown in an extract from a letter of the Commissioner transmitting the form of the first waiver to petitioner. That extract

shows that the petitioner had, of its own volition, submitted an appeal to the Commissioner; that this created a situation in which the delay incident to giving consideration to the appeal might jeopardize the assessment and that the waiver was to protect this situation. This can not be tortured into a promise by the Commissioner that he would hear the appeal if the waiver were made. The evidence shows that the appeal then on file was not considered because not in proper form, but that the defects therein were called to the attention of petitioner in the letter transmitting the second waiver and that in compliance with the suggestions in that letter, another appeal was prepared by petitioner and transmitted to the Commissioner and that conference later took place, in connection therewith, between petitioner and officials of the Bureau. With this revelation from the record, there is no basis for any claim that this first extension should be held invalid because that particular appeal was not passed upon.

It is contended by petitioner that the burden is on the Commissioner to show the validity of the two waivers and that the Commissioner has failed to show that the first waiver was on file in the Bureau at the time the second waiver was executed, or that either waiver was properly signed by the Commissioner, or under his authority. Since the Commissioner relies upon a waiver to avoid the statutory limitations, it may be assumed that the burden is upon him to show a waiver which could have that effect and that this requirement could be met only by the showing of a waiver properly executed by the Commissioner and, in this instance, that the first waiver was on file in the office of the Bureau at the time the second was executed, since the second refers only to a waiver then on file. While this burden is upon the Commissioner, the character or amount of proof necessary to satisfy this burden is another matter. Here the proof is sufficient to make out, at least, a prima facie case of the receipt of the first waiver before the letter containing the form for the second waiver was mailed by the Commissioner. This prima facie case is made out by two matters, one a presumption, and the other affirmative evidence. The presumption intended is that the evidence shows both that the first waiver was mailed from Kansas City to the Commissioner, at Washington, five days before the Commissioner mailed the second waiver, and that it required no more than that time for the transmission of mail between those two points. Therefore, the presumption would be that the first waiver had been received in due course of mail. The affirmative evidence intended is that the second waiver, differing in this respect from the first waiver, refers to an existing waiver "already on file with the Bureau" and this first waiver is the only one which could possibly have been on file. It is difficult to explain this difference in the two waivers except on the basis of the presence of the first waiver in the files of the Bureau at the time the second waiver was sent by the Commissioner.

The contention as to the proper signature is met by the waiver itself, which contains the signature "D. H. Blair, Commissioner," and the presumption of the verity of the acts of public officials. (*United Thacker Coal Co.* v. *Commissioner*, 46 Fed. (2d), 231, 233, C. C. A. 1; *Trustees for Ohio & Big Sandy Coal Co.* v. *Commissioner*, 43 Fed. (2d), 782, 784, C. C. A. 4.)

In general, it may be said as to this controversy and those of a related character, that a waiver of this kind is "essentially a voluntary, unilateral waiver of a defense by the taxpayer," as stated in *Stange* v. *Burnet* (282 U. S., 270, 276); also see *Florsheim Bros. Co.* v. *United States* (280 U. S., 453, 466); that the signature by the Commissioner is a statutory requirement made, not for contract purposes, but "to meet exigencies of administration," as said in *Aiken* v. *Burnet* (282 U. S., 277, 281); also see *Stange* v. *Burnet* (282 U. S., 270, 276); *Burnet* v. *Chicago Railway Equipment Co.* (282 U. S., 295, 298 [Ct. D. 276, C. B. X–1, 323]); *Florsheim Bros. Co.* v. *United States* (280 U. S., 453, 466); *Greylock Mills* v. *Commissioner* (31 Fed. (2d), 655, 657, C. C. A. 2); and where the taxpayer, by the execution of the waiver, has obtained delay in the assessment of additional taxes, and a more deliberate and thorough consideration of the questions involved, and where the waiver is regular in form and in the possession of the proper governmental bureau, every presumption should be taken in favor of its validity and binding effect and the burden is upon the taxpayer to show such invalidity or ineffectiveness. (See *Trustees for Ohio & Big Sandy Coal Co.* v. *Commissioner*, 43 Fed. (2d), 782, 784, C. C. A. 4.)

The decision of the Board of Tax Appeals was in all respects correct and the petition for review should be and is dismissed.

SECTION 252.—REFUNDS

ARTICLE 1036: Claims for refund of taxes erroneously collected.

REVENUE ACT OF 1918.

Application of limitation of section 284(h) of the Revenue Act of 1926 and the meaning of the words "date the return was due." (See Ct. D. 444, page 201.)

TITLE XIII.—GENERAL ADMINISTRATIVE PROVISIONS.

SECTIONS 1318, 1319, AND 1320.—LIMITATIONS UPON SUITS AND PROSECUTIONS.

ARTICLE 1050: Suits for recovery of taxes erroneously collected. XI-3-5362 Ct. D. 440

INCOME TAX—REVENUE ACTS OF 1921 AND 1926—DECISION OF COURT.

1. CLAIM FOR REFUND—SUFFICIENCY—SUPPLEMENTAL CLAIM.

A claim by a life insurance company for a refund containing a general allegation that all taxes erroneously collected should be refunded is not a sufficient claim under section 3226 of the Revised Statutes as amended to support a suit based on the ground that the deduction of 4 per cent of the mean of its reserve funds should not be reduced by the amount of tax-exempt interest, and a second claim for refund stating a new and different ground filed after the first claim had been disallowed and after the expiration of the statutory period for filing the claim, is not supplemental to or an enlargement of the original claim and does not effect a postponement of the time within which a suit must be brought as provided in that section.

2. CLAIM FOR REFUND—DISALLOWANCE—SUFFICIENCY.

A communication from the Commissioner to the taxpayer in writing that its claim for refund would be rejected and that said rejection would appear in the next schedule to be approved by the Commissioner constitutes a disallowance of the claim and starts the running of the 2-year period of limitation for the commencement of a suit provided by section 3226 of the Revised Statutes as amended.

3. JURISDICTION—COURT OF CLAIMS.

The jurisdiction of the Court of Claims of the United States in a suit for the refund of a tax is not dependent upon the provisions of section 24, paragraph 20, of the Judicial Code, as amended, reenacted by section 1122(c) of the Revenue Act of 1926, which applies to the jurisdiction of district courts which in suits against the United States is made concurrent with that of the Court of Claims in certain cases wherein the collector by whom the tax was collected is dead or is out of office at the time the suit is commenced.

COURT OF CLAIMS OF THE UNITED STATES. No. K-420.

New England Mutual Life Insurance Co., a Corporation, v. *The United States.*

[October 22, 1931.]

OPINION.

LITTLETON, Judge, delivered the opinion of the court.

In this suit plaintiff seeks to recover $211,618.91, together with interest, on account of overpayments of income tax for 1921, 1922, and 1923 on the ground that the Commissioner of Internal Revenue in computing the income for said

years reduced the deduction from gross income of 4 per cent of the mean of its reserve funds required by law to be held at the beginning and end of the taxable year by the amount of interest received by it during the year on tax-exempt securities. The amount of such exempt interest was $1,020,519.09 for 1921, $1,108,776.19 for 1922, and $1,126,317.13 for 1923. This resulted in the overpayment of $64,049.48 for 1921, $113,772.46 for 1922, none of which has been refunded or credited, and $135,183.97 for 1923, of which $101,387 has been refunded and $33,796.97 has not been refunded or credited. The question is whether the plaintiff filed sufficient and timely claims for refund.

The plaintiff, a mutual life insurance company, was organized under the laws of the Commonwealth of Massachusetts. It filed returns for the taxable years in question and paid a total tax of $74,046.25 for 1921 in four installments during 1922, a tax of $113,772.46 for 1922 in four installments during 1923, and a tax of $135,183.97 for 1923 in four installments during 1924. April 3, 1923, it filed a claim for refund of $10,000 for 1921 on account of an alleged error in computation of its gross income, which claim was allowed by the Commissioner of Internal Revenue for $9,996.77 and applied as a credit on plaintiff's tax for the calendar year 1924, leaving a balance of $64,049.48 herein sought to be recovered for 1921. Thereafter, on January 28, 1926, plaintiff filed claims for refund for the calendar years 1921, 1922, and 1923, each upon the specific ground that it was entitled to the allowance of certain so-called "additional reserve funds required by law," and in these claims sought the refund of the full amount of all taxes assessed and paid for the three years mentioned except the amount of $9,996.77 theretofore allowed as an overpayment and credited. Each of these refund claims contains the statement that

"3. Claimant also asks for the refund of all taxes that may now, or hereafter, be properly refundable to it on account of having been illegally, erroneously, or in any manner wrongfully collected from it for the years 1921, 1922, 1923."

The Commissioner of Internal Revenue considered these claims for refund and on July 6, 1926, notified the plaintiff in writing that the claim for refund filed January 28, 1926, for 1921 would be rejected and that said rejection would appear in the next schedule to be approved by him, and on August 23, 1926, and May 26, 1927, gave similar notices as to the claims for refund filed January 28, 1926, for the calendar years 1922 and 1923. The Commissioner gave plaintiff no further written notice of his rejection of the claims. Subsequent to the decision of the Supreme Court in *National Life Insurance Co.* v. *United States* (277 U. S., 508 [T. D. 4206, C. B. VII–2, 296]), plaintiff on June 12, 1928, filed further claims for refund for 1921, 1922, and 1923, respectively, based on said decision, claiming refund on the ground that 4 per cent of the mean of its reserve funds should not be reduced by the amount of tax-exempt interest. This ground for refund was presented to the Commissioner for the first time in these claims of June 12, 1928. The claims for 1921 and 1922, filed June 12, 1928, each contain the statement that

"(*) This claim is supplemental to the original claim filed January 27, 1926. * * *"

The last-mentioned claims for refund for 1921 and 1922 were rejected by the Commissioner January 11, 1929, and on November 7, 1928, the Commissioner notified the plaintiff that its claim for refund of $135,183.97 for 1923 would be allowed for $101,387 and rejected for $33,796.97. The amount for which this claim was allowed was refunded to plaintiff February 25, 1929. The Commissioner rejected the claims for 1921 and 1922, filed June 12, 1928, for the reason that the grounds thereof had not been set forth in a timely claim and that these claims were filed after the expiration of the statute of limitation.

As to the claim for 1923, the Commissioner refunded the amount of the tax paid within the period of limitation prior to the filing of the claim.

Plaintiff's position is that the claims for refund for 1921, 1922, and 1923, filed January 28, 1926, within four years after the payment of taxes, were sufficient to entitle it to a refund of all taxes paid for those years under the decision of the *National Life Insurance Co.* v. *United States*, supra, in that it asks for the refund "of all taxes that may now, or hereafter, be properly refundable to it on account of having been illegally, erroneously, or in any manner wrongfully collected from it for the years 1921, 1922, 1923." It further argues that the Commissioner of Internal Revenue never disallowed the claims for refund of January 28, 1926, until he acted upon the claims filed June 12, 1928, in that the letters of July 6 and August 23, 1926, and May 26, 1927, did not

constitute a notice of disallowance of claims and that no notice of such disallowance was given within 90 days as required by section 3226 of the Revised Statutes, as amended by section 1014(a) of the Revenue Act of 1924; that the rejection of the claims filed occurred on November 7, 1928, and January 11, 1929, and that this suit was therefore instituted within the time allowed by law. Finally, plaintiff contends that if the notices mailed by the Commissioner in July and August, 1926, and May, 1927, with respect to the claims filed January 28, 1926, constituted his decision disallowing them, this suit was, nevertheless, instituted in time under paragraph 20 of section 24 of the Judicial Code, as amended, reenacted by section 1122(c) of the Revenue Act of 1926 (43 Stat., 972), giving the district courts concurrent jurisdiction with the Court of Claims against the United States in excess of $10,000 for taxes illegally collected if the collector by whom such tax was collected was dead or was not in office at the time such suit or proceeding was commenced and providing that no suit against the Government should be allowed under this paragraph unless brought within six years after the right accrued for which the claim was made.

The defendant demurs to the petition on the ground, first, that it fails to state facts which constitute a cause of action and, secondly, that it fails to state facts which constitute a cause of action within the jurisdiction of this court.

We are of the opinion that the demurrer is well taken and must be sustained. The claims for refund filed January 28, 1926, did not present the claim which forms the basis for this suit. The general allegation in these claims that all taxes erroneously collected should be refunded is not a sufficient claim to constitute a basis for this suit. (*United States* v. *Felt & Tarrant Mfg. Co.*, 283 U. S., 269 [Ct. D. 336, C. B. X–1, 431]; *The Mutual Life Insurance Co. of New York* v. *United States*, K–377 [Ct. D. 363, C. B. X–2. 292], decided by this court May 4, 1931.) These claims were rejected by the Commissioner July 6 and August 23, 1926, and May 26, 1927, respectively, and the notices mailed to the plaintiff constituted a disallowance thereof. (*Daily Pantagraph, Inc.*, v. *United States*, 68 C. C., 251, 37 Fed. (2d), 783; *Connell* v. *Hopkins*, 43 Fed. (2d), 773 [Ct. D. 248, C. B. IX–2, 407]. Compare *United States* v. *Michel*, 282 U. S., 656 [Ct. D. 310, C. B. X–1, 297].)

The second claims for refund filed June 12, 1928, were not supplemental to the earlier claims in that they stated new and different grounds, and were filed after the claims of June 26, 1926, had been disallowed. (*Sugar Land Railway Co.* v. *United States*, H–394 [Ct. D. 382, C. B. X–2, 309], decided by this court April 6, 1931; *The Mutual Life Insurance Co. of New York* v. *United States*, supra.) Furthermore, this suit was not instituted until September 11, 1929.

There is no merit in the contention of the plaintiff that this suit was timely under section 24, paragraph 20 (title 28, chapter 2, section 41), United States Code, 867, 868. That provision relates solely to the jurisdiction of district courts of the United States and in terms applies to the jurisdiction of the district courts which, in suits against the United States, is made concurrent with that of the Court of Claims in certain cases wherein the collector by whom the tax was collected was dead or was out of office at the time the suit was commenced. The jurisdiction of this court in cases of this character is in no wise dependent upon the provisions of section 24, paragraph 20, Judicial Code, as amended.

The demurrer is sustained and the petition is dismissed. It is so ordered.

ARTICLE 1050: Suits for recovery of taxes erroneously collected.

REVENUE ACT OF 1918.

Suit upon basis not presented in claim. (See Ct. D. 447, page 271.)

SECTION 1324.—INTEREST ON REFUNDS AND JUDGMENTS.

ARTICLE 1040: Interest on refunds and judgments. XI-1-5345 Ct. D. 437

INCOME TAX—REVENUE ACT OF 1921—DECISION OF COURT.

INTEREST—REFUND—FISCAL YEAR 1918—SUPPLEMENTAL RETURN.

The tax returned and assessed by the Commissioner on a return for the fiscal year 1918 made by a corporation pursuant to section 239 of the Revenue Act of 1918, when there had been an assessment of a tax under a return for the same year, imposed by the Revenue Act of 1916 as amended by the Revenue Act of 1917 and by the Revenue Act of 1917, is not an additional assessment within the meaning of the interest provisions of section 1324(a) of the Revenue Act of 1921. Interest on a refund allowed under the Revenue Act of 1921 of a part of the balance of the tax, shown on the return required by the Revenue Act of 1918 for the fiscal year 1918, after allowing the credit for the tax paid on the previous return, is payable pursuant to section 1324(a)3 of the Revenue Act of 1921.

COURT OF CLAIMS OF THE UNITED STATES. No. K-357.

Whitney Bodden Shipping Co. v. *The United States.*

[October 20, 1931.]

OPINION.

LITTLETON, Judge, delivered the opinion of the court.

Plaintiff contends that the refund of $9,688.50 for the fiscal year ended May 31, 1918, was paid "pursuant to an additional assessment" as that term is used in section 1324(a) of the Revenue Act of 1921, and that it is entitled to additional interest of $2,609.27 on the payments of $4,623.58 and $5,064.92 from June 16 and December 16, 1919, respectively, to March 15, 1924.

Before the enactment of the Revenue Act of 1918, which was approved February 24, 1919, plaintiff filed income and profits tax returns for its fiscal year ended May 31, 1918, in accordance with the Revenue Act of 1917 then in force. The Revenue Act of 1918 was retroactive to January 1, 1918, and section 230 thereof imposed a tax at greater rates for the calendar year 1918 and subsequent taxable years in lieu of the taxes imposed by the Revenue Act of 1916, as amended by the Revenue Act of 1917 and by section 4 of the Revenue Act of 1917. Section 200 of the 1918 Act provided that "The first taxable year, to be called the taxable year 1918, shall be the calendar year 1918 or any fiscal year ending during the calendar year 1918." Sections 205(a) and 335(a) of the Revenue Act of 1918 prescribe the method to be employed in computing the total tax due for a fiscal year beginning in 1917 and ending in 1918 under the Revenue Acts of 1916, 1917, and 1918. And, section 205(a), supra, provided that any amount theretofore paid on account of the tax imposed for such fiscal year by prior Revenue Acts should be credited toward the payment of the tax imposed for such fiscal year by the 1918 Act. Under section 239 of the Revenue Act of 1918 and the regulations of the Treasury Department, taxpayers having a fiscal year beginning in 1917 and ending in 1918 were required to file returns for such year under and in accordance with the 1918 Revenue Act. (*Davis Feed Co.*, 2 B. T. A., 616; *Covert Gear Co.*, 4 B. T. A., 1025; *Fred T. Ley & Co.*, 9 B. T. A., 749; *M. Brown & Co.*, 9 B. T. A., 753; *John Wanamaker*, 8 B. T. A., 864.) The return under the 1918 Act, known as Form 1120, was duly prescribed by the Commissioner of Internal Revenue, and the plaintiff on June 16, 1919, duly made and filed such return for its fiscal year ended May 31, 1918, showing a total tax for such fiscal year of $30,449.96, or $10,129.84 in excess of the tax shown in the returns theretofore filed under the Revenue Acts of 1916 and 1917.

The question in this case therefore is whether a tax returned and assessed by the Commissioner on a return made under the Revenue Act of 1918, when there had been an assessment of a tax under a return for the same year under

a previous statute for a fiscal year beginning in 1917 and ending in 1918, is an additional assessment within the meaning of the interest provisions of section 1324(a) of the Revenue Act of 1918. In our opinion it is not. The term "additional assessment" has reference to the determination and assessment by the Commissioner of a deficiency for the taxable year in respect of the tax returned and paid by the taxpayer. This seems to be manifest from the statement in the section that an additional assessment means a further assessment of a tax of the same character *previously paid in part*. In this case the Commissioner only assessed the tax shown by the taxpayer upon its statutory returns to be imposed by and due under the statute in force at the time the assessments were made. The Commissioner did not determine that only part payment of the tax had been made and assess an additional amount, but first assessed the tax shown by the taxpayer on its return to be due under the rates imposed by the Revenue Act of 1917, and later, after the enactment of the Revenue Act of 1918, assessed the amount of the tax shown by the taxpayer upon its return to be due under the rates imposed by the Revenue Act of 1918, the last-mentioned amount being the tax imposed by the 1918 Act in lieu of the tax imposed by the previous Act. The second assessment was, therefore, a new and original tax. In one sense the last assessment may be said to have been an additional assessment, because the amount thereof was in addition to the assessment which had been made on the returns filed under the prior Revenue Acts, but, for the purpose of the interest provisions of section 1324, such tax falls under clause (1) of the section which deals with interest upon the amount of tax voluntarily returned and paid without protest. The Revenue Act of 1918 and the Treasury regulations required all taxpayers having a fiscal year ending in 1918 to file a return under that Act. This was *the* return required by law for such taxable year. The plaintiff made such return, and, after taking credit for the tax paid on the previous returns, against the tax imposed by the 1918 Revenue Act, paid the balance, upon which interest is here claimed, without protest. The Commissioner, according to his usual custom, assessed the tax shown on this return as being due under the Revenue Act of 1918 in excess of the tax theretofore returned, assessed, and paid under the previous Acts. Income and profits taxes are assessed and collected in one of three ways; i. e., upon the statutory return made by the taxpayer, or, in the absence of such a return, upon a return made under section 3176 of the Revised Statutes, or by an additional assessment of an amount in excess of that returned by the taxpayer in his return or in excess of the amount shown by the return made under section 3176.

Section 1324(a) of the Revenue Act of 1921 was the first provision of law authorizing the payment of interest on refunds of taxes, and under it interest was allowable only when the taxpayer filed a claim for refund or credit. One of the purposes of the section was that in a case where a taxpayer voluntarily paid the tax shown to be due upon his statutory return, interest would be allowed upon any overpayment only from a reasonable time after the taxpayer put the Commissioner of Internal Revenue upon notice by the filing of a claim that, in his opinion, the tax in excess of the amount due had been collected. This case falls within that purpose. The fact that a retroactive taxing Act, which increases the tax rate, requires the taxpayer to file a second return upon which the Commissioner makes a second assessment does not take the case out of the rule above stated and make the second assessment an additional assessment of a tax previously paid in part. The reason for the allowance of interest upon a refund of a tax paid as a result of an additional assessment was that, in such case, it was the decision of the Commissioner and not of the taxpayer that brought about such payment. The tax upon which interest is here claimed was assessed by the Commissioner upon a return which the taxpayer was required to file under the Revenue Act of 1918 and represented the tax shown by the taxpayer upon such return as being due under the rates specified in the 1918 Act. Prior to the enactment of the Revenue Act of 1918 the Commissioner assessed and the taxpayer had paid the entire tax due under the statutes then in force. In such circumstances the assessment of the tax in question by the Commissioner was not an additional assessment within the meaning of section 1324(a) of the Revenue Act of 1921.

The petition must be dismissed. It is so ordered.

ARTICLE 1040: Interest on refunds and judgments. XI-22-5496 Ct. D. 491

FEDERAL TAXES—REVENUE ACT OF 1921—DECISION OF COURT.

INTEREST — REFUND — SPECIFIC PROTEST — REQUEST FOR SPECIAL ASSESSMENT.

Two letters written by a taxpayer which amount only to a request for a special assessment under section 210 of the Revenue Act of 1917 are not "a specific protest setting forth in detail the basis of and reasons for such protest" within the meaning of subdivision (a)1 of section 1324 of the Revenue Act of 1921 and therefore interest on a refund is not allowable as provided therein.

COURT OF CLAIMS OF THE UNITED STATES. No. K-105.

Chestnut & Smith, Inc., a Corporation, v. *The United States.*

[February 8, 1932.]

OPINION.

WILLIAMS, Judge, delivered the opinion of the court.

The plaintiff seeks to recover the sum of $31,461.43, additional interest to that allowed by the Commissioner of Internal Revenue on account of an overpayment of its income and excess-profits taxes for the year 1917, which was refunded and credited during the year 1923.

The plaintiff on April 1, 1918, filed with the collector of internal revenue its tentative income and excess-profits tax return for the year 1917 showing an income tax due thereon of $64,665.61, and an excess-profits tax amounting to $602,820.38. At the same time plaintiff filed with the collector a supplemental income and excess-profits tax return, in which return the excess-profits tax was not computed; the only difference between the original and the supplemental excess-profits tax return being that in the original or tentative return the excess-profits tax was computed without including in invested capital the value of certain gas leases owned by plaintiff, while in the supplemental return the value of the gas leases was included in invested capital but the excess-profits tax due thereon was not computed.

On June 10, 1918, the plaintiff was notified by the Commissioner of Internal Revenue that while the amount of its taxes for the year 1917 had not been definitely determined, it appeared that the amount would not be less than $469,903.42, and that with the payment of that amount plaintiff might file a claim for the abatement of the amount assessed in excess of that amount. The plaintiff thereupon, on June 12, 1918, forwarded its check to the Commissioner for the aforesaid amount, together with a letter which will be hereinafter considered, protesting the said payment.

The plaintiff on December 18, 1920, filed its amended income and excess-profits tax returns for the year 1917, and also filed on the same day a claim for refund based on the amended returns. In the amended returns the value of plaintiff's gasoline contracts was included in invested capital at $1,983,595.58, the total invested capital shown in the return being $2,406,649.04.

Upon final audit of the plaintiff's income and excess-profits tax returns for the year 1917 the Commissioner of Internal Revenue determined the correct tax liability to be $131,047.04, resulting in an overassessment of $331,766.61. The amount of the overpayment was credited and refunded to plaintiff in the year 1923. There is no issue between the parties as to the amount of the overpayment or as to the manner in which it was credited and refunded. The controversy relates entirely to the amount of interest plaintiff is entitled to receive on the overpayment. In allowing interest on the overpayment of $331,766.61, the Commissioner computed it from six months after the filing of the claim to the date of the allowance. The plaintiff contends interest should have been computed from the date on which the tax was paid, June 15, 1918, in accordance with the provisions of section 1324(a) of the Revenue Act of 1921 (chapter 136, 42 Stat., 227, 316):

"That upon the allowance of a claim for the refund of or credit for internal-revenue taxes paid, interest shall be allowed and paid upon the total amount

of such refund or credit at the rate of one-half of 1 per centum per month to the date of such allowance as follows: (1) If such amount was paid under a specific protest setting forth in detail the basis of and reasons for such protest, from the time when such tax was paid * * *."

The plaintiff, relying upon two letters written by it, one bearing date March 29, 1918, forwarded to the collector of internal revenue with its tentative and supplemental tax returns, the other dated June 12, 1918, transmitted to the collector of internal revenue with its check for $469,903.42, contends that it paid its taxes for the year 1917 under "specific protest."

What constitutes a valid protest within the meaning of section 1324(a) of the 1921 Revenue Act has been defined by the Supreme Court. Its purpose is to invite the attention of the taxing officers to the illegality of the collection so that they may take remedial measures at once. It must be specific, and the reasons assigned for it must furnish information that will aid in determining whether an overassessment has been made, and must be such as will afford a valid basis for a refund of the taxes. (*Girard Trust Co.* v. *United States*, 270 U. S., 163 [T. D. 3919, C. B. V-2, 209]; *United States* v. *Magnolia Petroleum Co.*, 276 U. S., 160 [T. D. 4153, C. B. VII-1, 287].)

The letter of March 29, 1918, is set out in full in finding 22. This letter is quite lengthy and its contents need not be recited in detail, but its purpose clearly appears in the first two paragraphs:

"Filed herewith are two reports for the income and excess-profit tax of Chestnut & Smith, Inc., Tulsa, Okla. One is a tentative return based on the strict application of the law and the other a supplementary return, which we desire to submit as an example of a representative company engaged in like business.

"We desire to appeal for relief under section 210 as explained in articles Nos. 52, 18 and 24 of Regulations No. 44 [41] of the excess profits tax law. You will note from the tentative return—these are the facts on which we base our appeal."

This language is unmistakable in its meaning and does not require interpretation. It is a specific request for special assessment under section 210 of the 1917 Revenue Act.

The remainder of the letter is devoted entirely to a statement of the facts on which the request for special assessment is made. It is stated the taxable income as disclosed in the tentative return "is seriously disproportionate to the capital invested," and "it is impossible for us to accurately determine the amount of invested capital used in the business," and that "the strict enforcement of the law in regard to the payment of the income and excess-profits tax by Chestnut & Smith will work a serious hardship * * *." Although the letter states, "By ruling of the honorable advisory board, these gas leases used in the manufacture of casing-head gasoline have been held to be tangible property and so admissible under article B, page 2, of the excess-profit tax law," plaintiff makes no request that its tax liability be computed under the ordinary statutory method, on the basis of a determination of its invested capital, including the value of its gas leases. The supplemental return clearly was not submitted for that purpose but as "an example of a representative company engaged in like business," and as a basis for assessment under the provisions of section 210 as explained in articles Nos. 18, 24, and 52 of Regulations 41, which plaintiff in the letter specifically requested.

In the letter of June 12, 1918, plaintiff said:

"We are sending you to-day $469,903.42, being in accordance with notice received from Daniel C. Roper, Commissioner, as our excess and income taxes as assessed by the Internal Revenue Department at Washington.

"The amount of taxes relative to companies of this kind have been pending before the advisory board at Washington. We want it understood that in the payment we are making, we are making it with the view and idea that we shall be credited by any relief that may be granted by the said advisory board to companies in a similar or like business, or to this particular industry.

"We are making this payment under protest, but in order that your office may not be inconvenienced and that there shall be no delay in paying what we justly owe, we are sending this amount at present."

This language falls short of being a "specific protest setting forth in detail the basis of and reasons for such protest." It is a general protest based on the statement payment is being made "with a view and idea that we shall be credited by any relief that may be granted by the said advisory board to com-

panies in a similar or like business, or to this particular industry." The illegality of the tax is not asserted, and the reason assigned for the protest gives no information or states nothing that would aid the Commissioner in determining whether an overassessment had been made, or that affords a valid basis for a refund of the taxes. The protest stated in this letter undoubtedly relates back to the plaintiff's request for special assessment under section 210 of the Revenue Act of 1917 in its letter of March 29, 1918.

It is manifest the two letters relied upon by the plaintiff as constituting a specific protest against the payment of its 1917 taxes amount only to a request for special assessment. Request for special assessment under section 210 of the Revenue Act of 1917 is not a specific protest within the meaning of section 1324(a) of the Revenue Act of 1921. (*Maas & Waldstein Co.* v. *United States*, 283 U. S., 583.)

The overpayment in this case was determined on the basis of the amended returns and the claim for refund filed on December 18, 1920, and not on the basis of information furnished in the letter of March 29, 1918, in which special assessment was requested, nor on the letter of June 12, 1918, where payment of the tax was protested "with the view and idea that we shall be credited by any relief that may be granted by the said advisory board to companies in a similar or like business, or to this particular industry."

The Commissioner of Internal Revenue properly computed interest on the overpayment from six months after the filing of the claim for refund, as is provided in clause 3 of section 1324(a) of the Revenue Act of 1921.

The petition is therefore dismissed. It is so ordered.

SECTION 1331.—CONSOLIDATED RETURNS FOR YEAR 1917.

ARTICLE 1735: Consolidated returns for year 1917. XI–21–5489
(Also Section 240, Article 633.) Ct. D. 487

INCOME TAX—REVENUE ACTS OF 1918 AND 1921—DECISION OF COURT.

CONSOLIDATED RETURN—AFFILIATION—STOCK OWNERSHIP—CONTRACT RELATIONS.

Two corporations are not affiliated within the meaning of section 240(b) of the Revenue Act of 1918 and section 1331(b) of the Revenue Act of 1921 where substantial equality of ultimate burden of losses or benefit of profits, as between the stockholders of the two corporations, depends not upon stock ownership or control but upon contract relations between the two corporations.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT.

United States and Routzahn v. *The Mahoning Coal Railroad Co.*

[December 30, 1931.]

OPINION.

Per curiam: In this case we held that the Central and the Mahoning could not be considered as affiliated corporations for the making of a combined return of income and profits. We followed a group of decisions, one of which was *Handy* v. *Burnet* (2d C. C. A., 47 Fed. (2d), 184). The last-named case was pending in the Supreme Court on certiorari, and we have held this petition for rehearing until the Supreme Court decided that case. This was done by opinion filed November 23 last, affirming the court below [Ct. D. 425, C. B. X–2, 370]. This would seem to call for a denial of this petition; but the railroads urge that the opinion of the Supreme Court declares a principle which requires the conclusion that they are affiliated and claim this principle to be that the affiliation permitted or required was intended to secure—and the Act should be interpreted so as to apply to all cases where such affiliation will operate to secure—"substantial equality as between stockholders who ultimately bear the burden." It

is pointed out that the shareholders of the Central ultimately bear the entire burden of whatever tax is assessed, jointly or separately, and the stockholders of the Mahoning carry no tax burden. The quoted phrase from the Supreme Court opinion we [was] intended to refer to a case where the tax burdens upon the stockholders who ultimately carry them are the same—equal—whether the income goes to one or the other of the corporations.

It is not enough to find that a particular instance is within the general principle of equity or policy which probably induced the passage of a law; it must also be inquired whether the language of the law reasonably extends to that instance. Elaborating slightly what was said in our opinion, and what we take to be the support of what we there quoted from the Supreme Court opinion, it seems to us that Congress observed a class of instances where two corporations were operated as an economic unit or single business enterprise, and where it would be advisable, both from the standpoint of the corporations and from that of the Government, that the taxable income and profits should be considered as a unit. The natural criterion, in compelling or permitting this unity, would be whether it made any substantial difference to any stockholder in either company which company bore the losses or earned the profits of the associated enterprise. It was only in those cases where there was this indifference or equality that affiliation would be clearly appropriate, because only in those cases could the stockholders show a clear right to the privilege of affiliation, and in those cases only could the companies, without injury to their stockholders, shift the profits and losses as between themselves, and thus be rightly subjected to compulsory affiliation.

Adopting the criterion—substantial immateriality to any stockholder—it is now evident that there are (at least) two situations where that immateriality exists. One is where there is practically unity of stock ownership or control; the other is where contract or other relations between the companies have so fixed, as between themselves, the disposition of earnings and losses that the same immateriality exists as to the effect upon any stockholder of either company.

Assuming this probable underlying purpose, Congress might well have adopted language which would include both of these instances, but it did not. It expressly confined the statute to cases where the equality of ultimate burdens or benefit depended upon stock ownership or control. It omitted the cases (perhaps of equal appeal) where this equality came from contract relations. We are not convinced that the Handy opinion requires us to change the result which we had reached.

The application for rehearing is denied.

ESTATE TAX RULINGS.

TITLE III.—ESTATE TAX. (1926)

TRANSFERS BY DECEDENT IN HIS LIFETIME.

REGULATIONS 70(1929), ARTICLE 16(1): Transfers made in contemplation of death. XI-16-5453 Ct. D. 473

ESTATE TAX—REVENUE ACT OF 1926—DECISION OF SUPREME COURT.

GROSS ESTATE—TRANSFER IN CONTEMPLATION OF DEATH—CONCLUSIVE PRESUMPTION—CONSTITUTIONALITY.

The second sentence of section 302(c) of the Revenue Act of 1926, requiring the inclusion in the gross estate of property transferred by a decedent within two years prior to his death as a transfer conclusively presumed to be in contemplation of death, is unconstitutional.

SUPREME COURT OF THE UNITED STATES.

D. B. Heiner, Collector of Internal Revenue, Twenty-third District of Pennsylvania, v. *John H. Donnan, Sidney B. Donnan, Alvan E. Donnan, et al., etc.*

On certificate from the United States Circuit Court of Appeals for the Third Circuit.

[March 21, 1932.]

OPINION.

Mr. Justice SUTHERLAND delivered the opinion of the court.

This case is here on a certificate from the Circuit Court of Appeals for the Third Circuit. On March 1, 1927, John W. Donnan, by complete and irrevocable gift inter vivos, transferred without consideration certain securities to trustees for his four children, and also, without consideration, advanced a sum of money to his son. He died on December 23, 1928, less than two years after the gifts and advancement were made. The Commissioner of Internal Revenue included in the gross estate of decedent the value of the property transferred, and imposed a death transfer tax accordingly, on authority of the clause in section 302(c) of the Revenue Act of 1926 (ch. 27, 44 Stat., 9, 70 (U. S. C., Sup. V, Title 26, section 1094)), which, without regard to the fact, provides that such a transfer made within two years prior to the death of the decedent shall "be deemed and held to have been made in contemplation of death within the meaning of this title." [1]

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[1] SEC. 302. The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated—

* * * * * * *

(c) To the extent of any interest therein of which the decedent has at any time made a transfer, by trust or otherwise, in contemplation of or intended to take effect in possession or enjoyment at or after his death, except in case of a bona fide sale for an adequate and full consideration in money or money's worth. *Where within two years prior to his death* but after the enactment of this Act and without such a consideration the decedent has made a transfer or transfers, by trust or otherwise, of any of his property, or an interest therein, not admitted or shown to have been made in contemplation of or intended to take effect in possession or enjoyment at or after his death, and the value or aggregate value, at the time of such death, of the property or interest so transferred to any one person is in excess of $5,000, then, to the extent of such excess, *such transfer or transfers shall be deemed and held to have been made in contemplation of death within the meaning of this title.* Any transfer of a material part of his property in the nature of a final disposition or distribution thereof, made by the decedent within two years prior to his death but prior to the enactment of this Act, without such consideration, shall, unless shown to the contrary, be deemed to have been made in contemplation of death within the meaning of this title. [Italics supplied.]

The executors paid the tax, and, after rejection of a claim for refund, brought this action in the Federal District Court for the Western District of Pennsylvania to recover the amount of the tax attributable to the inclusion of the property in question by the Commissioner. The trial court found that neither the transfer in trust nor the advancement was made in contemplation of death. Judgment was rendered in favor of the executors on the ground that the foregoing provision of section 302(c) was unconstitutional as contravening the due process clause of the fifth amendment, and void as being repugnant to other sections of the Act. (48 F. (2d), 1058.) An appeal was taken, and the Circuit Court of Appeals has certified to this court two questions of law upon which instruction is desired:

"1. Does the second sentence of section 302(c) of the Revenue Act of 1926 violate the due process clause of the fifth amendment to the Constitution of the United States?

"2. If the answer to the first question be in the negative, is the second sentence of section 302(c) of the Revenue Act of 1926 void because repugnant to sections 1111, 1113(a), 1117, and 1122(c) of the same Act?"

A negative answer to the first question, if made, must rest either upon the ground that Congress has the constitutional power to deny to the representatives of the estate of a decedent the right to show by competent evidence that a gift made within two years prior to the death of the decedent was in fact not made in contemplation of death; or upon the theory that, although the tax in question is imposed as a death transfer tax, it nevertheless may be sustained as a gift tax.

First. Section 301 of the Revenue Act of 1926 imposes a tax "upon the transfer of the net estate of every decedent," etc. There can be no doubt as to the meaning of this language. The thing taxed is the transmission of property from the dead to the living. It does not include pure gifts *inter vivos*. The tax rests, in essence, "upon the principle that death is the generating source from which the particular taxing power takes its being and that it is the power to transmit, or the transmission from the dead to the living, on which such taxes are more immediately rested. * * * it is the power to transmit or the transmission or receipt of property by death which is the subject levied upon by all death duties." (*Knowlton* v. *Moore*, 178 U. S., 41, 56, 57.) The value of property transferred without consideration and in contemplation of death is included in the value of the gross estate of the decedent for the purposes of a death tax, because the transfer is considered to be testamentary in effect. (*Milliken* v. *United States*, 283 U. S., 15, 23 [Ct. D. 320, C. B. X–1, 472].) But such a transfer, not so made, embodies a transaction begun and completed wholly by and between the living, taxable as a gift (*Bromley* v. *McCaughn*, 280 U. S., 124 [Ct. D. 140, C. B. VIII–2, 392]), but obviously not subject to any form of death duty, since it bears no relation whatever to death. The "generating source" of such a gift is to be found in the facts of life and not in the circumstance of death. And the death afterwards of the donor in no way changes the situation; that is to say, the death does not result in a shifting, or in the completion of a shifting, to the donee of any economic benefit of property, which is the subject of a death tax (*Chase National Bank* v. *United States*, 278 U. S., 327, 338 [Ct. D. 40, C. B. VIII–1, 308]; *Reinecke* v. *Northern Trust Co.*, 278 U. S., 339, 346 [T. D. 4261, C. B. VIII–1, 305]; *Saltonstall* v. *Saltonstall*, 276 U. S., 260, 271); nor does the death in such case bring into being or ripen for the donee or anyone else, so far as the gift is concerned any property right or interest which can be the subject of any form of death tax. (Compare *Tyler* v. *United States*, 281 U. S., 497, 503 [Ct. D. 190, C. B. IX–1, 383].) Complete ownership of the gift, together with all its incidents, has passed during the life of both donor and donee, and no interest of any kind remains to pass to one or cease in the other in consequence of the death which happens afterwards.

The phrase "in contemplation of or intended to take effect * * * at or after his death," found in the provisions of section 302(c) of the Act of 1926 and prior Acts, as applied to fully executed gifts *inter vivos*, puts them in the same category for purposes of taxation with gifts *causa mortis*. In this light, the meaning and purpose of the provision were considered, in a recent decision of this court dealing with the Revenue Act of 1918 (*United States* v. *Wells*, 283 U. S., 102, 116–117, 118 [Ct. D. 340, C. B. X–1, 475]):

"The dominant purpose is to reach substitutes for testamentary dispositions and thus to prevent the evasion of the estate tax. (*Nichols* v. *Coolidge*, 274

U. S., 531, 542 [T. D. 4072, C. B. VI-2, 351]; *Milliken* v. *United States*, ante, 15.) As the transfer may otherwise have all the indicia of a valid gift *inter vivos*, the differentiating factor must be found in the transferor's motive. Death must be 'contemplated,' that is, the motive which induces the transfer must be of the sort which leads to testamentary disposition. As a condition of body or mind that naturally gives rise to the feeling that death is near, that the donor is about to reach the moment of inevitable surrender of ownership, is most likely to prompt such a disposition to those who are deemed to be the proper objects of his bounty, the evidence of the existence or nonexistence of such a condition at the time of the gift is obviously of great importance in determining whether it is made in contemplation of death. The natural and reasonable inference which may be drawn from the fact that but a short period intervenes between the transfer and death, is recognized by the statutory provision creating a presumption in the case of gifts within two years prior to death. But this presumption, by the statute before us (Act of 1918), is expressly stated to be a rebuttable one, and the mere fact that death ensues even shortly after the gift does not determine absolutely that it is in contemplation of death. The question, necessarily, is as to the state of mind of the donor.

* * * * * * *

"If it is the thought of death, as a controlling motive prompting the disposition of property, that affords the test, it follows that the statute does not embrace gifts *inter vivos* which spring from a different motive. Such transfers were made the subject of a distinct gift tax, since repealed."

There is no doubt of the power of Congress to provide for including in the gross estate of a decedent, for purposes of the death tax, the value of gifts made in contemplation of death; and likewise no doubt of the power of that body to create a rebuttable presumption that gifts made within a period of two years prior to death are made in contemplation thereof. But the presumption here created is not of that kind. It is made definitely conclusive—incapable of being overcome by proof of the most positive character. Thus stated, the first question submitted is answered in the affirmative by *Schlesinger* v. *Wisconsin* (270 U. S., 230) and *Hoeper* v. *Tax Commission* (284 U. S., 206). The only difference between the present case and the Schlesinger case is that there the statute fixed a period of six years as limiting the application of the presumption, while here it is fixed at two; and there the fourteenth amendment was involved, while here it is the fifth amendment. The length of time was not a factor in the case. The presumption was held invalid upon the ground that the statute made it conclusive without regard to actualities, while like gifts at other times were not thus treated; and that there was no adequate basis for such a distinction. "The presumption and consequent taxation," the court said (page 240), "are defended upon the theory that, exercising judgment and discretion, the legislature found them necessary in order to prevent evasion of inheritance taxes. That is to say, 'A' may be required to submit to an exactment forbidden by the Constitution if this seems necessary in order to enable the State readily to collect lawful charges against 'B.' Rights guaranteed by the Federal Constitution are not to be so lightly treated; they are superior to this supposed necessity. The State is forbidden to deny due process of law or the equal protection of the laws for any purpose whatsoever."

The Schlesinger case has since been applied many times by the lower Federal courts, by the Board of Tax Appeals, and by State courts;[2] and none of them seem to have been at any loss to understand the basis of the decision, namely, that a statute which imposes a tax upon an assumption of fact which the taxpayer is forbidden to controvert, is so arbitrary and unreasonable that it can not stand under the fourteenth amendment.

Nor is it material that the fourteenth amendment was involved in the Schlesinger case, instead of the fifth amendment, as here. The restraint imposed upon legislation by the due process clauses of the two amendments is the same. (*Coolidge* v. *Long*, 282 U. S., 582, 596.) That a Federal statute passed under the taxing power may be so arbitrary and capricious as to cause it to fall before the due process of law clause of the fifth amendment is settled.

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[2] See, for example, *Hall* v. *White* (48 F. (2d), 1060); *Donnan* v. *Heiner* (48 F. (2d), 1058 (the present case)); *Guinzburg* v. *Anderson* (51 F. (2d), 592); *American Security & Trust Co. et al., Executors* (24 B. T. A., 334); *State Tax Commission* v. *Robinson's Executor* (234 Ky., 415) (involving a 3-year period).

(*Nichols* v. *Coolidge*, 274 U. S., 531, 542 [T. D. 4072, C. B. VI-2, 351]; *Brushaber* v. *Union Pac. R. R.*, 240 U. S., 1, 24–25; *Tyler* v. *United States*, supra, 504.)

In *Hoeper* v. *Tax Commission*, supra, this court had before it for consideration a statute of Wisconsin which provided that in computing the amount of income taxes payable by persons residing together as members of a family, the income of the wife should be added to that of the husband and assessed to and payable by him. We held that, since in law and in fact the wife's income was her separate property, the State was without power to measure his tax in part by the income of his wife. At page 215 we said:

"We have no doubt that, because of the fundamental conceptions which underlie our system, any attempt by a State to measure the tax on one person's property or income by reference to the property or income of another is contrary to due process of law as guaranteed by the fourteenth amendment. That which is not in fact the taxpayer's income can not be made such by calling it income. Compare *Nichols* v. *Coolidge* [supra] (274 U. S., 531, 540)."

The suggestion of the State court that the provision was valid as necessary to prevent frauds and evasions of the tax by married persons was definitely rejected on the ground that such claimed necessity could not justify an otherwise unconstitutional exaction.

In substance and effect, the situation presented in the Hoeper case is the same as that presented here. In the first place, the tax, in part, is laid in respect of property shown not to have been transferred in contemplation of death and the complete title to which had passed to the donee during the lifetime of the donor; and secondly, the tax is not laid upon the transfer of the gift or in respect of its value. It is laid upon the transfer, and calculated upon the value, of the estate of the decedent, such value being enhanced by the fictitious inclusion of the gift, and the estate made liable for a tax computed upon that value. Moreover, under the statute the value of the gift when made is to be ignored, and its value arbitrarily fixed as of the date of the donor's death. The result is that upon those who succeed to the decedent's estate there is imposed the burden of a tax, measured in part by property which comprises no portion of the estate, to which the estate is in no way related, and from which the estate derives no benefit of any description. Plainly, this is to measure the tax on A's property by imputing to it in part the value of the property of B, a result which both the Schlesinger and Hoeper cases condemn as arbitrary and a denial of due process of law. Such an exaction is not taxation but spoliation. "It is not taxation that government should take from one the profits and gains of another. That is taxation which compels one to pay for the support of the government from his own gains and of his own property." (*United States* v. *Railroad Company*, 17 Wall., 322, 326.)

The presumption here excludes consideration of every fact and circumstance tending to show the real motive of the donor. The young man in abounding health, bereft of life by a stroke of lightning within two years after making a gift, is conclusively presumed to have acted under the inducement of the thought of death, equally with the old and ailing who already stands in the shadow of the inevitable end. And although the tax explicitly is based upon the circumstance that the thought of death must be the impelling cause of the transfer (*United States* v. *Wells*, supra, 118), the presumption, nevertheless, precludes the ascertainment of the truth in respect of that requisite upon which the liability is made to rest, with the result, in the present case and in many others, of putting upon an estate the burden of a tax measured in part by the value of property never owned by the estate or in the remotest degree connected with the death which brought it into existence. Such a statute is more arbitrary and less defensible against attack than one imposing arbitrarily retroactive taxes, which this court has decided to be in clear violation of the fifth amendment. As said by Judge Learned Hand in *Frew* v. *Bowers* (12 F. (2d), 625, 630 [T. D. 3789, C. B. IV-2, 258]), "Such a law is far more capricious than merely retroactive taxes. Those do indeed impose unexpected burdens, but at least they distribute them in accordance with the taxpayer's wealth. But this section distributes them in accordance with another's wealth; that is a far more grievious injustice."

To sustain the validity of this irrebuttable presumption it is argued, with apparent conviction, that under the *prima facie* presumption originally in force there had been a loss of revenue, and decisions holding that particular gifts were not made in contemplation of death are cited. This is very near to

saying that the individual, innocent of evasion, may be stripped of his constitutional rights in order to further a more thorough enforcement of the tax against the guilty, a new and startling doctrine, condemned by its mere statement and distinctly repudiated by this court in the Schlesinger (page 240) and Hoeper (page 217) cases involving similar situations. Both emphatically declared that such rights were superior to this supposed necessity.

The Government makes the point that the conclusive presumption created by the statute is a rule of substantive law, and, regarded as such, should be upheld; and decisions tending to support that view are cited. The earlier Revenue Acts created a *prima facie* presumption, which was made irrebuttable by the later Act of 1926. A rebuttable presumption clearly is a rule of evidence which has the effect of shifting the burden of proof (*Mobile, J. & K. C. R. R.* v. *Turnipseed*, 219 U. S., 35, 43), and it is hard to see how a statutory rebuttable presumption is turned from a rule of evidence into a rule of substantive law as the result of a later statute making it conclusive. In both cases it is a substitute for proof; in the one open to challenge and disproof, and in the other conclusive. However, whether the latter presumption be treated as a rule of evidence or of substantive law, it constitutes an attempt, by legislative fiat, to enact into existence a fact which here does not, and can not be made to, exist in actuality, and the result is the same, unless we are ready to overrule the Schlesinger case, as we are not; for that case dealt with a conclusive presumption and the court held it invalid without regard to the question of its technical characterization. This court has held more than once that a statute creating a presumption which operates to deny a fair opportunity to rebut it violates the due process clause of the fourteenth amendment. For example, *Bailey* v. *Alabama* (219 U. S., 219, 238, et seq.); *Manley* v. *Georgia* (279 U. S., 1, 5-6). "It is apparent," this court said in the Bailey case (page 239), "that a constitutional prohibition can not be transgressed indirectly by the creation of a statutory presumption any more than it can be violated by direct enactment. The power to create presumption is not a means of escape from constitutional restrictions."

If a legislative body is without power to enact as a rule of evidence a statute denying a litigant the right to prove the facts of his case, certainly the power can not be made to emerge by putting the enactment in the guise of a rule of substantive law.

Second. The provision in question can not be sustained as imposing a gift tax, (1) because the intent of Congress to enact the provision as an incident of the death tax and not as a gift tax is unmistakable; and (2) because, if construed as imposing a gift tax, it is in that aspect still so arbitrary and capricious as to cause it to fall within the ban of the due process clause of the fifth amendment.

1. The intent of Congress to include gifts made in contemplation of death as integral parts of the decedent's estate for the purposes of the death tax only is so clear as, reasonably, to preclude argument to the contrary. In *United States* v. *Wells*, supra, this court held, as already shown, that since it is the thought of death, as a controlling motive prompting the gift, that affords the test whether it is made in contemplation of death, "it follows that the statute does not embrace gifts *inter vivos* which spring from a different motive. Such transfers were made the subject of a distinct gift tax, since repealed." And see *Reinecke* v. *Northern Trust Co.*, supra, at page 347. It is significant that the repeal of the gift tax referred to was made by the same Act (ch. 27, section 1200 (a), 44 Stat., 9, 125) which contains the provision here in question. The tax is imposed upon the transfer of the net estate, but it is first necessary to ascertain the value of the gross estate, and the statute provides that this is to be determined by including, among other things, the value of any interest in property of which the decedent has at any time made a transfer in contemplation of his death. The statute requires that this value shall be determined as of the time of the decedent's death, without regard to the value of the gift when received. The event upon which the tax is made to depend is not the transfer of the gift, but the transfer of the estate of the decedent. The tax falls upon the estate and not upon the gift, and is computed not upon the value of the gift, but, by progressively graduated percentages, upon the value of the entire estate. It is so apparent from a consideration of these features of the statute that Congress could not have had, even remotely, in mind the imposition of a gift tax, that to construe the provision in question as imposing such a tax is to disregard the plain language and the plain intent of the Act. For this court to do so would

be to enact a law under the pretense of construing one and thus pronounce itself guilty of a flagrant perversion of the judicial power.

2. But if we assume, contrary to what is reasonable, that a gift tax is imposed by providing that the value of property transferred without consideration by a decedent within two years prior to his death shall be included in the value of the gross estate, the case for the Government is no better. In the Schlesinger case, the Supreme Court of Wisconsin had expressly held that the tax could not be supported as one on gifts *inter vivos* only, saying, "Under such taxation the classification is wholly arbitrary and void. We perceive no more reason why such gifts *inter vivos* should be taxed than gifts made within six years of marriage or any other event. It is because only one class of gifts closely connected with and a part of the inheritance tax law is created that the law becomes valid." (*Estate of Schlesinger*, 184 Wis., 1, 10.) This court accepted that view in these words (page 239): "The court below declared that a tax on gifts *inter vivos* only could not be so laid as to hit those made within six years of the donor's death and exempt all others—this would be 'wholly arbitrary.' We agree with this view and are of opinion that such a classification would be in plain conflict with the fourteenth amendment." And it follows that the present provision, written in almost identical terms, is in plain conflict with the fifth amendment. The provisions of the statute referred to in the preceding paragraph of this opinion necessarily condition the tax, however it be characterized. If it be a gift tax, it nevertheless is based, not upon the transfer of the gift, but upon the transfer of the estate: and upon the value of the estate, and not that of the gift. Obviously these are bases having no relation whatever to the gift. Moreover, the value of the gift is not to be determined as of the time when made, but, considered as a part of the estate, is to be fixed as of the date of the decedent's death—a condition so obviously arbitrary and capricious as, by itself, to condemn the tax, viewed as a gift tax, as violative of due process. It is to be paid by the beneficiaries of the decedent, although it is impossible for them to share in the gift which has passed beyond recall. It is, therefore, a contribution to the Government exacted of one person, based *pro tanto* upon the wealth of another.

Considered as a gift tax, these conditions demonstrate the entire lack of relation between the taxpayer and the transfer which is the subject of the tax. They disclose that there is no rational ground for measuring the tax, considered as a gift tax and not as a death tax, by the value of an estate coming into being after the gift has become complete and irrevocable, and of which the gift comprises no part. And they show that to impose liability for the tax, as a gift tax, upon the estate, as they in terms require, is, in effect, to exact tribute from the gains or property of one measured by the gains or property of another.

The first question must be answered in the affirmative and this makes it unnecessary to answer the second.

It is so ordered.

Mr. Justice CARDOZO took no part in the consideration or decision of this case.

REGULATIONS 70 (1929), ARTICLE 18: Reservation of income or an annuity.

XI-16-5455
T. D. 4336

ESTATE TAX—TRANSFERS.

Article 18, Regulations 70 (1929 edition), as amended by Treasury Decision 4285 [C. B. IX-1, 356], amended.

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

To Collectors of Internal Revenue and Others Concerned:

Article 18 of Regulations 70 (1929 edition), approved March 23, 1929, as amended by Treasury Decision 4285, approved March 15, 1930, is further amended to read as follows:

ART. 18. *Retention of possession, enjoyment, or income.*—Any transfer which was made by the decedent after 10.30 p. m., Washington, D. C., time, March 3,

total amount of tax imposed upon the said gifts, and to report its actions and doings to the court. In compliance with this order the plaintiff on June 4, 1927, filed a claim for refund in the sum of $256,888.61, which was rejected by the Commissioner of Internal Revenue on the ground that the agreement previously entered into had settled all questions between the parties. On April 6, 1928, without first tendering back to the Government the amount refunded, a second petition was filed in the Court of Claims by the plaintiff, based upon the rejection of the claim for refund, and upon demurrer to the petition the court held that the claim set up therein was res adjudicata. The demurrer was sustained, and the petition dismissed. Plaintiff thereafter applied to the Supreme Court of the United States for a writ of certiorari, which was denied, whereupon on October 2, 1929, the plaintiff instituted the instant action against Fred L. Woodworth, collector of internal revenue, to which, under the plea of general issue, special defenses were interposed by the defendant, including the defense of res adjudicata.

The issues involved are:

(1) Was the additional estate tax here sought to be recovered unlawfully collected?

(2) If unlawfully collected is the plaintiff estopped from recovery (a) by previous litigation against the United States in the Court of Claims, (b) by the instrument signed by the testamentary trustee purporting to close the case under section 1106(b) of the Revenue Act of 1926, (c) by the fact that no tender was made in the court of a previous refund?

I shall consider first the question of estoppel, and as bearing upon it the effect of the previous litigation in the Court of Claims, and the decision therein made, because it is obvious that if that issue is decided against the plaintiff this suit must fail, and it will become unnecessary to pass upon the remaining issues in the case. There were two actions brought by the plaintiff in the Court of Claims for the recovery of the refund claimed in this proceeding. The first action was dismissed by an order based upon the settlement agreement. In the second action the Court of Claims held that the order of dismissal in the first action was res adjudicata, and a bar to the second suit. (*Second National Bank of Saginaw* v. *United States*, 66 Ct. of Cls., 166, certiorari denied, 280 U. S., 553 [T. D. 4238, C. B. VII–2, 356].) I confine my consideration strictly to the effect of the decision in the case above cited. The parties to that action were the plaintiff and the United States of America. The parties to the instant suit are the plaintiff and the collector of internal revenue. The plaintiff contends that this difference in parties avoids the bar of res adjudicata, and relies principally upon the decision of the Supreme Court in the case of *Sage* v. *United States* (250 U. S., 33), wherein it was held that a suit against the collector is not a bar to a subsequent suit against the United States, and wherein Mr. Justice Holmes used the following pertinent language:

"But no one could contend that technically a judgment of a district court in a suit against a collector was a judgment against or in favor of the United States. It is hard to say that the United States is privy to such a judgment, or that it would be bound by it if a suit were brought in the Court of Claims. The suit is personal, and its incidents, such as the nature of the defense open and the allowances of interest, are different. It does not concern property in which the United States asserts an interest in its own behalf, or as trustee, as in *Minnesota* v. *Hitchcock* (185 U. S., 373–388). At the time the judgment is entered the United States is a stranger. Subsequently the discretionary action of officials may, or it may not, give the United States a practical interest in the amount of the judgment, as determining the amount of the claim against it, but the claim would arise from the subsequent official act, not from the judgment itself."

This is not the ground, however, upon which the case was decided, for Mr. Justice Holmes continues significantly:

"But perhaps it would be enough to say that if the judgment otherwise were a bar, the bar would be removed by the subsequent enactment of the Act of July 27, 1912 (ch. 256, 37 Stat., 240), upon which, as well as the Act of 1902, this claim is based."

It is not necessary, however, to regard the argument of Mr. Justice Holmes as dicta, nor to ignore it. There is an important distinction between the facts of the case at bar and those of the Sage case. The judgment pleaded in the latter as a bar to the action therein was a judgment against the collector. The judgment herein set up as a bar is a judgment against the United States. A collector of internal revenue is a public officer, and in that capacity is an agent or trustee

for the Government. It is not contended here that the defendant collector acted in anything but his official capacity. It is not contended that the tax paid is now in his possession, or that he has failed to turn it over to the Government. While the instant suit is against the collector personally, it is against him by reason of his acts as collector, and not otherwise. It may be conceded that a judgment against an agent does not bind the principal, but that is not to say that the converse is true, and that a judgment against the principal is not a bar to an action against the agent, where the latter is in privy with the former in respect to the subject matter of the suit.

Bank of Kentucky v. *Stone et al.* (88 Fed., 383) was a case decided by the United States Circuit Court for the District of Kentucky wherein a bill was filed by the plaintiff to restrain the assessment and collection of certain taxes for the benefit of the city of Louisville. The bill was filed against the board of assessors. There had been a prior adjudication in relation to the same taxes in a suit in which Franklin County, wherein Louisville is situated, was a party. It was held, Judge Taft writing the opinion, that a judgment enjoining a town and county from enforcing an illegal tax is conclusive in a subsequent suit to restrain the board of assessors of such county and town from certifying such tax for collection. The members of the board being but the agents of the real parties in interest are in respect to the former judgment privy to the county and city. This case was appealed to the Supreme Court of the United States, and the judgment therein affirmed. (*Stone* v. *Bank of Kentucky*, 174 U. S., 799. See also *Cuneo Importing Co.* v. *American Importing Co.*, 241 Fed., 421, affirmed 247 Fed., 413; *Warren Featherbone Co.* v. *DeCamp*, 154 Fed., 198.) One need only test the question of privity between the collector and the Government in order to determine that it exists by contemplating what the situation would be if judgment in the instant suit is had against the defendant. As was pointed out by Mr. Justice Holmes in the Sage case, such judgment is to be paid by the United States. The collector is exempted from execution if a certificate is granted by the court that there was probable cause for his act, and that there was a permanent appropriation for the refunding of taxes illegally collected. Certainly in this case the collector would not pay the judgment personally, but would seek to be exempted from execution by making application for a certificate of probable cause under the statute. There would be no reason to deny him such certificate. The Government would then be in the position of assuming an obligation for a claim previously litigated in a proper court and upon which a decision had been rendered in its favor. Can it then be said that there is no privity between the collector and the Government in a suit brought against the Government? I think not. And this is a far different thing than to say, as Mr. Justice Holmes did, that there is no privity between the Government and the collector in a suit brought against the collector personally. The collector in this suit can make no defenses that were not open to the United States before the Court of Claims. The issues here are precisely the same issues as were presented to that court. They might not be if it were the other way around. To say that the principal is not bound by judgment against an agent is not the same thing as saying that the agent is not bound by a judgment against the principal in respect to the subject matter of the agency. I conclude from the foregoing that the dismissal of the second action brought by the plaintiff herein in the Court of Claims is a bar to his recovery here. Judgment may be entered in favor of the defendant and as against the plaintiff for no cause of action.

TITLE III. PART I.—ESTATE TAX. (1924)

TRANSFERS BY DECEDENT IN HIS LIFETIME.

REGULATIONS 68, ARTICLE 18: Reservation of income or an annuity.

XI–16–5456
T. D. 4335

ESTATE TAX—TRANSFERS.

Article 18, Regulations 68 (1924 edition), as amended by Treasury Decision 4184 [C. B. VII-2, 358], as amended by Treasury Decision 4284 [C. B. IX–1, 358], revoked.

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

To Collectors of Internal Revenue and Others Concerned:

Article 18 of Regulations 68 (1924 edition), approved March 26, 1925, as amended by Treasury Decision 4184, approved July 27, 1928, as amended by Treasury Decision 4284, approved March 15, 1930, is hereby revoked.

DAVID BURNET,
Commissioner of Internal Revenue.

Approved April 11, 1932.
OGDEN L. MILLS,
Secretary of the Treasury.

TITLE IV.—ESTATE TAX. (1921)

TRANSFERS BY DECEDENT IN HIS LIFETIME.

REGULATIONS 63(1922), ARTICLE 20: Reservation of income. XI–16–5457 T. D. 4334

ESTATE TAX—TRANSFERS.

Article 20, Regulations 63 (1922 edition), as amended by Treasury Decision 4183 [C. B. VII–2, 368], as amended by Treasury Decision 4283 [C. B. IX–1, 366], revoked.

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

To Collectors or Internal Revenue and Others Concerned:

Article 20 of Regulations 63 (1922 edition), approved July 27, 1922, as amended by Treasury Decision 4183, approved July 27, 1928, as amended by Treasury Decision 4283, approved March 15, 1930, is hereby revoked.

DAVID BURNET,
Commissioner of Internal Revenue.

Approved April 11, 1932.
OGDEN L. MILLS,
Secretary of the Treasury.

TITLE II.—ESTATE TAX. (1916)

REGULATIONS 37(1921), ARTICLE 38: General provisions relating to deductions. XI–14–5436 Ct. D. 467

ESTATE TAX—REVENUE ACT OF 1916—DECISION OF SUPREME COURT.

DEDUCTION—MASSACHUSETTS INHERITANCE TAX.

The Massachusetts inheritance tax is not deductible from the value of the gross estate under section 203(a)1 of the Revenue Act of 1916.

SUPREME COURT OF THE UNITED STATES. No. 468.—OCTOBER TERM, 1931.

Robert M. Leach, Executor, etc., petitioner, v. *Malcolm E. Nichols, Formerly Collector of Internal Revenue.*

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

[March 14, 1932.]

OPINION.

Mr. Justice MCREYNOLDS delivered the opinion of the court.

William E. Walker, of Taunton, Mass., died testate November 9, 1918. Petitioner, as executor of the estate, paid the taxes imposed by the State in respect of the property which passed from the decedent. He also paid to respondent the Federal estate taxes prescribed by the Revenue Act 1916 (39 Stat., 756, 778), which the Commissioner reckoned without deducting from the gross estate the taxes exacted by the State. The circuit court of appeals denied his right to recover the alleged overpayment—the difference between the sum demanded and what would have been due if the claimed deduction had been allowed. The district court had held otherwise.

Here the insistence is that to ascertain the net estate under section 203, Revenue Act September 8, 1916, it was necessary to deduct from the gross estate the tax paid to Massachusetts as required by chapter 65 of her general laws. Also, that in the circumstances the circuit court of appeals should not have decided this question of law.

The record shows that the court below properly considered and ruled upon the point of law. The district court—where the cause was tried without a jury—had said of the State tax "there can be no question that it was legally deductible." The amended declaration alleges that the Commissioner wrongfully refused to allow the deduction. The answer contains a general denial. The agreed statement of facts points out "That in arriving at the value of the net estate upon which the said total tax was computed the Commissioner did not make any deduction or allowance for the amount required to pay the Massachusetts inheritance tax, which the estate was required to pay and did pay to the Commonwealth of Massachusetts." And the defendant asked the court to find as matter of law "Plaintiff is not entitled to recover anything of the defendant and his declaration must be dismissed with judgment for the defendant for his costs." The trial court misconstrued the Federal statute. With his petition for appeal from its judgment, the defendant presented, among others, the following assignment of error: The district court erred in holding: "It is obvious that the United States had demanded and received a tax levied upon the estate of the plaintiff's testator in excess of the amount lawfully due. It is not the correct tax measured by the net estate in view of decisions of the court."

The Revenue Act of 1916 (amended as to rates March 3, 1917, 39 Stat., 1000, 1002, and October 3, 1917, 40 Stat., 300, 324) imposed a graduated tax upon the transfer of the net estate, ascertained as directed by section 203, of every person dying thereafter.

"SEC. 203. That for the purpose of the tax the value of the net estate shall be determined—

"(a) In the case of a resident, by deducting from the value of the gross estate—

"(1) Such amounts for funeral expenses, administration expenses, claims against the estate, unpaid mortgages, losses incurred during the settlement of the estate arising from fires, storms, shipwreck, or other casualty, and from theft, when such losses are not compensated for by insurance or otherwise, support during the settlement of the estate of those dependent upon the decedent, and such other charges against the estate, as are allowed by the laws of the jurisdiction, whether within or without the United States, under which the estate is being administered; * * *."

The General Laws of Massachusetts (1921), volume 1, chapter 65, provide—

"SECTION 1. All property within the jurisdiction of the Commonwealth, corporeal or incorporeal, and any interest therein, whether belonging to inhabitants of the Commonwealth or not, which shall pass by will, or by laws regulating intestate succession * * * shall be subject to a tax at the percentage rates fixed by the following table: * * *.

"SEC. 6. Administrators, executors and trustees, grantees or donees under conveyances or gifts made during the life of the grantor or donor, and persons to whom beneficial interests shall accrue by survivorship, shall be liable for the taxes imposed by this chapter, with interest, until the same have been paid.

"SEC. 7. Taxes imposed by this chapter upon property or interests therein, passing by will or by laws regulating intestate succession, shall be payable to the State treasurer by the executors, administrators or trustees at the expiration of one year from the date of the giving of bond by the executors, administrators or trustees first appointed; * * *.

"SEC. 9. Property of which a decedent dies seized or possessed, subjected to taxes as aforesaid, in whatever form of investment it may happen to be, and all property acquired in substitution therefor, shall be charged with a lien for all taxes and interest thereon which are or may become due on such property. * * *

"SEC. 17. An executor, administrator or trustee holding property subject to the tax imposed by this chapter shall deduct the tax therefrom or collect it from the legatee or person entitled to said property; and he shall not deliver property or a specific legacy subject to said tax until he has collected the tax thereon. An executor or administrator shall collect taxes due upon land passing by inheritance or will which is subject to said tax from the heirs or devisees entitled thereto, and he may be authorized to sell said land, in the manner prescribed by section 29, if they refuse or neglect to pay said tax."

Manifestly, the State taxes paid by the executor were not permissible deductions unless they were such "charges against the estate, as are allowed by the laws of the jurisdiction, * * * under which the estate is being administered." Charges against an estate are only such as affect it as a whole. They do not include taxes on the rights of individual beneficiaries. (*New York Trust Co.* v. *Eisner*, 256 U. S., 345, 350.)

The Massachusetts statute by plain words places the real burden of the tax upon the legatee or other person who receives a decedent's property. Payments required of an executor are only preliminary; ultimately they must be met by the beneficiaries.

Decisions of the Massachusetts Supreme Court show with adequate certainty that the right of succession is the real object of the charge laid because of property which passes by will or under the laws relative to intestacy. The thing burdened is the right to receive. (*Attorney General* v. *Stone*, 209 Mass., 186, 190; *Magee* v. *Commissioner*, 256 Mass., 512; *Boston Safe Deposit & Trust Co.* v. *Commissioner*, 267 Mass., 240; *Coolidge* v. *Commissioner*, 268 Mass., 443, 447. See *Saltonstall* v. *Saltonstall*, 276 U. S., 260.)

It is unnecessary for us to consider whether the petitioner filed a proper claim for refund within the period prescribed by the statute.

The challenged judgment is affirmed.

REGULATIONS 37(1921), ARTICLE 38: General provisions relating to deductions. XI-24-5515 Ct. D. 500

ESTATE TAX—REVENUE ACT OF 1916—DECISION OF SUPREME COURT.

DEDUCTION—CALIFORNIA SUCCESSION TAX.

The California tax levied under the inheritance tax act of 1913 (Cal. Stats., 1913, page 1066), as amended (Cal. Stats., 1915, pages 418, 435), being a tax upon the succession according to the decisions of its highest court, is not deductible from the value of the gross estate under section 203(a)1 of the Revenue Act of 1916.

SUPREME COURT OF THE UNITED STATES. No. 704.—OCTOBER TERM, 1931.

The United States of America, petitioner, v. *Barnim Kombst et al.*

On certiorari to the Circuit Court of Appeals for the Ninth Circuit.

[May 23, 1932.]

OPINION.

Mr. Justice BRANDEIS delivered the opinion of the court.

The question for decision is whether the sum of $261,811.42 paid to the State of California for inheritance taxes should have been deducted from the gross

estate of the decedent before calculating the Federal estate tax under the Revenue Act of 1916, as amended.

On April 25, 1917, Rosa von Zimmermann died in California, a German alien enemy, leaving a net estate valued at $1,927,610.88. Her will was probated there. Her executors, who were citizens of that State, paid in 1918 to the United States an estate tax of $144,889.78, and to California for inheritance taxes the sum of $261,811.42. In the same year, the Alien Property Custodian served notice and demand upon the executors to convey and pay over to him all interest, in the estate, of the residuary legatees, who were likewise German alien enemies. In 1922, the executors, having rendered a final account and turned over the residue of the estate to the Alien Property Custodian, were discharged. After March 4, 1923, the effective date of the Winslow Act (42 Stat., 1511, ch. 285), a claim for refund was filed with the Commissioner of Internal Revenue by Barnim Kombst and the other residuary legatees. One of the grounds assigned was that the sum paid to California by way of an inheritance tax should have been deducted from the gross estate before calculating the Federal estate tax. Subsequently, the Alien Property Custodian filed a like claim. The Commissioner rejected both claims. Thereupon, the legatees and the Alien Property Custodian brought this action in the Court of Claims to recover the amount alleged to have been wrongfully exacted. The court sustained their contention, and allowed recovery of $23,563.03, with interest. (52 F. (2d), 1030.) Certiorari was granted. (265 U. S., 532.) The Government contends that the sum paid to California was not deductible; and that even if it should have been deducted, there can be no recovery, because the claim for refund was not made within the period allowed by law.

The Revenue Act of 1916 (section 203(a)1), under which the excise tax is laid, does not allow as a deduction from the gross estate a sum paid by way of succession tax, as distinguished from an estate tax.[1] (*Leach* v. *Nichols*, 285 U. S., 165 [Ct. D. 467, page 334]; *New York Trust Co.* v. *Eisner*, 256 U. S., 345, 350. Compare *United States* v. *Woodward*, 256 U. S., 632, 635 [T. D. 3195, C. B. 4, 153].) Whether the California tax was a succession tax or an estate tax is to be determined by reference to the decisions of its highest court. (*Leach* v. *Nichols*, supra; *Keith* v. *Johnson*, 271 U. S., 1, 8 [T. D. 3864, C. B. V–1, 236].) The California tax was levied under the inheritance tax act of 1913 (Cal. Stats., 1913, page 1066), as amended (Cal. Stats., 1915, pages 418, 435). This act differs in no substantial respect from its predecessors (Cal. Stats., 1905, page 341, and Cal. Stats., 1911, page 713), which have uniformly been held by the supreme court of the State to impose a tax upon the succession. (*Estate of Kennedy*, 157 Cal., 517, 523; *Estate of Hite*, 159 Cal., 392, 394; *Estate of Miller*, 184 Cal., 674, 678. Compare *Estate of Potter*, 188 Cal., 55; *Estate of Letchworth*, 201 Cal., 1. See *Stebbins* v. *Riley*, 268 U. S., 137, 144.)

It is urged that the original and all later California inheritance tax acts were patterned after the New York act; and that, under the New York act, the tax is one upon the transfer. (*Keith* v. *Johnson*, 271 U. S., 1. Compare *United States* v. *Mitchell*, 271 U. S., 9 [T. D. 3865, C. B. V–1, 233].) As the highest court of California has construed its statutes as laying a succession tax, we have no occasion to consider the construction given by the courts of New York to its legislation. (Compare *Stonebraker* v. *Hunter*, 215 Fed., 67, 69.)

The Commissioner properly refused to allow as a deduction the amount paid to the State. We have, therefore, no occasion to consider the question whether the claim for refund was filed in time.

Reversed.

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[1] Act of September 8, 1916 (39 Stat., 756, 778, ch. 463):

"SEC. 203. That for the purpose of the tax the value of the net estate shall be determined—

"(a) In the case of a resident, by deducting from the value of the gross estate—

"(1) Such amounts for funeral expenses, administration expenses, claims against the estate, unpaid mortgages * * * and such other charges against the estate, as are allowed by the laws of the jurisdiction * * * under which the estate is being administered; * * *."

SALES TAX RULINGS.

TITLE IV.—ADMINISTRATIVE PROVISIONS. (1928)

SECTION 610(b): Recovery of amounts erroneously refunded. XI–10–5407 Ct. D. 455

SALES TAX—REVENUE ACTS OF 1918, 1921, AND 1928—DECISION OF COURT.

1. ASSESSMENT—REASSESSMENT—COMMISSIONER'S AUTHORITY.

Where a refund of taxes is made by mistake under an erroneous construction of the law the Commissioner has authority to reconsider his action and to reassess the tax within the statutory period for an assessment.

2. SUIT—ERRONEOUS REFUND—LIMITATION—MISTAKE.

Where a refund of taxes is made by mistake under an erroneous construction of the law, the United States may without an assessment recover the amount so refunded by an action commenced within the period prescribed therefor by section 610(b) of the Revenue Act of 1928.

DISTRICT COURT OF THE UNITED STATES, NORTHERN DISTRICT OF ILLINOIS, EASTERN DIVISION.

No. 36393. *United States* v. *Tuthill Spring Co., a Corporation.*

No. 35708. *Tuthill Spring Co.* v. *Mabel G. Reinecke, Collector of Internal Revenue.*

[December 21, 1931.]

OPINION.

WOODWARD, District Judge: These two cases involve the application of the same principles of law. Hence, a single opinion will dispose of both cases.

The Tuthill Spring Co. from March 25, 1919, to and including June 22, 1922, was engaged in the manufacture of leaf springs for replacement parts of automobiles. The Tuthill Spring Co. designed and manufactured some 800 odd different sizes of types of springs called Titanic Springs and designated each particular size of type of spring in its catalogue by a particular stock number. Each spring so designated by a stock number was designed, manufactured, advertised, and sold by the Tuthill Spring Co. as a replacement spring upon some particular make and model of automobile or motor truck.

From February, 1919, to and including June, 1922, the Tuthill Spring Co. reported and paid to the collector of internal revenue an excise tax upon the sale of leaf springs pursuant to the provisions of section 900(3) of the Revenue Acts of 1918 and 1921, which reads as follows:

"That there shall be levied, assessed, collected, and paid upon the following articles sold or leased by the manufacturer, producer, or importer, a tax equivalent to the following percentages of the price for which so sold or leased:

"(1) Automobile trucks and automobile wagons (including tires, inner tubes, parts, and accessories therefor, sold on or in connection therewith or with the sale thereof), 3 per centum;

"(2) Other automobiles and motor cycles (including tires, inner tubes, parts, and accessories therefor, sold on or in connection therewith or with the sale thereof), except tractors, 5 per centum;

"(3) Tires, inner tubes, parts, or accessories, for any of the articles enumerated in subdivision (1) or (2), sold to any person other than a manufacturer or producer of any of the articles enumerated in subdivision (1) or (2), 5 per centum; * * *."

Revenue Act of 1918 (O. 18, 40 Stat., 1057, 1122, 1123).

At the time the excise taxes were paid upon the sale of the leaf springs, article 15 of Regulations 47, promulgated by the Treasury Department on May 1, 1919, was in force and read as follows:

"*Definition of parts.*—A 'part' for an automobile truck, automobile wagon, or other automobile, or motor cycle is any article designed or manufactured for the special purpose of being used as or to replace, a component part of any such vehicle, and which by reason of some peculiar characteristic is not such a commercial commodity as would ordinarily be sold for general use, and which is primarily adaptable only for use as a component part of such vehicle. Mere stock or commercial commodities, such as bolts, nuts, washers, screws, etc., though used as components for such vehicles, are not 'parts' within the meaning of subsection (3) of section 900. Articles, however, which ordinarily would be classed as commercial commodities become parts when, because of their design or construction, they are primarily adaptable for use as component parts of such vehicles. Component parts of articles taxable under this definition are taxable when sold separately if they have reached such stage of manufacture that they are primarily adaptable for use as such a component part."

On August 8, 1922, the Commissioner of Internal Revenue promulgated Sales Tax Rule 395 [S. T. 395, C. B. I–2, 295], holding that leaf springs of the type manufactured and sold by the Tuthill Spring Co., for use upon automobiles were not automobile parts within the meaning of section 903. Thereupon the taxes paid by the Tuthill Spring Co., for the period from February 25, 1919, to and including June, 1922, were refunded by the Commissioner of Internal Revenue. However, on December 17, 1923, the Commissioner of Internal Revenue issued Sales Tax Ruling 438 [C. B. III–1, 460], in which he revoked the ruling of August 8, 1922, and held that such leaf springs were taxable parts of automobiles. Thereafter, on January 18, 1924, the tax liability of the Tuthill Spring Co. having in the meantime been reopened, an excise tax on account of the sale of leaf springs by the Tuthill Spring Co. were reassessed for the period of December 19, 1919, to June, 1922, both inclusive. The payment of the taxes so reassessed was protested but the taxes were collected under distraint. For the recovery of these taxes, suit was instituted by the Tuthill Spring Co. against the United States in case No. 35708. This case is submitted on a stipulation of facts. In this case issue was joined on the plea of the general issue and a special plea and a stipulation of facts.

No. 36393 is an action prosecuted by the United States to recover the taxes from February, 1919, to and including November, 1922, which were refunded to the taxpayer.

Both parties have submitted elaborate briefs and arguments. In the view of this case taken by the court, it is unnecessary to review the arguments at length. It is necessary to state only a few leading principles which, in the judgment of the court, are applicable to this case:

(1) The taxes in the first instance were properly collected as excise taxes. (*Universal Battery Co.* v. *U. S.*, 281 U. S., 580 [Ct. D. 220, C. B. IX–2, 422].) It follows, therefore, that the regulation of August 8, 1922, was without authority and void. It follows, further, that the taxes were erroneously and unlawfully refunded to the taxpayer.

(2) Where the erroneous refund was made under a mistaken view of the applicable taxing statute by the administrative officers, the United States may recover by suit the taxes so erroneously refunded, or may reopen the case and redetermine the tax. The court believes that under the repeated decisions of the courts the above principles are well settled and, as above stated, are applicable to this case. (*Burnet* v. *Porter*, 283 U. S., 230; *Champ Spring Co.* v. *U. S.*, 38 Fed. (2d), 988, 47 Fed. (2d), 1 [Ct. D. 323, C. B. X–1, 446]; *Wisconsin Central Railroad Co.* v. *U. S.*, 164 U. S., 190; *U. S.* v. *Standard Spring Manufacturing Co.*, 23 Fed. (2d), 495; *Austin* v. *Commissioner*, 35 Fed. (2d), 910 [Ct. D. 189, C. B. IX–1, 332]; *McIlhenny* v. *Commissioner*, 39 Fed. (2d), 356; *Talcott* v. *U. S.*, 23 Fed. (2d), 897 [T. D. 4137, C. B. VII–1, 319].)

The court, therefore, in both cases, holds for the Government. In No. 36393 the demurrer is sustained.[1] In No. 35708 the court holds with the defendant, and will enter judgment dismissing the cause at plaintiff's costs.

[1] The context here shows the word "sustained" was used inadvertently in the opinion in that the word "overruled" was intended instead in this particular sentence.

TITLE V.—TAX ON ADMISSIONS AND DUES. (1926)

ADMISSIONS.

REGULATIONS 43(1928), ARTICLE 5: Regular or established price defined. XI-26-5530 Ct. D. 508

ADMISSIONS TAX—REVENUE ACT OF 1926—DECISION OF COURT.

1. CONSTITUTIONALITY.

The tax imposed by section 500(a)3 of the Revenue Act of 1926 is constitutional.

2. GRATUITY—PART OF PURCHASE PRICE OF TICKETS—PROPERTY OF LESSEE OPERATING THEATER—EVIDENCE.

Evidence that amounts received by a box office treasurer of a theater for admissions in excess of the regular established price are paid with regularity, dependent upon the number of tickets sold, and that in return therefor the lessee and operator of the theater performs services in facilitating the sale and delivery of the tickets supports the findings of a jury that the additional amounts received were not gratuities and were the property of the lessee and operator, which is, therefore, liable for the taxes on such amounts imposed by section 500(a)3 of the Revenue Act of 1926.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

Apollo Operating Corporation, plaintiff-appellant, v. *Charles W. Anderson, Individually and as Collector of Internal Revenue for the Third District of New York, defendant-appellee.*

[January 19, 1932.]

OPINION.

MANTON, Circuit Judge: Appellant was the lessee and operator of the Apollo Theater in New York City, at which a play was produced between June, 1926, and June, 1927. During this time the box office received $51,598 above established prices for the tickets sold. The Commissioner taxed this sum under the provision of section 500(a) of the Revenue Act of 1926, subdivision 3 of which provides:

"A tax equivalent to 50 per centum of the amount for which the proprietors, managers, or employees of any * * * theater, or other place of amusement sell or dispose of tickets or cards of admission in excess of the regular or established price or charge therefor, such tax to be returned and paid, in the manner and subject to the interest provided in section 602, by the person selling such tickets."

It is contended by the appellant that this sum of money was received in the form of gratuities or tips and was not received as an amount in addition to the established price of the tickets. And, it is argued, that it is therefore untaxable. It is said that such moneys were received by the box office employees and that appellant is not responsible for any tax thereon.

The trial court submitted two questions to the jury: First, whether the amount received was a gratuity or part of the purchase price of the tickets; second, whether the tickets were sold by the appellant or by the box office manager. The jury resolved both these questions against the appellant. The moneys received were divided 75 per cent to the appellant and 25 per cent to the box office manager.

This appeal presents the question of the constitutionality of section 500(a), subdivision 3, of the Revenue Act of 1926 (February 26, 1926, ch. 27, section 500, 44 Stat., 91), and whether there is any evidence to support the finding of

the jury. We considered the constitutionality of section 2 of the Revenue Act of 1926, in *Alexander Theater Ticket Office* v. *United States* (23 Fed. (2d), 44), and held subdivision 2 to be constitutional. That subdivision imposed a tax of 5 per cent or 50 per cent of the amount above the established price of the ticket, depending upon whether or not this excess sum was 50 cents or less, or more than 50 cents, if the ticket was sold away from the box office of the place of amusement. The excess tax under subdivision 3 is for the sums received above the established price of the tickets when the ticket is sold at the place of amusement. We found the tax to be an excise, not a direct, tax in the Alexander case, and held that it withstood the same constitutional objections urged here. The subject matter of the tax in the instant case relates to an incident of the right of ownership of property. The tax upon the act of selling a ticket at the box office at an amount in excess of the established price printed upon the face of the ticket is a transaction sufficient upon which to base the imposition of an excise tax. The tax does not burden the right of ownership in the possessor of the ticket or make it impossible to deal freely in the privilege represented by the ticket. (*Bromley* v. *McCaughn*, 280 U. S., 124 [Ct. D. 140, C. B. VIII–2, 392]; *Brushaber* v. *Union Pac. Ry.*, 240 U. S., 1.)

The claim that it is violative of the tenth amendment of the Constitution was answered in the Alexander case, where we held that the Act imposing a tax on the selling of tickets away from the box office was not an unauthorized exercise by Congress of State powers. It is not any more a violation of the powers reserved to the State to impose a tax upon the excess price of tickets sold at the box office than to impose a tax on the excess price of tickets sold away from the box office. (*Lambert* v. *Yellowley*, 272 U. S., 581.) The argument that the tax imposed, because of its amount, is drastic and confiscatory was also considered in the Alexander case, and we said:

"To be able to find fault with the law is not to judge its invalidity. It may be unjust and oppressive, and yet be free from judicial interference. Mere errors of government are not subject to judicial review; it is only its palpable arbitrary exercise which can be declared void under the fifth and fourteenth amendments."

An argument is made that the statute imposes a tax fixed upon the price at which the employers, managers, or employees, sell tickets and that the return is to be made and the tax paid by the person selling the tickets, and that here the tickets were sold by the box office treasurer of the theater, which was under lease to the appellant. It is contended that it is not the appellant who must pay the tax but the box office treasurer who must make return and pay the tax. The jury found that the amount paid in excess of the established price was the property of the appellant. The box office treasurer did testify that under an agreement made with appellant he received 25 per cent and appellant received 75 per cent. However, the jury found on the evidence that the additional sum was paid with regularity, dependent upon the number of tickets sold, and that in return therefor the appellant performed services in facilitating the sale and delivery of the tickets. This justified the conclusion that the additional sums received were the property of appellant. The evidence presented a jury question. We find no error in the admission or exclusion of evidence, or in the charge to the jury.

The judgment is affirmed.

TAXES ON CHARGES IN EXCESS OF ESTABLISHED PRICE.

REGULATIONS 43(1928), ARTICLE 6: Rate and computation of tax. XI–9–5402 Ct. D. 453

TAX ON ADMISSIONS—REVENUE ACTS OF 1926 AND 1928—DECISION OF COURT.

SALE OF TICKETS BY BROKERS.

Section 500(a)2 of the Revenue Act of 1926 and that paragraph as amended by section 412(a) of the Revenue Act of 1928 are constitutional.

COURT OF CLAIMS OF THE UNITED STATES. No. M-64.

A. Couthoui, Inc., an Illinois Corporation, v. *The United States.*

[December 7, 1931.]

OPINION.

GREEN, Judge, delivered the opinion of the court.

The plaintiff in this case paid $167,606.22 as taxes on broker's sales of admission tickets from October 30, 1926, to September 30, 1930, inclusive. Within due time, the plaintiff filed a claim for refund of this tax on the ground that the statutes under which it was imposed were unconstitutional. The Commissioner denied the claim and the plaintiff has brought suit thereon. The only issue in the case is as to the validity of the Act.

The statutes under which the tax was imposed are section 500(a)2 of the Revenue Act of 1926, and section 412 of the Revenue Act of 1928, which amends paragraph (2) of subdivision (a) of section 500 of the earlier Act to read as follows:

" (2) Upon tickets or cards of admission to theaters, operas, and other places of amusement, sold at news stands, hotels, and places other than the ticket offices of such theaters, operas, or other places of amusement, at not to exceed 75 cents in excess of the sum of the established price therefor at such ticket offices plus the amount of any tax imposed under paragraph (1), a tax equivalent to 5 per centum of the amount of such excess; and if sold for more than 75 cents in excess of the sum of the established price plus the amount of any tax imposed under paragraph (1), a tax equivalent to 50 per centum of the whole amount of such excess, such taxes to be returned and paid, in the manner and subject to the interest provided in section 502, by the person selling such tickets."

The only substantial change made by the amendment is the substitution of " 75 cents " for " 50 cents " in two places.

In support of the contention of the plaintiff that the Act in question is unconstitutional, it is urged, among other things, that its provisions fixing the rates of the tax are arbitrary, capricious, and discriminatory, that the Act as a whole is an attempt to regulate a private business in respect to the manner in which it can be conducted and that its purpose is to fix and limit the price at which tickets may be sold. It is therefore argued that the Act is unconstitutional.

We do not think it is necessary to discuss at any length the objection that the statutes involved are an exercise of the police power. Considered apart from its rates, it is simply an ordinary excise tax which the Government had the undoubted power to impose. In discussing its validity it should be kept in mind that its constitutionality is challenged solely on the basis of the rates which it fixed. We will therefore take up the specific rates used in the statute attacked herein and consider whether the use of these rates made the tax invalid.

In this connection we find that one of the chief objections to the tax is based upon the fact that under its provisions the excess in price of the tickets when sold over the established price is taxed only 5 per cent when such excess does not exceed 75 cents, but if so sold that the excess exceeds 75 cents then a tax of 50 per cent of the excess is imposed. Plaintiff particularly relies on the fact that the broker can not profitably charge more than a certain amount of excess, unless he finds customers who are willing to pay a sufficiently high price for tickets to return a greater profit than would be received if the ticket was sold at a price not exceeding the figure at which the rate of tax was made higher. So far as the question of profit is concerned, it is obvious that within certain limits a tax on tickets sold at a price exceeding 75 cents (over and above the box-office price) would be so much greater than the tax which would have been imposed if the ticket had been sold for a price not exceeding 75 cents, that when, in each case, the tax was deducted, it would be found that more profit was realized if the ticket was sold at a lower price. It is therefore contended on behalf of the plaintiff that the effect of the tax is to prohibit sales of tickets within a certain zone of prices. In an economic way the conclusion is well drawn, for it is clear that no broker would sell tickets at a price higher than 75 cents above the established price unless he could thereby realize a greater profit than he would at selling for less than that

figure. But as an actual fact, the broker was not prohibited from so selling, and the mere fact that a tax is so imposed that its economic effects are to restrict business within certain lines, or even to put certain persons out of business, is not sufficient to make the act imposing it unconstitutional. This we think may be shown to be a rule which is uniformly followed in imposing taxes, and which is supported by the decisions of the Supreme Court.

The State of Iowa, for example, imposes a tax of $500 per annum upon every dealer of cigarettes. The tax is absolute and flat, and makes no difference or allowance on account of the amount of business or the profit which may be received or whether there is in fact a loss. The economic effect of this tax when it was imposed was necessarily to force the small dealers, some of whom did not sell that amount of cigarettes in a year, to go out of business, for it is plain that no dealer could afford to sell cigarettes unless he received in profits a sum considerably larger that the tax. Although the tax created a situation under which there was a zone in which no one could profitably carry on the business of selling cigarettes, it never has been contended and we do not think it ever will be contended that the statute is unconstitutional or that a similar statute enacted by the Federal Government would be unconstitutional.

The taxes that are subject to such objections as can be made against the Iowa tax on cigarettes are so numerous and well known that it is not necessary to list them. The courts have uniformly upheld such taxes when this was the only objection, and have considered them entirely within the constitutional powers of the legislative bodies which enacted them.

It is urged also that the tax is discriminatory. This objection is often made against a tax as a ground for holding it unconstitutional, but all taxes are discriminatory in the sense that the word is used in argument. Economists are agreed that there never was a tax that did not sometimes work out unequally and unfairly as between the different taxpayers, and most taxes often have that effect. In many instances the taxes are not assessed in the same proportion that is used under other conditions. But the mere fact that in certain cases a tax works unfairly or even oppressively is not sufficient to render it unconstitutional. In *Metropolis Theatre Co.* v. *Chicago* (228 U. S., 61) the Supreme Court said:

"*To be able to find fault with a law is not to demonstrate its invalidity.* It may seem unjust and oppressive, yet be free from judicial interference. *The problems of government are practical ones and may justify if they do not require rough accommodations*—illogical, it may be, and unscientific. But even such criticism should not be hastily expressed. What is best is not always discernible; the wisdom of any choice may be disputed or condemned. Mere errors of government are not subject to our judicial review. It is only its palpably arbitrary exercises which can be declared void under the fourteenth amendment; and such judgment can not be pronounced of the ordinance in controversy. (*Quong Wing* v. *Kirkendall*, 223 U. S., 59." [Italics ours.]

It is also said that the tax is arbitrary and capricious. In the sense in which these words are often used, many of the oldest taxes and those most firmly established in the revenue system are subject to the objection now being considered. In a large number of excise taxes an arbitrary figure is used in computing the tax, for which no reason can be given than that in the judgment of the legislative body enacting the law it was the one best suited for the combined purpose of obtaining the revenue and applying the tax in the manner least harmful to the public. It is said in argument that a tax can not be imposed on red-headed men, leaving all others exempt from the same tax. It must be admitted that a mere difference in the color of the hair will not prevent taxpayers from standing on an equal basis and being entitled to equal taxation, but surrounding circumstances may make color in some instances a proper basis for taxation. It will be noted that in *In re Kollock* (165 U. S., 526) the Supreme Court sustained a statute which levied a tax of 2 cents a pound on yellow oleomargarine but left uncolored oleomargarine exempt and provided for regulations which would cause the colored article to be identified when it was put upon the market. It seemed to be conceded in the case that one purpose of the Act was to prevent the deception of purchasers who might buy the colored oleomargarine for butter. But the court said the Act was on its face an Act for the purpose of producing revenue, and the court could not assume that its primary purpose was something else, and it held the discrimination between colored and uncolored oleomargarine to be one which Congress was authorized to

make and sustained the Act. In the case at bar the same rule would apply. The large amount of taxes sought to be recovered in this case show that the tax would produce a very considerable revenue, and it can not be assumed that its primary purpose was not to bring money into the Treasury but to regulate business practices.

It will be observed in the Kollock case, supra, that more revenue would have been raised if both the white and yellow oleomargarine had been taxed, but this is no objection to a tax. In a large number of instances where classifications are made in imposts the revenue would be largely increased by abolishing classifications, making classifications in some other manner, or not making any exemptions; but this does not make the classification invalid. The question is not whether it would produce more or less revenue, but whether Congress had the right to make the classification in the first instance. If it had the right to make the classification, the manner of levying the tax and exemptions made thereto are wholly, as we think, for the Legislature to determine. In *McCray* v. *United States* (195 U. S., 27) the Supreme Court passed upon the validity of the Oleomargarine Act of 1886, as amended, which imposed a tax of one quarter of 1 cent a pound on oleomargarine not artificially colored yellow and yet levied a tax of 10 cents a pound if so colored. The statute in question would seem to be subject to all of the objections that are made in the instant case. It will be observed that the tax on colored oleomargarine was forty times that imposed on the uncolored article, and the taxpayer pleaded in substance as a part of his answer to the Government's suit for the tax that the impost was so heavy that if enforced it would entirely prevent anyone from doing business in the manufacture of colored oleomargarine, that this was the real purpose of the Act and not to raise revenue, that the discrimination was purely arbitrary, and the whole Act a species of police regulations not within the power of Congress. But the Supreme Court said—

"* * * that even although it be true that the effect of the tax in question is to repress the manufacture of artificially colored oleomargarine, it can not be said that such repression destroys rights which no free government could destroy, and, therefore, no ground exists to sustain the proposition that the judiciary may invoke an implied prohibition upon the theory that to do so is essential to save such rights from destruction."

The plaintiff in the case at bar concedes, as must be conceded, that Congress had the right to make the tax higher where the profit exceeded a certain amount. Necessarily it follows, as we think, that plaintiff's case must stand or fall upon the proposition that if the tax may be considered too high as compared with a tax levied under circumstances somewhat but not entirely similar, then the impost is invalid. This point was disposed of by the Supreme Court in the McCray case, supra, in the following language:

"The proposition that where a tax is imposed which is within the grant of powers, and which does not conflict with any express constitutional limitation, the courts may hold the tax to be void because it is deemed that the tax is too high, is absolutely disposed of by the opinions in the cases hitherto cited, and which expressly hold, to repeat again the language of one of the cases (*Spencer* v. *Merchant*), that 'The judicial department can not prescribe to the legislative department limitations upon the exercise of its acknowledged powers. The power to tax may be exercised oppressively upon persons; but the responsibility of the legislature is not to the courts, but to the people by whom its members are elected.'"

A tax may be laid upon the privilege of engaging in the real estate business without levying one on the privilege of engaging in the practice of law; or it can be levied upon the privilege of engaging in the practice of law without levying it against those who are engaged in the practice of medicine. All these occupations are perfectly legitimate, all are beneficial to the community if properly exercised, but no reason can be given as to why one should be taxed and the others left exempt, except that Congress has so decreed. Indeed, occupation taxes generally are in one sense arbitrary, capricious, and discriminatory in the selection of the persons taxed and in the unfairness of the levies which are made under them. An occupation tax of a few hundred dollars per annum would prevent many a beginner from ever getting started in many businesses and professions. A tax of $500 per annum assessed against real estate brokers might put the small dealer out of business entirely, and in any event would appropriate a very large proportion of his profits, while it would be a mere bagatelle to a concern whose profits were $100,000

or more a year. It should be noted that occupation taxes are usually fixed at amounts which are purely arbitrary.

Modern economists have assailed the direct tax on real property as levied by the States as unfair, unjust, and discriminatory. In most States the fact that the title holder of a parcel of land has executed a mortgage, or some equivalent instrument, conveying under certain conditions the property to secure an indebtedness, so that in fact he has but a small interest therein, does not prevent his being assessed for the whole value thereof, even if the real fact is that he has but a small interest in the property. In a case of this kind where the tax was attacked as being discriminatory and not affording the taxpayer the equal protection of the laws, the tax was nevertheless held to be constitutional. See *Paddell* v. *City of New York* (211 U. S., 446), in which the court said: "* * * you can not carry a constitution out with mathematical nicety to logical extremes." It might be said in this connection that the discrimination in the case above mentioned is only one of the many objections that are being made against the tax on real property, but the laws that impose it have been so long on our statute books that no one would now think of attacking them as unconstitutional.

Counsel for plaintiff say in argument that if the rates of the tax in the instant case had been made progressive in the manner used in the Federal tax upon excess profits, there would be no objection thereto. The illustration can not be said to be apt. We have already noted that all taxes have a degree of discrimination and unfairness as between different taxpayers and discriminate as between them, but the excess-profits tax is one that nearly always worked unfairly and in a discriminating manner as between taxpayers engaged in exactly the same kind of business and making the same percentage of profits upon the cost of the articles or goods produced and sold. This took place because the tax was not computed by using the percentage of profits made upon cost, but upon the relation which the profits bore to the amount of capital invested. The result was that two concerns engaged in the same business, making or producing the same product, and having the same percentage of profit upon cost, would pay altogether different rates; and often the concern that charged the public a lower rate of profit, and sold its goods to the public at a more reasonable price, would pay a higher tax. This was because one concern was moderately and reasonably capitalized, while the other, by reason of having bought up and united with other concerns at an inflated valuation, was highly capitalized, and the tax was estimated by the relation of the profits to the amount of capital. This was one of the reasons given for the repeal of the excess-profits tax at the debates at the time when such action was being considered by Congress, although perhaps not the most important one. It should also be said that there was another feature of the tax that made it seem in one sense extremely arbitrary.

These illustrations show that inequalities in taxation as between the individuals subject to a tax, even though they may be in the ordinary sense of the words, arbitrary, unfair, unjust, and discriminatory, do not necessarily render the tax invalid, for all taxes are subject to this objection to some extent and many of them in a high degree. Most of these discriminations arise from the fact that it is impossible to enact a taxing statute which will adjust itself to the infinite variations in the conditions of the different individuals upon which it is imposed. Others arise from the fact that the legislative body has considered other matters besides those that relate purely to the amount of revenue to be raised by the tax, and this brings us to another objection made to the tax based upon what plaintiff claims was the intent and purpose in imposing it.

It is a common but, as we think, erroneous opinion in some quarters that the legislative body enacting a taxing statute can not with propriety take into consideration any other matters but the revenue sought to be obtained and that if it has other purposes besides raising revenue in imposing the tax, or in prescribing a particular manner in which it shall be levied, the tax is invalid. When enacting a statute it is not only the right but the duty of a legislative body in such cases to take into consideration the effect of the tax in an economic way on the people as a whole, and the beneficial or injurious effects as the case may be which will result from the manner in which the tax is levied. If this were not done, the result might be highly injurious to the public generally and result in a condition of affairs which would arouse so much protest and objection that our institutions would be endangered. In *Bell's Gap R. R. Co.* v. *Pennsylvania* (134 U. S., 232, 237) it was said "that the fourteenth

amendment was not intended to compel the State to adopt an iron rule of equal taxation," and also that such a construction "would render nugatory those discriminations which the best interests of society require * * * and which every State, in one form or another, deems it expedient to adopt." It is certain that if no attention were paid to such matters, complaints against the hardship of taxes, already so numerous would become more strenuous than ever. The benefit or injury to society at large is often considered, and in levying a tax on real property all of our States exempt property used for certain purposes such as that of colleges, philanthropic institutions, and religious bodies. Also in most of the States a certain proportion of personal property used or kept in connection with the home is exempt. Everything else is taxed either at its full value or a certain percentage thereof without any gradation. In this way large amounts of property both real and personal escape taxation entirely, but it has always been held that the State may prescribe such exemptions from taxation as it sees fit. Here again it will be seen that the State may prescribe that persons having certain kinds of personal property, or a certain amount of personal property, shall not be taxed thereon, and it may also provide without any gradation that persons having a different kind of personal property shall be taxed upon all of their property, while under other provisions other persons may be taxed on none of the personal property which they own. It should be noted also that in imposing our Federal income tax certain exemptions are provided, and the amount above these exemptions is subject to a graded normal tax. A person who has no income above the limits set for the normal tax pays no tax on the income he has received which is within the amount of the exemptions. But when the surtaxes are imposed, the amount of the exemption is not considered; or, to put it another way, the total amount of the income of the taxpayer forms the basis for the imposition of the surtaxes. The result is that income which is entirely exempt to one party from tax is not entirely exempt to another, but the Supreme Court in *Brushaber* v. *Union Pacific R. R. Co.* (240 U. S., 1) brushed this objection away without discussion merely stating that there was no violation of the uniformity clause of the Constitution within its proper meaning.

When the objections to the tax are analyzed and the basis therefor ascertained they are found to rest upon the fact that Congress, after dividing the taxpayers under the statute in controversy into two classes, namely, those who sold tickets at a certain excess above the established price and those whose sales included an excess in a lesser amount, fixed a different rate of tax for the respective classes. That Congress had a right to so classify the taxpayers we think must be conceded. It is said that the classification must bear some relation to the tax. Conceding this statement to express the true rule, and giving to it the broadest meaning of which it is capable, it will be found when the rule is applied that in this case the tax is one upon profits and therefore a classification in accordance with the amount of the profits has a very obvious relation to the nature of the tax. If this were not the rule, our income tax could not be sustained. So far it is clear that no constitutional principle has been violated, and the question to be decided in the case is the comparatively narrow one of whether it was beyond the power of Congress under the Constitution to impose a rate upon each of the respective classes that was disproportionate between them, considering the matter in a purely mathematical way.

It seems to be contended on behalf of plaintiff, in substance, that the taxes imposed on the class selling tickets at a price above the excess limit as prescribed by the statute should be at a rate, as compared to the tax on those who sold for less, which would not be considered by counsel as unfair or unreasonable. But it will be observed that the contention is in fact based on the mathematical proportion of the taxes on the respective classes. Having a right to make the classification, Congress is not controlled by mathematical proportions. There is no constitutional inhibition against disregarding the mathematical proportion and grading the tax on some other considerations, which may seem to Congress much more important. Whether Congress erred in this respect is not for the courts to say. With questions that relate solely to the wisdom or policy of the laws that are enacted by that body we have nothing to do, and, as we have before stated, even though it appeared to us (and we do not mean to intimate that it does so appear) that the action of Congress was oppressive or unreasonable, this fact alone will not make such action unconstitutional.

Exactly similar provisions in statutes have been upheld by the Supreme Court. In *Citizens' Telephone Co.* v. *Fuller* (229 U. S., 322), it appeared that the State of Michigan levied a tax on the property of telephone companies on an *ad valorem* basis but provided that telephone companies whose gross receipts for the fiscal year did not exceed $500 should be exempt from taxation. It was urged that the proviso made an unjust discrimination, that the tax was levied on property in accordance with its value, and each dollar's worth should be treated alike. In other words, as the court said in the opinion, the appellant made the basis of comparison the value of the property, and contended that this was an illegal classification because it had no proper relation to the legislative purpose. The district court, on the contrary, considered the inducement of the legislation and its administrative possibilities as giving character to the classification. It will be observed in this case that those companies which were assessed paid a tax not only on property that was above the exemption, but on property which was entirely free from taxation to the companies which were made exempt by the statute. The tax was sustained by the Supreme Court, citing a number of other Supreme Court cases wherein a discrimination had been made between taxpayers upon a number of different grounds, among which might be mentioned that of *Dow* v. *Beidelman* (125 U. S., 680), where a classification of railroads by their length in fixing the rate of passengers' fare was sustained.

With reference to the numerous cases cited in the Citizens' Telephone Co. case, supra, the court said:

"They illustrate the power of the legislature of the State over the subjects of taxation and the range of discrimination which may be exercised in classifying those subjects when not obviously exercised in a spirit of prejudice and favoritism. (*Cook* v. *Marshall County*, 196 U. S., 261, 274; *Missouri* v. *Dockery*, 191 U. S., 165.) The cases decided subsequent to the decision in *Bell's Gap Railroad Co.* v. *Pennsylvania*, supra, have applied its principle to many varying instances. Granting the power of classification, we must grant government the right to select the differences upon which the classification shall be based, and they need not be great or conspicuous. (*Keeney* v. *New York*, 222 U. S., 525, 536.) The State is not bound by any rigid equality. This is the rule—its limitation is that it must not be exercised in 'clear and hostile discriminations between particular persons and classes.' (See 223 U. S., 59, 62, 63.) Thus defined and thus limited, it is a vital principle, giving to the Government freedom to meet its exigencies, not binding its action by rigid formulas but apportioning its burdens and permitting it to make those '*discriminations which the best interests of society require.*'" [Italics ours.]

In *Magoun* v. *Illinois Trust & Savings Bank* (170 U. S., 283) it appeared that an inheritance tax had been imposed which exempted estates of $500, but did not allow that exemption to larger estates. Moreover, it prescribed progressive rates rising in steps with the amount of the gift and applying to the entire gift and not merely to the excess. Under the law a legatee of $10,000, being subject to a 3 per cent tax, would receive net $9,700, whereas a legatee of $10,001, being subject to a 4 per cent tax on the entire legacy, would receive net only $9,600.96. The court held the classification reasonable. Stepped taxes of this type are found in a number of State statutes and have always been held valid.[1] In *Metropolis Theatre Co.* v. *Chicago*, supra, an ordinance which laid a tax of $1,000 upon theaters whose admission was $1 or more, but only $400 upon those similarly situated whose admission prices were less than $1 and more than 50 cents was held valid.

The cases which have been cited above show that property may be taxable upon its value when such value is above a sum fixed in the statute, but that it is constitutional for a legislative body to provide that when the property held or owned by an individual is below a certain sum in value it shall not be taxable at all. If it be said that these decisions have applied only to cases where the tax was not in an undue or unreasonable proportion so that in fact it only amounted to a gradation of the tax, the answer is that the State is not compelled to levy the tax in any particular proportion, and even though the proportion used may seem to be unreasonable it is no reason why the statute should be declared unconstitutional. The same rule applies to gradations which are for the legislative body, in its wisdom, to determine. If it be said that the

[1] See note 5 to dissenting opinion in *Louisville Gas Co.* v. *Coleman* (277 U. S., 32, 46).

decisions cited above apply only to cases where a certain amount of the basis of the tax was exempt, the distinction on the facts is apparent, but so far as the application of the principle is concerned it is clear that if the legislature could make a certain amount exempt entirely it could instead levy a tax thereon which was less than that imposed on a higher amount of the taxable basis.

As we consider that Congress had the power to make the classification in question, we think it is not necessary to also find a reason therefor, but if a reason is necessary we think one can be found. The principle that excessive and extortionate profits may be made subject to a heavy or what might be called an excessive tax is now firmly established. The Federal tax on excess profits, repealed some years ago, ran as high as 80 per cent—a rate which at one time would have been thought confiscatory. True, it was originally imposed in a time of war, but it was maintained in time of peace and no one thought of questioning its validity. Congress, it seems to us, might well have considered that a profit of above 75 cents on the sale of a ticket was not merely excessive but extortionate and it had the right to take into consideration in imposing a tax thereon the injury done the community by the extortion of these excessive prices, as the circumstances of the case show that the buyer was often at the mercy of the ticket broker. If it were for us to pass on the question, we would say that we have no doubt that it was for the interests of the community in general as well as for the particular individuals who purchased the tickets and for the business of carrying on legitimate theaters that the taxes be so levied as to have a tendency to stop such practices. Our opinion, however, is immaterial except that it may afford a basis for concluding that Congress may have had a valid reason for imposing the tax in such a manner that one-half of the profits was taken when the tickets were sold above a certain amount.

We conclude therefore that the classification and the rates of the tax are not palpably arbitrary, discriminatory, or whimsical, and unless they are we ought not to hold the Act imposing the tax unconstitutional. A discrimination was in one sense made by Congress but the presumption is that this discrimination was one "which the best interests of society require," and we find nothing in the language of the Act or the surrounding circumstances to overthrow this presumption.

In accordance with the views above expressed the plaintiff's petition will be dismissed, and it is so ordered.

TITLE V.—TAX ON TELEGRAPH AND TELEPHONE MESSAGES. (1921)

REGULATIONS 57, ARTICLE 9: Messages transmitted under contract. XI-7-5389 Ct. D. 449

TRANSPORTATION TAX—REVENUE ACTS OF 1918 AND 1921—DECISION OF COURT.

Where telegraph messages are transmitted under a contract between a telegraph company and a railroad company for a mutual exchange of services, which provides for the passing of no money from one to the other but by the terms of which each year the telegraph company will give to the railroad company freight business which at tariff rates will equal in volume 55.47 per cent of the commercial day rate of the telegraph business given by the railroad company to the telegraph company and in case the telegraph business exceeds the freight business there will be no charge for the excess, the messages are transmitted for a charge within the meaning of section 500(f) of the Revenue Act of 1918 and section 500(a) of the Revenue Act of 1921, and are therefore taxable thereunder. The tax is to be computed at the commercial rate for telegraph services published by the telegraph company and not at 55.47 per cent of the commercial rate as provided in the contract.

COURT OF CLAIMS OF THE UNITED STATES. No. K–547.

Erie Railroad Co. v. *The United States.*

[December 7, 1931.]

OPINION—ON DEMURRER.

WHALEY, Judge, delivered the opinion of the court.

The plaintiff brings this suit to recover $52,156.60, with interest, paid by it as excise taxes on the transmission of telegraphic messages. The defendant demurs to the amended petition on the ground that the petition does not set forth a cause of action against the United States. In considering the demurrer the material allegations of the amended petition are assumed to be admitted as true.

The plaintiff was a corporation organized under the laws of the State of New York, and was, during the period involved, operating a system of railroads in several States. In conducting its business the plaintiff had many telegraphic messages transmitted for it by the Western Union Telegraph Co. under the terms of a contract for a mutual exchange of services. The excise taxes on the transmission of the telegraph messages were assessed against and paid by the plaintiff under the provisions of subdivision (f) of section 500 of the Revenue Act of 1918 and subdivision (a) of section 500 of the Revenue Act of 1921 (provisions of both statutes being identical), for the period between January, 1921, and June, 1924. The plaintiff duly filed claims for refund which were rejected by the Commissioner of Internal Revenue.

It is only necessary to insert the pertinent parts of the statute of the Revenue Act of 1918 (40 Stat., 1057, 1101), as the Act of 1921 (42 Stat., 227, 284) is identical in its provisions.

"SEC. 500. That from and after April 1, 1919, there shall be levied, assessed, collected, and paid, in lieu of the taxes imposed by section 500 of the Revenue Act of 1917—

* * * * * * *

"(f) In the case of each telegraph, telephone, cable, or radio, dispatch, message, or conversation, which originates on or after such date within the United States, for the transmission of which the charge is more than 14 cents and not more than 50 cents, a tax of 5 cents; and if the charge is more than 50 cents, a tax of 10 cents: *Provided*, That only one payment of such tax shall be required, notwithstanding the lines or stations of one or more persons are used for the transmission of such dispatch, message, or conversation; and

"(g) A tax equivalent to 10 per centum of the amount paid after such date to any telegraph or telephone company for any leased wire or talking circuit special service furnished after such date. This subdivision shall not apply to the amount paid for so much of such service as is utilized (1) in the collection and dissemination of news through the public press or (2) in the conduct, by a common carrier or telegraph or telephone company, of its business as such;

* * * * * * *

"SEC. 501. (a) That the taxes imposed by section 500 shall be paid by the person paying for the services or facilities rendered.

* * * * * * *

"(c) The taxes imposed by section 500 shall apply to all services or facilities specified in such section when rendered for hire, whether or not the agency rendering them is a common carrier. * * *"

Article 9 of Regulations No. 57 is, in part, as follows:

"ART. 9. *Messages transmitted under contract.*—Where, by contract, a telegraph, telephone, radio, or cable company agrees, in consideration of the payment of a lump sum or of the performance of services, to transmit messages on frank, such messages are subject to the tax imposed by this section (500(a)) of the Act. The tax on each such message is to be computed upon the amount of the regular established charge for the transmission of similar messages for ordinary customers, calculated at the regular fixed rate provided in the tariffs of the transmitting carrier. The questions as to whether such messages relate to the operation of the business of a common carrier and whether they are 'on line' or 'off line' are immaterial. Thus, a telegraph company agrees to trans-

mit over its lines on a railroad line all messages relating to railroad business 'free' and all such messages over its lines off the railroad lines 'free' to an amount not exceeding $10,000 per year calculated at its regular rates, and all messages over that amount at half rates, in consideration of services to be performed by the railroad in the transportation of men and materials of the telegraph company. All such messages, whether 'on line' or 'off line,' and whether 'free' or at half rates, are subject to the tax provided by this section (500(a)) of the Act. The tax must be computed, collected, and paid upon each such message * * *."

The contract is dated September 25, 1907, and commenced to run on October 1, 1907, ending September 30, 1928. The material provisions of the contract for our consideration are set forth in the fourth and fifth paragraphs and are as follows:

"Fourth. All messages of the railroad company, and of its officers, employees and agents, pertaining to its business, shall be transmitted free of charge by railroad operators on the wires set apart for said business, between all telegraph stations, offices or other buildings of the railroads covered by this agreement.

"The telegraph company agrees to issue or cause to be issued to such officials of the railroad company, and of its own subsidiary railroad, coal, transportation and steamboat companies, and of its own freight and transportation lines, as may be designated by the president, vice president or general manager of the railroad company, annual franks authorizing the transmission of messages signed by such officials, and answers thereto, relating strictly to the business of the railroad company and its subsidiary companies, originating at or destined to points on the telegraph company's lines in the United States and Canada, either on or off the line of said railroads.

"The tolls on all such messages shall be calculated at 55.47 per cent of the regular commercial day rates of the telegraph company between points where such messages originate and points to which destined, and charged to the railroad company in one account to be settled for as hereinafter provided. No charge shall be made for any message between points on the lines of the railroads at any time covered by this agreement, but if sent between the telegraph company's independent offices such messages shall be charged up to the railroad company. Settlements of all accounts between the parties hereto shall be made annually.

"The telegraph company agrees that in each and every year during the continuation of this agreement it will furnish to the railroad company freight traffic of the kind described in subdivision (C) of article fifth, to such an amount that the earnings of the railroad company thereon at its regularly established rates shall not be less than the amount charged by the telegraph company against the railroad company for telegraph messages in the same year as above provided. The telegraph company further agrees that in case of its failure so to do its charge for telegraph service for the railroad company and its subsidiary companies in such year shall be reduced to the gross earnings of the railroad company upon such freight traffic of the telegraph company.

"It is understood and agreed that the telegraphic service under franks herein provided for applies only to the transmission of messages concerning the operations and business of the railroad company, and shall not be extended to any messages for transmission by ocean cable, and shall not be so used by the railroad company as to compete with the telegraph company.

"In the use of said franks by the freight and transportation lines aforesaid the railroad company shall pay, or cause to be paid, to the telegraph company as herein provided, the amounts chargeable to other interests than the railroad company, as determined by the railroad company; statements of such freight and transportation lines' telegraphic service to be rendered separately by the telegraph company to the railroad company monthly.

"It is further agreed that messages sent upon business of freight and transportation lines, in which the railroad company has a minor interest, other than those hereinbefore mentioned in this section, shall to the extent of such interest, be deemed to be upon the business of the railroad company and subject to the provisions in respect to such business herein contained; and any charges made by the telegraph company upon business of such freight or transportation lines shall, to the extent they are charged by said lines to the railroad company, or to the extent of the proportion of the railroad

company's ownership in such lines, be refunded to the railroad company and the amount thereof charged to the railroad company's account.

"Fifth. The railroad company, so far as it lawfully may, agrees (A) to issue to the general officers of the telegraph company, annual passes authorizing their transportation over the railroads covered by this agreement, when traveling on the business of said telegraph company covered thereby.

"(B) to transport over all such railroads, upon application of a superintendent or other general officer of the telegraph company, all persons in the employ of the telegraph company, when traveling on such business of said company, and to transport over such railroads, including train service for distribution wherever required along any of said railroads, all poles, wire, cross-arms and other material and supplies of the telegraph company for the construction, maintenance, operation, repair and reconstruction of the lines and wires upon and along such railroads, and of such additional wires and lines of poles and wires as may be erected under the provisions of this agreement; and also to so transport all supplies for the establishment, equipment, maintenance and operation of the telegraph offices of the telegraph company and the railroad company, at places along and adjacent to, or at the termini of said railroads, and also old material from the offices and lines along said railroads returned to the telegraph company's supply department. It being clearly understood that the transportation outlined does not cover any material for the building, repairs or renewal of any telegraph line not on the line of said railroads, nor for the offices of such line, nor for any offices unless the mains leading from them run along the railroads covered by this agreement; and

"(C) to transport the telegraph company's poles, wires, cross-arms and its other material and supplies over any or all the railroads covered by this agreement, to be used beyond or off the line of all such railroads, and that all the transportation covered by this paragraph C shall be charged up by the railroad company to the telegraph company's account at regular current, through or local transportation rates, as the case may be, and settlements made therefor annually as above provided in the fourth article of this agreement.

"All passes or transportation in any form granted by said railroad company, at the request of said telegraph company, shall be subject to the railroad company's usual contract releasing it from all liability for any injury to the person or for any loss or injury to the property of the person to whom passes or transportation may be issued, whether such injury or loss shall be caused by the negligence of the railroad company itself, its agents or servants, or otherwise."

It will be seen from the terms of the contract set out above that each year the telegraph company will give to plaintiff freight business which at tariff rates will equal in volume 55.47 per cent of the commercial day rate of the telegraph business given by plaintiff to the telegraph company, and in case the telegraph business exceeds the freight business, there will be no charge for the excess.

The plaintiff contends that (1) there being a mere exchange of services, no money passing from one to the other, there is no charge upon which the excise tax can be computed and therefore it is not assessable; (2) that in any event the excise tax should not exceed that based on 55.47 per cent of the commercial rates, the Commissioner of Internal Revenue having made his assessment at 100 per cent of the commercial rate.

Contracts for the exchange of services between railroad and telegraph companies involving practically the same question now presented have been before the courts on several occasions. The material question to be decided is whether the services rendered under this contract were computed in money or on a monetary basis. It is true that no money was actually passed in the exchange, but the exchange of services each year was calculated on the full tariff rates as to the freight business of the railroad, and as to the telegraph business at the full public rate and then reduced to 55.47 per cent of the commercial rates.

In *Hellmich* v. *Missouri Pacific* (273 U. S., 242, 254 [T. D. 4040, C. B. VI-2, 305]) there was also an exchange of services between the railroad and the telegraph company except that the excess of one business over the other, freight over telegraph, or vice versa, with certain immaterial exceptions, was to be paid at public rates. The question there was, as stated by the court, whether the payment of the telegraph messages by transportation was "a charge which can be measured, or measures itself, in money." (The same statutes were

under consideration in that case as are involved in the instant case.) The court said: "The most significant evidence that it is, appears in the conduct of the parties themselves, for in their exchange of such services they make actual payments to each other in money above a certain amount of business, which amount itself they determine by a carefully kept account of actual services in money figures."

The only difference between this case and the Hellmich case is that in the latter case money actually passed in the settlement. In the instant case no money was passed between the parties, but the services rendered to the railroad company by the telegraph company were computed in money on the basis of the commercial rate for the general public, and reduced to a percentage, and the services of the railroad company were likewise computed on the published tariff rate in money, and if not equal to the total amount for services rendered by the telegraph company on the fixed percentage basis, the latter still further reduced the percentage to a sum equal to the amount found due to the railroad company. Money, or its equivalent, is the underlying basis of the method of arriving at the value of the respective services and the exchange thereof. The rendition of each act of service is first ascertained on the commercial public rates of the respective carriers. We can see no difference between the contract in the Hellmich case and the contract in the instant case.

The plaintiff contends that if the excise tax is assessable it should be computed, not at the commercial rate for telegraph services, but at 55.47 per cent of the commercial rate, as called for in the contract.

In *Western Union Telegraph Co.* v. *Delaware, L. & W. R. Co.* (282 Fed., 925 [T. D. 3369, C. B. I–2, 272]), considering a similar contract for exchange of services, the court said:

"Giving reasonable scope to the legislative intent, the Act, in my judgment, must be construed to cover all messages transmitted for an economic consideration—money or money's worth. It is difficult under a sound taxing policy to find a basis for differentiation between exchanges and cash-paid services."

The Treasury Department issued article 9, Regulations 57, as an aid in the administration of the excise tax herein assessed. That regulation provides, among other things:

"The tax on each such message is to be computed upon the amount of the regular established charge for the transmission of similar messages for ordinary customers, calculated at regular fixed rate provided in the tariffs of the transmitting carrier."

The Supreme Court held that this regulation was proper to carry out the statute with reference to such a contract as was involved in the Hellmich case. The plaintiff's contract must be construed to provide for the payment of messages in money's worth and the regulation promulgated by the Treasury Department is appropriate also to plaintiff's contract.

The same regulation was under consideration in the *Western Union Telegraph Co.* v. *Delaware, L. & W. R. Co.*, supra, and the court held:

"The regulation issued by the Commissioner seems to comport with the general tenor of the Act, and the record and arguments advanced before me do not indicate that it is unreasonable as applied to the present controversy. In cases of this kind, administrative rulings made by the Department, after careful consideration of the problem as it affects the country as a whole, ought not lightly to be disturbed by the courts."

Considering a similar contract and construing the same regulation, Judge Hand said in *Delaware, L. & W. R. Co.* v. *Bowers* (28 Fed. (2d), 33, 35 [T. D. 3816, C. B. V–1, 373]):

"It is clear that the franked messages are not transmitted by the telegraph company for the benefit of the railroad without compensation, but in each case are in exchange for some valuable consideration. They are not, to be sure, paid in cash. I have had no little difficulty in arriving at a valuation for the messages, but there is a charge in fact made, and the method adopted by the departmental regulation fixing the value of the services is not unreasonable. The amount ordinarily charged to the public seems a fair measure of the worth of the service."

The regular established charge for the public represents the amount upon which the tax is to be computed. (*United Cigar Stores Co.* v. *United States*, No. F–102, decided by this court June 1, 1931, 72 C. Cls. [Ct. D. 888, C. B.

X-2, 413]; *United Profit Sharing Corporation* v. *United States*, 43 Fed. (2d), 266; and *Colgate & Co.* v. *United States*, 66 C. Cls., 510 [T. D. 4160, C. B. VII-1, 302].)

The Commissioner was correct in assessing the excise tax upon the regular commercial rate as published by the telegraph company. The petition does not state a cause of action and should be dismissed. It is so ordered.

TITLE V.—TAX ON TRANSPORTATION AND OTHER FACILITIES, AND ON INSURANCE. (1918)

TRANSPORTATION OF OIL BY PIPE LINE.

REGULATIONS 42, ARTICLE 76: Miscellaneous provisions. XI-14-5434 Ct. D. 466

TAX ON TRANSPORTATION—REVENUE ACT OF 1918—DECISION OF COURT.

1. TAX ON TRANSPORTATION OF OIL—REPEAL—"SAVING CLAUSE."

The tax for the transportation of oil by pipe line from April 1, 1919, to December 31, 1921, levied under the provisions of sections 500(e) and 501(d) of the Revenue Act of 1918 accrued under the Revenue Act of 1918 within the meaning of the "saving clause" contained in section 1400(b) of the Revenue Act of 1921, although prior to the repeal of said sections 500 and 501 no correct determination of a reasonable charge for such transportation was made by the Commissioner in accordance with section 501(d)2 of the Revenue Act of 1918.

2. SAME—CONSTITUTIONALITY.

The tax paid by the owner of oil transported by pipe line levied under the provision of section 500(e) and section 501(d)2 of the Revenue Act of 1918 is constitutional although prior to the repeal of said sections no correct determination of a reasonable charge for such transportation was made by the Commissioner in accordance with section 501(d)2 of the Revenue Act of 1918.

3. COLLECTION — VALIDITY — ABATEMENT — ALLOCATION TO ONE OF THREE ASSESSMENTS.

Where for the period from April 1, 1919, to December 31, 1921, there have been three assessments of tax, each covering a part of the period, for the transportation of oil by pipe line levied under sections 500(e) and 501(d)2 of the Revenue Act of 1918, which were paid after demand on the basis of a recomputation in March, 1924, the subsequent allocation of an amount abated to the second assessment can not be made the basis for a valid claim that the tax was not properly collected for the transportation in the last three months of 1921 which were not covered by the second assessment.

UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF CALIFORNIA, SOUTHERN DIVISION.

Standard Oil Co. of California, a Corporation, plaintiff, v. *John P. McLaughlin, United States Collector of Internal Revenue for the First District of California, defendant.*

[January 16, 1932.]

OPINION.

KERRIGAN, Judge: Plaintiff seeks to recover taxes in the sum of $1,619,143.11 together with interest from September 3, 1924, at 6 per cent per annum. The tax covers the transportation of oil by pipe line from April 1, 1919, to December 31, 1921. It was levied under the provisions of sections 500 and 501 of the Rev-

enue Act of 1918 (40 Stat. L., 1101, 1103), the pertinent portions of which are as follows:

"SEC. 500. That from and after April 1, 1919, there shall be levied, assessed, collected and paid, in lieu of the taxes imposed by section 500 of the Revenue Act of 1917—

* * * * * * *

"(e) Tax equivalent to 8 per centum of the amount paid for the transportation on or after such date of oil by pipe line; * * *."

These sections were in effect from April 1, 1919, to December 31, 1921, being repealed by the Revenue Act of 1921, effective January 1, 1922. The repeal, however, was subject to the saving clause contained in section 1400, subdivision (b), of the Revenue Act of 1921 (42 Stat. L., 321):

"(b) The parts of the Revenue Act of 1918 which are repealed by this Act shall (unless otherwise specifically provided in this Act) remain in force for the assessment and collection of all taxes which have accrued under the Revenue Act of 1918 at the time such parts ceased to be in effect, and for the imposition and collection of all penalties or forfeiture which have accrued or may accrue in relation to any such taxes. In the case of any tax imposed by any part of the Revenue Act of 1918 repealed by this Act, if there is a tax imposed by this Act in lieu thereof, the provision imposing such tax shall remain in force until the corresponding tax under this Act takes effect under the provisions of this Act. The unexpended balance of any appropriation heretofore made and now available for the administration of any such part of the Revenue Act of 1918 shall be available for the administration of this Act or the corresponding provision thereof."

Plaintiff contends, first, that the taxes did not accrue under the Revenue Act of 1918 and were, therefore, not saved by section 1400(b); second, that the law under which the tax was assessed was unconstitutional; third, that if the tax was in fact legal and constitutional it is excessive in amount.

The plaintiff is an oil corporation which, during the period in question, was engaged in the business of producing, purchasing, refining and marketing crude oil and its products. It maintained private pipe lines which were used exclusively for transporting its own products. At no time was there any charge made for the transportation of these products; nor were there any bona fide actual rates or tariffs in existence from which the tax could be computed nor any basis of rates or tariffs of other pipe lines for like service. It is conceded that the tax due from plaintiff had, therefore, to be computed on the basis of a reasonable charge for transportation. May 7, 1919, in accordance with Treasury Decision No. 2834, Regulations 49, plaintiff reported these facts to the Commissioner of Internal Revenue and requested him to fix the reasonable charge for transportation. This determination was delayed and the time within which plaintiff should file its return was extended from time to time until on September 28, 1920, the Commissioner of Internal Revenue certified an assessment of taxes in the sum of $467,853.74, covering taxes due from April 1, 1919, to May 31, 1920. Demand for payment was made by the collector in April, 1921, and on April 14, 1921, plaintiff made a claim for abatement. Another assessment was certified February 14, 1922, covering taxes due from April 1, 1919, to September 30, 1921, in the sum of $2,333,042.17, as to which assessment a claim for abatement was filed March 10, 1922. Finally a third assessment in the sum of $598,967.23, covering additional tax due for the period from April 1, 1919, to September 30, 1921, and also tax due from October 1, 1921, to December 31, 1921, was certified December 27, 1922, demand for payment being made by the collector January 16, 1923, and a claim for abatement being filed January 23, 1923. No determination was had as to any of the claims for abatement until July 24, 1924, when the sum of $853,710.22 was allowed by way of abatement on the second assessment, the claims as to the first and third assessments being allowed in full, the notice stating "As your entire liability for the period covered by this assessment has been paid and credited against another assessment, the claim is allowed in full."

At the time when the formal notice of adjustment of the claim for abatement was given, the taxes abated had in fact been paid, upon a recomputation of which plaintiff received informal notice February 16, 1923, and formal notice June 27, 1923. Formal demand for payment of the recomputed tax was made March 10, 1924; the tax was paid under protest March 29, 1924, and negotiations for compromise of demands for penalty and interest at 1

per cent per month were entered into. The penalty was compromised, but the interest was not, and plaintiff finally paid under protest the interest at 1 per cent per month from the time of formal notice of the recomputation (June 27, 1923) to the time when the tax was paid. A claim for refund having been duly made this action was commenced to recover the taxes and interest paid.

The procedural steps have been stated thus in detail because of their bearing upon the various contentions of plaintiff. It is conceded that the tax finally computed was based upon a correct determination of a reasonable charge for the transportation of oil actually transported but it is contended that the fact that this determination, in 1923, was made over a year after the repeal of the Revenue Act of 1918 is a major factor to be considered in deciding whether the tax was constitutional in its application to plaintiff and whether the tax "accrued" prior to the repeal of the Revenue Act of 1918.

In considering whether this tax had "accrued" prior to the repeal of the applicable portion of the Revenue Act of 1918, within the meaning of the saving clause of the Revenue Act of 1921, the first inquiry is as to the incidence of the tax. The taxing Act itself and the decisions construing it (*Motter* v. *Derby Oil Co.*, 16 Fed (2d), 717 [T. D. 3965, C. B. VI–1, 294]; *Dixie Oil Co.* v. *U. S.*, 24 Fed. (2d), 804 [T. D. 4166, C. B. VII–1, 295]) make it plain that what is taxed is the privilege of using certain property in a certain way, i. e., the privilege of using pipe line facilities for the transportation of oil. The statute levies the tax and fixes the rate at 8 per cent of the amount paid for the transportation of oil by pipe line. Recognizing, however, that much oil was carried through pipe lines by private carriers and not for hire, and expressly desiring that such transportation should be taxed, Congress provided, in section 501(d), a method by which the tax to be paid at the designated rate should be determined and fixed in amount. The incidence of the tax is, however, not thereby shifted from the privilege of transportation being taxed, and in the present case it is conceded that all of the transportation taxed occurred prior to the repeal of sections 500 and 501 of the Revenue Act of 1918, and that the charge for such transportation finally determined by the Commissioner as the basis for computing the tax is a reasonable charge.

However, the plaintiff takes the position that a determination of the reasonable charge for transportation is a condition precedent to the coming due of the tax, and that, as no *correct* determination was made prior to the repeal, payment of the tax was not due at the time of the repeal, hence that the tax had not "accrued" at the time of the repeal. (See *United States* v. *Woodward*, 256 U. S., 632 [T. D. 3195, C. B. 4, 153].) This position is not tenable for two reasons. In the first place, looking at the sections of the Revenue Act of 1918 with which we are concerned, it is apparent that, as had been said previously, the essential factor in the creation of a liability to pay the 8 per cent tax there imposed is the fact of transportation of oil by pipe line. After transportation had occurred, the only factor remaining to be ascertained was the "amount paid" for it; in the case of plaintiff, this "amount paid" was to be fixed on the basis of a reasonable charge as determined by the Commissioner.

With this situation in mind, the meaning of the phrase "all taxes which have accrued" in the saving clause of the Revenue Act of 1921 as applied to the tax with which we are here concerned, may be determined. In connection with estate taxes, this phrase has already been construed, as it appears in the same form in both the Revenue Acts of 1918 and 1921, and has been held to mean all taxes which "have arisen under" the prior Acts. (*Page* v. *Skinner*, 298 Fed.. 731 [T. D. 3600, C. B. III–1, 485]; *Eubank* v. *United States*, 50 Fed. (2d), 409; and see *Alker* v. *United States*, 47 Fed. (2d), 229.) In these cases a tax was held to have "accrued" under a prior Act when the right to succession arose under the earlier Act although payment was not due until after the repeal. I am satisfied that the same construction is applicable here, and that the taxes in question, for the period from April 1, 1919, to December 31, 1921, "accrued" before the repeal of the Revenue Act of 1918, even though the tax were considered to be uncollectible prior to the repeal because of a failure of determination of the basis for computation.

This brings me to a consideration of the second ground for holding these taxes to have accrued prior to the repeal of the Act of 1918. The Commissioner had in fact made a determination of a basis for computing the tax prior to the repeal of the statute, and had based an assessment thereon. He had exercised his jurisdiction in this regard. It is true, that it is now conceded that his conclusions were erroneous, but this does not make them void. (*Foltz* v. *St.*

Louis & S. F. Ry. Co., 60 Fed., 316, 318; *United States* v. *Ness*, 230 Fed., 950, 953.) Until reviewed by virtue of the claim for abatement or tested by action in the courts of the United States following payment by plaintiff and claim for refund, this determination stood. Plaintiff might accept it or protest it, but until a different basis of computing the tax was arrived at, either by the Commissioner or by a judgment, the last act necessary to make this tax collectible stood accomplished. And this was done before repeal, as the first assessment was certified in 1920, payment being demanded in April, 1921. At that time, and without any assessment, the United States could have sued for tax then computed to be due, and from that time on, up to the final recomputation and accession to plaintiff's contentions in that regard, could have sued for successive accruals of taxes, relying upon the first computation whether it was right or wrong. In such a suit the same defenses would have been open to plaintiff as those which finally led to the result actually accomplished through proceedings before the Commissioner. (*United States* v. *Chamberlin*, 219 U. S., 250; *United States* v. *Nashville, C. & St. L. Ry.*, 249 Fed., 678; *United States* v. *Ayer*, 12 Fed. (2d), 194 [T. D. 3869, C. B. V–1, 397].) Hence, applying the test suggested by plaintiff, that it must appear that the taxes had become due and collectible prior to the repeal of sections 500 and 501(d), I must hold that these taxes had accrued within the meaning of section 1400(b) of the Revenue Act of 1921.

In considering the correctness of the determination of the amount of tax due, it is to be remembered that the plaintiff admits that the computation represents the 8 per cent due for the actual transportation of oil upon the basis of a reasonable charge. It is argued, however, that because the notice of allowance of the claim for abatement July 24, 1924, allocated the tax paid to the second assessment which covered the period from April 1, 1919, to September 30, 1921, plaintiff is entitled to recover the tax paid for transportation of oil during the months of October, November, and December of 1921, which were not covered by the second assessment. I can not agree with this conclusion. The tax was actually paid under protest, not upon any one of the three assessments, but upon the demand for payment on the basis of the recomputation, March 19, 1924. The subsequent allocation of the amount abated to the second assessment must be regarded as merely a convenient form of completing the Department record and can not be made the basis for a claim that the tax for the last three months of 1921 was not properly collected, especially as the Revenue Act of 1918 (section 502) provides that the tax (once computed) is due and payable without assessment. Section 502, referred to, also affords the basis for the collection of the interest charged.

The question of the constitutionality of the statute remains to be discussed. There can be no question of the general validity of this excise tax upon the privilege of transporting oil, by pipe line. (*Meischke-Smith* v. *Wardell*, 286 F., 785 [T. D. 3461, C. B. II–1, 256]; *Motter* v. *Derby Oil Co.*, 16 Fed. (2d), 717; *Dixie Oil Co.* v. *United States*, 24 Fed. (2d), 804.) Plaintiff's first attack upon the constitutionality of the statute is upon the ground that the delegation to the Commissioner of the power to find the reasonable charge for transportation to be taken as a basis for computing the tax is an unconstitutional delegation of legislative power. The taxing statute, however, designates the thing to be taxed—transportation of oil; fixes the rate of taxation—8 per cent; and levies the tax. The only thing remaining to be determined is, in the case of taxpayers situated as is plaintiff, the reasonable charge for transportation to be used as a basis for computing the tax levied. The Commissioner is left to find a fact, which in the nature of things Congress could not find in advance; what he is required to do is merely in execution of the Act of Congress in levying this transportation tax. This is not a delegation of legislative power contrary to the Constitution. (*Hampton & Co.* v. *United States*, 276 U. S. 394.)

Nor can it be said that the failure of the statute to provide for a hearing before the Commissioner prior to his determination of a reasonable charge for the transportation constitutes a denial of due process. (*Hager* v. *Reclamation District No. 108*, 111 U. S., 701.) Assuming that plaintiff, in view of its concession that the charge actually fixed is reasonable, is in a position to raise this question, it is sufficient to say that the absence of provisions for hearing prior to the determination does not leave the taxpayer without remedy, as appears from the procedure followed by plaintiff itself. The question of the reasonableness of the charge may be presented to the administrative authority

by means of claim for abatement, and, after payment, in a claim for refund. It may further be presented to the courts by such a suit as this. Although the question is not necessary to the determination of this case, I do not believe that were the matter in issue, I would be foreclosed from examining into the reasonableness of the charges fixed by the Commissioner by the case of *Williamsport Wire Rope Co.* v. *United States* (277 U. S., 551 [T. D. 4172, C. B. VII–2, 323]), relied upon by the defendant. That case denies review of the discretionary selection of one section of a statute rather than another as the proper section under which to make an assessment, whereas the reasonableness of the charge determined under section 501(d) would appear to me to be a finding of fact similar to those mentioned at page 560 of the opinion in the Williamsport case and open to review.

The final contention with regard to the constitutionality of the imposition of this tax upon plaintiff arises from the following facts: It is alleged in the complaint, and admitted in the answer, that during the period while the tax was in force "the contracts of plaintiff with its customers provided that said customers would pay any tax levied upon the product sold or delivered to them by plaintiff, or upon the transportation thereof; that in the absence of an establishment by the Department of Internal Revenue of rates upon which the tax could be based, plaintiff was totally unable to and therefore did not collect any such tax from its customers." Plaintiff's standard contract is attached to the complaint as an exhibit, the pertinent portion reading: "Any internal revenue tax, war tax, impost, tonnage tax, shipping tax or other tax or charge of any kind hereafter made effective (whether similar to the taxes and charges herein before specified or not) and levied by governmental authority on the said oil delivered hereunder, its container, on any pipe line, or on any boat that may be used in transporting said oil, its tackle, apparel or furniture, or on the transportation of said oil, or on this contract, the price, or any matter connected with this contract, shall be added to the price of the said oil herein stated, and shall be paid by the buyer while the same is in effect, unless the buyer elects to terminate this contract; whereupon, unless the seller elects to pay such tax or charge, this contract shall terminate."

It is argued that since the course of events was such that plaintiff could not collect the tax from its customers at the time when transportation occurred the tax lost its ostensible character as an excise tax which could be passed along to the consumer and became as applied to plaintiff, a direct tax unconstitutional as in violation of Article I, section 2, clause 3, and Article I, section 9, clause 4, of the Constitution. It should be noted once more that the thing taxed is transportation; neither the oil transported nor the sales thereof are taxed. The complaint and the annexed contract show that the purchasers of oil agreed to add the amount of certain taxes to the purchase price of the oil, but they do not show that these purchasers of oil paid for the transportation even indirectly. Nor does it appear that title to the oil passed to them prior to the transportation of the oil. (*Wheeler Lumber, etc., Co.* v. *United States*, 281 U. S., 572 [Ct. D. 196, C. B. IX–2, 417].) It is specifically alleged that no direct charge for transportation was made. On this state of the record plaintiff itself was the "consumer" of transportation subject, as any other owner of oil transporting his own products by pipe line, to this excise tax. (*Dixie Oil Co.* v. *United States*, 24 Fed. (2d), 804; *Wheeler Lumber Co.* v. *United States*, 281 U. S., 572.) I am not called upon, therefore, to speculate as to the situation were it apparent that plaintiff's customers were chargeable with the transportation cost and tax, and that plaintiff was unable to collect the tax from those from whom it was rightly due. In the present case, I must hold that it was plaintiff's corporation which was liable for the tax, and that it was as to plaintiff a valid excise tax.

Plaintiff's motions to strike out certain evidence offered by defendant and for special findings are denied. Exception noted. Following the suggestion in *Parker* v. *St. Sure*, decided by the Circuit Court of Appeals for the Ninth Circuit on October 26, 1931 (see Supplement to Manual of Federal Procedure, by Paul P. O'Brien, pages 5 and 6), this opinion is adopted by me as my findings of fact and conclusions of law.

Defendant's motion for judgment is granted and plaintiff may have an exception. I find generally for defendant. Let judgment be entered accordingly with costs.

TITLE IX.—EXCISE TAXES. (1918)

REGULATIONS 47(1921), ARTICLE 4: Discounts and expenses. XI-14-5435 Ct. D. 465

SALES TAX—REVENUE ACTS OF 1918, 1921, AND 1926—DECISION OF COURT.

1. TRADE DISCOUNTS—BURDEN OF PROOF.

Where in a suit to recover excise taxes paid under the provisions of section 900(19) of the Revenue Acts of 1918 and 1921 the taxpayer does not sustain its burden of proof that it consistently observed the policy of granting its customers trade discounts and not cash discounts or discounts made subsequent to sales, the taxpayer can not recover any part of the taxes computed on the list prices for which the taxable articles were sold.

2. ASSESSMENT—VALIDITY—UNNECESSARY EXAMINATION OF BOOKS.

The Commissioner's failure to comply with section 1105 of the Revenue Act of 1926 by notifying the taxpayer in writing that an additional examination of its books is necessary does not invalidate an assessment resulting from such examination though made under protest of the taxpayer and a threat of a fraud order if the taxpayer refused access to its books.

3. REFUND—LIMITATION—BURDEN OF PROOF—COMPUTATION OF JUDGMENT.

The burden of proof is upon the taxpayer to establish overpayments and where from the record the court is unable to find what proportion of alleged overpayments for which suit is brought was not barred from refund by section 3228, R. S., as amended, it is impossible for the court to compute the amount of the judgment and the taxpayer's suit must be dismissed.

COURT OF CLAIMS OF THE UNITED STATES. No. J-281.

Philip Mangone Co., Inc., v. *The United States.*

[December 7, 1931.]

OPINION.

BOOTH, Chief Justice, delivered the opinion of the court.

The plaintiff in this case concedes an excise tax liability. The petition is for the recovery of what is alleged as excessive excise taxes levied and collected contrary to the law and regulations of the Commissioner of Internal Revenue.

Plaintiff is a New York corporation engaged in manufacturing dresses, cloaks and suits. It made its excise tax returns for the years 1919, 1920, and 1921 on garments manufactured and sold by it and paid the taxes shown to be due thereon. In April, 1922, the plaintiff's books of account and records were examined, and as a result thereof the Commissioner determined an additional tax of $3,263.39, together with interest and penalties, was due, and subsequently the plaintiff paid the same in the aggregate sum of $3,860.36. In January, 1923, a second examination of such of plaintiff's books as were available was made by the Commissioner and an additional tax of $7,693.48 was assessed against the plaintiff, which aggregated, with interest and penalties, the sum of $10,516.53. On April 14, 1923, as a result of a claim in abatement this last additional tax was adjusted to $8,365.21 and the same was paid September 23, 1924. On July 27, 1925, plaintiff filed a claim for refund in the amount of $27,496.37, the same being denied by the Commissioner May 19, 1926.

Plaintiff's present claim is for $13,117, together with interest. The suit involves a question of fact and two legal propositions. The Revenue Act of 1918 (40 Stat., 1057) is as follows:

"SEC. 900. That there shall be levied, assessed, collected, and paid upon the following articles sold or leased by the manufacturer, producer, or importer,

a tax equivalent to the following percentages of the price for which so sold or leased—

* * * * * * *

"(19) Articles made of fur on the hide or pelt, or of which any such fur is the component material of chief value, 10 per centum * * *."

The Commissioner had promulgated the following regulations apropos of discounts and expenses, viz, Regulations 47:

"ART. 4. *Discounts and expenses.*—A discount for cash or discount made subsequently to the sale can not be deducted in computing the price for the purpose of the tax."

Plaintiff asserts that the facts in the case, respecting this particular issue, establish that in the conduct of its business, involving sales of the taxable articles, it consistently observed the policy of granting its customers trade discounts and not cash discounts or discounts made subsequent to sales. It is conceded by the Government that if the plaintiff's method of sales establishes a consistent trade discount the plaintiff is entitled to recover. There exists little room for dispute as to the exact method employed by plaintiff in making sales of its merchandise. Taxable garments sold to its customers were billed at list prices therefor. On the inventories going to the customers at the time of sale appeared the following symbols: "8/10" or "8/10 E. O. M." The first symbol indicated a discount of 8 per cent if the bill was paid in 10 days, and the other granted an 8 per cent discount if the bill was paid 10 days from the end of the month in which the goods were shipped. In some cases the plaintiff billed its goods at "2/10," "6/10," and "6/60." This last offer of discount, "6/60," afforded the customer an extended time for payment at a reduced discount rate. At times during the period here involved the plaintiff billed its customers at one rate of discount, and subsequently changed the rate and rendered another invoice. As a matter of fact, the plaintiff allowed its customers the rate of discount indicated, irrespective of whether they observed the terms of invoice or not. Where customers became delinquent and payments deferred, interest at the rate of 6 per cent per annum was imposed and collected, computed upon the basis of an arbitrary date fixed by the plaintiff. In the event of insolvency of a customer involving bankruptcy, receivership, or trusteeship, plaintiff's claims were presented on the basis of list prices.

There is no doubt that the trade and business in which plaintiff was engaged observed a long-established custom of granting to its customers a trade discount. The difficulty we encounter in the decision of the case is our inability from the record to find that the plaintiff followed any certain and consistent custom in this respect by which any degree of uniformity obtained in the ascertainment of the price for which the goods were sold. What the record establishes is that the plaintiff formulated its individual system of discounts, adopting in part the custom of the trade and discarding the same in the observance of granted discounts which best served its needs in the way and manner of procuring cash payments for its merchandise. A trade discount, as we understand it, fixes a price for the invoiced article to the customer at the time it is sold, i. e., the list price and the discount or reduced price are fixed so that the customer possesses information as to the cost of merchandise to him in advance of the sale, and the Commissioner experiences little difficulty in ascertaining the taxable price of the merchandise sold. The record, we think, is so decidedly indefinite as to just what price was fixed or received for the merchandise involved that the Commissioner was justified under the law and regulations in proceeding as he did. We can not hold from the evidence that any specific sales price was assented to by the customer or fixed by the plaintiff at the time the goods were sold, and hence, in our view of the case, the Commissioner could not have resorted to any source of information save the list price. No fault is to be found as to plaintiff's assertion of its legal rights in ascertaining tax liability with regard to this issue. The uncertainty and vacillating practice with regard thereto are what preclude the court from applying the law to the facts in the case and granting the relief contended for. (*J. H. Smith Grape Juice Co.* v. *United States*, 63 C. Cls., 140.)

Section 1105 of the Revenue Act of 1926 is a repetition of a similar provision carried in the Revenue Acts of 1921 and 1924. The section (44 Stat., 9, 113) reads as follows:

"SEC. 1105. No taxpayer shall be subjected to unnecessary examinations or investigations, and only one inspection of a taxpayer's books of account shall

be made for each taxable year unless the taxpayer requests otherwise or unless the Commissioner, after investigation, notifies the taxpayer in writing that an additional inspection is necessary."

It is a fact that the plaintiff did not request the second examination of its books of account. It is also proven that it protested against the proceeding, and it is established that the revenue agent stated that in the event the plaintiff refused access to the books of account he could secure a fraud order and examine them at any time. What the plaintiff should have done, if it did not want the second examination made or if it regarded such investigation as unnecessary, was to stand upon its rights under the provisions of law and continue to refuse access to its books until the law was complied with and it had received notice in writing from the Commissioner of Internal Revenue that an additional inspection was necessary. This it did not do, but yielded to the request under protest. Aside from all this, however, we can not hold that deficiency assessment is illegal when the facts upon which it was based were ascertained in the way and manner proven.

The Board of Tax Appeals said in the case of McDonnell (5 B. T. A., 685, 691):

"However, that section of the statute merely provides for the relief from unnecessary examinations of a taxpayer's books and does not propose to provide that any deficiency resulting from such investigation shall be void."

The plaintiff likens the testimony procured under the circumstances to testimony illegally forced from defendants in criminal cases. We feel confident the analogy is not sustainable, and that plaintiff's tax liability may not be determined upon the basis of the alleged illegal proceeding. We think the decision of the Board of Tax Appeals is sound.

The concluding paragraph of finding 8 shows that the plaintiff did add to its invoices of merchandise sold the amount of the excise tax it was legally obligated to pay upon its taxable garments sold, and that the amount added and collected in this manner is not established. Article 3 of Regulations 47 provides as follows:

"ART. 3. * * * Where a lump sum is specified as the price of a taxable article or articles, and other articles not taxable and not a component part of the taxable articles are included in the price, the tax attaches to the entire amount unless the selling prices of the taxable and nontaxable articles are segregated. In such case the tax will be measured by the price specified as the selling price of the taxable article or articles (examples 4 and 5). The following examples illustrate the method by which the manufacturer may separate the tax from the selling price in invoicing goods to the purchaser:

"Example (1): A, the manufacturer, quotes a selling price to B of $1 and bills the goods to B as:

"'Article No. 1; selling price, $1; tax, $0.05.'

"Example (2): A, the manufacturer, quotes a selling price of $1.05, stating that the price includes a tax of 5 cents, and bills the goods to B as:

"'Article No. 1; selling price, $1.05; 5 cents of the total represents tax.'

"Example (3): A, the manufacturer, quotes a selling price of $1.05, stating that 1/21 of the price represents a tax, and bills the goods to B as:

"'Article No. 1, selling price $1.05, 1/21 of the total represents tax.'

"The tax in examples (1), (2), and (3) is computed upon $1, the quoted and actual selling price."

The plaintiff challenges the verity of this finding, and presents what is claimed as irrefutable evidence that the finding does not state the facts. The evidence relied upon is a detailed statement prepared by certified public accountants. This statement recites upon its face that it is a compilation made by said accountants of "refund claimed to be due on account of excise taxes" paid by the plaintiff. From the point of computation the statement's accuracy is not challenged, but obviously it does not, nor does it purport to, disclose the plaintiff's custom and practice with respect to adding the excise tax to the price for which the goods were sold. There is no competent proof that it is a copy of the plaintiff's books of account or the invoices upon the basis of which collection was made by the plaintiff, and there is no way in which the court can find that plaintiff observed the regulations herein set forth in invoicing or receiving payment for the garments sold. The exhibit is part of the record and of course available for what it is worth, but assuredly it does not establish the facts for which plaintiff contends and is

no more than a detailed statement of the total amount of merchandise sold, the list price, the excise tax thereon, and the refund claimed to be due prepared by the accountants to form a basis for a claim for refund. We have before us no records of the plaintiff or other proof refuting the finding and, hence, it is manifest that no proof exists from which the court may find that the plaintiff did, in fact, overpay its excise taxes. (*Lash's Products Co.* v. *United States*, 278 U. S., 175 [T. D. 4259, C. B. VIII–1, 303].) The plaintiff apparently concedes that the finding was supported by the record, for it was not challenged in its main brief and seems to have escaped attention until emphasized by the defendant's brief, after which the plaintiff brings forward the exhibit discussed to prove the incorrectness of the finding. Plaintiff's own witness before the Commissioner sustains the finding.

There is a further reason why plaintiff may not recover. The taxes here involved were paid in different sums and on various dates from August 16, 1919, to January 23, 1922 (finding 3), the amount for the period totaling $103,105.91. Plaintiff's claim for refund was filed July 27, 1925. Section 1012 of the Revenue Act of 1924 (43 Stat., 253), amending section 3228 of the Revised Statutes, is as follows:

"(a) All claims for the refunding or crediting of any internal-revenue tax alleged to have been erroneously or illegally assessed or collected, or of any penalty alleged to have been collected without authority, or of any sum alleged to have been excessive or in any manner wrongfully collected must, * * * be presented to the Commissioner of Internal Revenue within four years next after the payment of such tax, penalty, or sum."

Obviously plaintiff's refund claim would extend only to taxes paid subsequent to July 27, 1921. No taxes were paid by plaintiff between March 22, 1921, and August 6, 1921 (finding 3); therefore any refund of taxes paid prior to August 6, 1921, would fall within the foregoing statute of limitations. The record fails to disclose the proportion of taxes paid during the period from August 6, 1921, to January 23, 1922, which would under plaintiff's contentions come within the revenue laws as overpayments, and from the facts adduced we would be unable to find what proportion of the alleged overpayments was barred by limitation. The burden of proof is upon the plaintiff to establish overpayments. A judgment for overpayments can not be predicated upon a basis of inferences, and we think the record sustains the defendant's contention that it is impossible for the court to compute any judgment upon the present state of the record in this case.

The petition is dismissed. It is so ordered.

CAPITAL STOCK TAX RULINGS.

TITLE VII.—SPECIAL TAXES. (1924)

EXEMPTION FROM TAX.

REGULATIONS 64(1924), ARTICLE 29: Exempt organizations and insurance companies. XI-20-5481 Ct. D. 483

CAPITAL STOCK TAX—REVENUE ACTS OF 1921 AND 1924—DECISION OF SUPREME COURT.

EXEMPTION—"INSURANCE COMPANY"—CLASSIFICATION.

A corporation engaged in guaranteeing title to real estate and in making loans on real estate secured by a mortgage thereon, delivering to the purchaser of a loan a guaranty of title to the real estate covered by the mortgage and a guaranty of payment of principal and interest of the debt, the amounts received as compensation for the foregoing constituting the larger part of its entire income and more than 75 per cent thereof when added to the fees and charges for examination of titles, appraisals and other services incident to its insurance business, is an insurance company within the meaning of section 246 of the Revenue Acts of 1921 and 1924 and it is therefore exempt from the capital stock tax imposed by section 1000 of the Revenue Act of 1921 and section 700 of the Revenue Act of 1924.

SUPREME COURT OF THE UNITED STATES. NO. 356.—OCTOBER TERM, 1931.

The United States of America, petitioner, v. *Home Title Insurance Co.*

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

[March 14, 1932.]

OPINION.

Mr. Justice BUTLER delivered the opinion of the court.

Respondent filed returns in respect of capital stock taxes for the years ending June 30, 1923, 1924, and 1925 under section 1000 of the Revenue Act of 1921 and section 700 of the Revenue Act of 1924.[1] The first two reported taxes due. In the other respondent claimed to be an insurance company taxable under section 246 and consequently exempt from the capital stock tax. It made returns and paid income taxes for the calendar years 1921 to 1925, inclusive. In February, 1926, respondent paid under protest the capital stock taxes. It made application for refund and, that being denied, brought this action in the District Court for Eastern New York to recover the amounts so exacted. The parties submitted the case on an agreed statement of facts. The court gave judgment for the United States. (41 F. (2d), 793.) The Circuit Court of Appeals reversed. (50 F. (2d), 107.)

The question is whether during the periods for which the capital stock taxes were paid, respondent was an insurance company taxable only under section 246.

Respondent was organized in 1906 under Article V of the New York insurance law. It was formed to examine and guarantee title to real estate, to lend money on real estate mortgages and to guarantee such mortgages as to payment of principal and interest and to do the work generally of a title insurance company. It is under the supervision of the State superintendent of insurance,

[1] Section 1000 of the Act of 1921 is the same as section 700 of the Act of 1924. Section 246 is the same in both Acts.

subject to the laws applicable to title and credit guaranty corporations and maintains the required guaranty fund.

Its business has always consisted of issuing two kinds of contracts: (1) Those in which it merely guarantees title and (2) those in which it guarantees (a) title to real estate covered by a mortgage and (b) payment of principal and interest of the debt. Preliminary to the issue of title insurance policies first mentioned, respondent prepared abstracts and made examination of the title. Its charges were based upon a scale dependent upon the amounts of the policies and included fees for examinations, searches and other services incident to the transaction. Policies guaranteeing both title and payment of such mortgage debts were issued substantially as follows. When respondent received an application for a loan, it made an appraisal of the property and an examination of the title. Upon its approval of the application, it received from the borrower his bond and mortgage and paid him the amount of the bond less charges for services incidental to title insurance and also for inspection and appraisal of the property. The fee covering title insurance was made a condition of every loan. Respondent did not charge any lending fee.

It sold the loans at face value and delivered to the purchaser of each a mortgage guaranty or, in case of the sale of part of a loan, a participation certificate. By every such guaranty or certificate, the purchaser appointed respondent his agent to collect principal and interest of the loan, and the latter guaranteed (1) the mortgage to be a valid first lien upon a good and marketable title in fee, (2) payment of principal when collected and in any event within 12 months after maturity and (3) payment of interest at a rate usually one-half of 1 per cent less than that specified in the bond. The difference was called premium. Generally about two months elapsed between the making of loans and their sale. The interest for that period was retained by respondent and constituted a part of its gross income.

It never held nor sold mortgages that were not acquired and guaranteed as above stated and never guaranteed other than those controlled by it. Its expenses were not assigned to its different classes of business, and its assets were used indiscriminately in connection with all its activities. Corporations organized under New York banking laws and subject to the supervision of the banking department are authorized to make mortgage loans and sell them with guaranties such as those given by respondent and from 1921 to 1925 at least two companies thus organized and supervised were engaged in that business.

Respondent's policies merely guaranteeing title amounted to more than six times its mortgage guaranties. A tabular statement in the margin [2] makes the comparison. Its title insurance, not connected with mortgage guaranties, outstanding in each of the five years amounted to more than $100,000,000. Another table [3] states its gross income from sources other than interest, rents, dividends

[2] Column 1 shows the amount of policies merely guaranteeing titles and column 2 shows the amount of mortgage guaranties.

	1.	2.
1921	$29,090,650	$4,359,346
1922	46,050,180	7,319,246
1923	67,138,820	7,989,950
1924	69,442,530	11,341,239
1925	87,965,580	13,214,092

[3]

	1921.	1922.	1923.	1924.	1925.
(1) Mortgage guaranty premiums	$90,449.14	$105,750.03	$134,349.66	$175,641.39	$227,869.93
(2) Inspection and appraisal fees	88,679.75	139,830.45	115,658.86	133,549.10	149,830.35
(3) Title insurance fees where no mortgage guaranty	270,030.79	406,019.93	565,155.86	576,771.36	714,949.06
(4) Title insurance fees where mortgage guaranty also	131,243.75	206,945.45	171,172.14	197,649.23	221,745.05
(5) Mortgage renewals	28,940.83	30,123.35	30,557.75	24,745.35	44,779.75
(6) Conveyancing fees	13,544.25	26,008.93	27,779.00	33,668.40	35,340.67
(7) Charges for searches	3,693.77	6,497.46	7,945.91	11,398.30	14,749.09
(8) Recording fees	3,316.28	4,094.43	6,723.69	6,133.14	9,252.70
(9) Charges for surveys	392.45	326.80	569.20	1,339.65	1,993.25
Total	630,291.01	925,596.83	1,059,912.07	1,160,895.92	1,420,509.85
Other income	75,167.80	103,223.94	156,721.05	209,926.81	240,544.43
Total income	705,458.81	1,028,820.77	1,216,633.12	1,370,822.73	1,661,054.28

and profits on sale of bonds, and classifies such income so as to show (1) the difference between interest received and that guaranteed by respondent; (2) fees and charges attributable to mortgage guaranties; (3) fees and charges attributable to title insurance where respondent did not make nor guarantee mortgages or loans; (4) compensation for guaranteeing mortgages to be first liens upon titles in fee; (5) income from mortgage renewals; etc.

The guaranty of payment of the principal and interest of mortgage loans constitutes insurance. (*Bowers* v. *Lawyers Mortgage Co.* [Ct. D. 484, below].) The amounts received as compensation for insuring title, for guaranteeing that mortgages are first liens and for guaranteeing payment constitute the larger part of respondent's income. And, when there are added the fees and charges for examination of title, appraisals, and other services incident to its insurance business, the total properly assignable to that business amounts to more than 75 per cent of all respondent's income. Undeniably insurance is its principal business. Indeed, it does not appear that any substantial part of its transactions was not connected with or the outgrowth of insurance. The admitted facts clearly show that in the tax years above mentioned respondent was an "insurance company" within the meaning of that phrase as commonly understood and as used in the Revenue Acts of 1921 and 1924. It was taxable under section 246 and therefore exempt from capital stock taxes.

Judgment affirmed.

TITLE X.—SPECIAL TAXES. (1921)

EXEMPTION FROM TAX.

REGULATIONS 64(1922), ARTICLE 29: Organizations and insurance companies exempt. XI-20-5482 Ct. D. 484

CAPITAL STOCK TAX—REVENUE ACT OF 1921—DECISION OF SUPREME COURT.

"INSURANCE COMPANY"—CLASSIFICATION—BUSINESS OF LENDING MONEY.

Where a corporation has as its principal business the lending of money on real estate security, the sale of bonds and mortgages given by borrowers and use of the money received from purchasers to make additional loans similarly secured, and where it received lending fees, extension fees, and accrued mortgage interest appertaining to that business, it is not an insurance company within the meaning of section 246 of the Revenue Act of 1921, although it is organized under and subject to State insurance laws, and it is therefore not exempt from the capital stock tax under section 1000(b) of that Act. The guaranty of the payment of principal and interest of mortgage loans, while constituting insurance, produced less than one-third of its income, and is not sufficient to make it an insurance company within the meaning of section 246.

SUPREME COURT OF THE UNITED STATES. No. 355.—OCTOBER TERM, 1931.

Frank Collis Bowers, as Executor of the Estate of Frank K. Bowers, formerly United States Collector, etc., petitioner, v. *Lawyers Mortgage Co.*

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

[March 14, 1932.]

OPINION.

Mr. Justice BUTLER delivered the opinion of the court.

Respondent voluntarily paid the capital stock tax imposed on domestic corporations by section 1000, Revenue Act of 1921 (42 Stat., 294) for the fiscal years ending June 30 in 1922 and 1923. Thereafter it applied for refund on the ground that it was an insurance company taxable only under section 246 (42

Stat., 262). The claim was denied. It brought this action in the Federal Court for the Southern District of New York to recover the amount so paid. The parties by written stipulation waived a jury and submitted the case on an agreed statement of facts. The district court gave judgment for respondent. (34 F. (2d), 504.) The circuit court of appeals affirmed. (50 F. (2d), 104.)

The question is whether on the admitted facts respondent was an insurance company subject to the tax imposed by section 246 and therefore not taxable under sections 230 and 1000.

Respondent was incorporated in 1893 under section 170(1) of Article V of the insurance law of New York[1] as the "Lawyers Mortgage Insurance Co." to examine titles, procure and furnish information in relation thereto and guarantee or insure bonds and mortgages and the owners of real estate against loss by reason of defective titles. In 1903 "insurance" was dropped from its name. In 1905, its certificate of incorporation was amended to include the making, and guarantee of the correctness, of searches for instruments, liens and charges affecting real estate and the guarantee of payment of bonds and mortgages.[2] In 1913,[3] the certificate of incorporation was further amended to include authority to insure payment of notes of individuals and partnerships and bonds and other evidences of indebtedness of corporations, when secured by real estate mortgages, and to "invest in, purchase and sell, with such guarantee (of payment) or with guarantee only against loss by reason of defective title or incumbrances, bonds and mortgages, and notes of individuals or partnerships secured by mortgages * * * and bonds, notes, debentures and other evidences of indebtedness of solvent corporations secured by deed of trust or mortgages * * *." It was subject to supervision by the State superintendent of insurance and to the laws applicable to title and credit guaranty corporations and was required to file with such superintendent statements of its condition at the end of each year.

Respondent never has insured titles. In the tax years, it carried on business as follows: Upon receiving an application for a loan it caused an appraisal of the proposed real estate security to be made and procured a title insurance company to survey the property, make a report as to title and insure the same. The borrower, having executed and delivered a bond and mortgage to respondent, received from it the amount specified therein less charges for title insurance, survey, disbursements and recording tax and less a lending fee which included the charge for appraisal. Respondent sold the mortgage loans. On the sale of a bond and mortgage as a whole, it delivered an assignable contract called "policy of mortgage guarantee" to the purchaser. On the sale of part of a loan, it issued a participation certificate assignable by indorsement and registration on respondent's books and containing substantially the same provisions as the policy. By every such policy or certificate the purchaser appointed respondent his agent to collect the principal and interest, and the latter agreed to keep the title guaranteed and the premises insured against fire and to require the owner to pay taxes, assessments, water rates and fire insurance premiums. Respondent guaranteed payment of principal, as and when collected but in any event within 18 months following written demand made after maturity, and payment of interest regularly at an agreed rate, usually one-half of 1 per cent less than that specified in the bond. Respondent kept the difference and called it "premium." Respondent also retained the interest accruing between the making of the loans and the sale of the securities. For renewals of loans it charged extension fees.

It issued some policies of guaranty as to mortgage loans which were not made or sold by it. While substantial in amount, that part of its business constituted but a small percentage of the total. It made no assignment or apportionment of assets to the different parts of its business but used them indiscriminately in its different activities. It kept on hand sufficient bonds and mortgages to maintain the guaranty fund required by the insurance law. Corporations organized under the New York banking laws and subject to its banking department are authorized to make loans and sell bonds, mortgages and participations therein with their guaranties under the same general method of doing business as that of respondent. And at least two companies so organized and supervised are carrying on that business.

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[1] Laws 1890, chapter 690.
[2] Laws 1904, chapter 543.
[3] Laws 1913, chapter 215. And see Laws 1911, chapter 525.

Pertinent provisions of the Act are printed in the margin.[4] The general rule declared by section 1000(a) is broad enough to include respondent. But, if it was an insurance company taxable under section 246, it was excepted from the general rule by subsection (b). As such corporations constitute a special class, respondent must be held liable for the capital stock tax unless clearly shown to have been an insurance company within the meaning of the Act. (*Bank of Commerce* v. *Tennessee*, 161 U. S., 134, 146; *Heiner* v. *Colonial Trust Co.*, 275 U. S., 232, 235 [T. D. 4112, C. B. VII–1, 207]; *Choteau* v. *Burnet*, 283 U. S., 691, 696.) The Act does not define "insurance company" or definitely indicate criteria by which corporations meant to be so specially dealt with may with certainty be identified. General definition is not necessary in order to determine whether, having regard to the purpose of the classification and the considerations on which it probably was made, respondent's business brought it within the special class.

Under section 230, Revenue Act of 1918 (40 Stat., 1075), insurance companies were taxed as were other business corporations. The applicable definition of gross income was comprehensive and included gains, profits and income derived from any source whatever. (Section 213, page 1065.) It was substantially the same in the 1921 Act. (Section 213, 42 Stat., 237.) But section 246 of the latter Act dealt with certain classes of insurance companies separately and defined gross income to be "investment income," i. e., interest, dividends and rents, and "underwriting income," i. e., premiums earned less losses and expenses. Capital gains and income from other sources were omitted.

A statement showing respondent's lending fees, extension fees, interest and premiums follows:

Year.	Lending fees.	Extension fees.	Interest.	Premiums.[a]
1922	$655,283.70	$214,303.56	$372,795.12	$619,986.38
1923	990,855.37	73,745.71	426,842.31	750,803.21

[a] These amounts are derived from interest collected by respondent from borrowers in excess of the rates payable to purchasers under the contract of sale and from charges on policies covering mortgage loans not made or sold by it.

While name, charter powers, and subjection to State insurance laws have significance as to the business which a corporation is authorized and intends to carry on, the character of the business actually done in the tax years determines whether it was taxable as an insurance company. (*United States* v. *Phellis*, 257 U. S., 156, 168 [T. D. 3270, C. B. 5, 37]; *Weiss* v. *Stearn*, 265 U. S., 242, 254 [T. D. 3609, C. B. III–2, 51].) Evidently that was the basis of the classification. Congress did not intend to exempt from the capital stock tax under section 1000(a) and the income tax under section 230 corporations not doing insurance business even though organized under and subject to State insurance laws.

The dropping of "insurance" from respondent's name and the extension of charter powers to the purchase and sale of mortgage loans suggest purpose to carry on an investment rather than an insurance business. Respondent did not consider itself an insurance company taxable under section 246 until after it

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[4] SEC. 1000. (a) * * * Every domestic corporation shall pay annually a special excise * * * equivalent to $1 for each $1,000 of * * * its capital stock * * *;

(b) The taxes imposed by this section shall not apply * * * to any insurance company subject to the tax imposed by section * * * 246. * * *

SEC. 246. (a) That, in lieu of the taxes imposed by sections 230 and 1000, there shall be levied, collected and paid * * * upon the net income of every insurance company (other than a life or mutual insurance company) a tax as follows:

(1) In the case of such a domestic insurance company the same percentage of its net income as is imposed upon other corporations by section 230; * * *

(b) * * * (1) The term "gross income" means the combined gross amount, earned during the taxable year, from investment income and from underwriting income as provided in this subdivision, computed on the basis of the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners;

(2) The term "net income" means the gross income as defined in paragraph (1) of this subdivision less the deductions allowed by section 247;

(3) The term "investment income" means the gross amount of income earned during the taxable year from interest, dividends and rents * * *;

(4) The term "underwriting income" means the premiums earned on insurance contracts during the taxable year less losses incurred and expenses incurred; * * *.

had twice made and paid capital stock taxes under section 1000(a) and income taxes under section 230. The lending of money on real estate security, the sale of bonds and mortgages given by borrowers and use of the money received from purchasers to make additional loans similarly secured constituted its principal business. Undoubtedly the guaranties contained in the policies and participation certificates were in legal effect contracts of insurance. (*Tebbets* v. *Mercantile Credit Guarantee Co.*, 73 Fed., 95, 97; *Guarantee Co.* v. *Mechanics' Sav. Bank & Trust Co.*, 80 Fed., 766, 772; *State ex rel. Peach Co.* v. *Bonding & Surety Co.*, 279 Mo., 535, 553, 556; *The People* v. *Potts*, 264 Ill., 522, 527; *The People* v. *Rose*, 174 Ill., 310; *Commonwealth* v. *Wetherbee*, 105 Mass., 149, 160; *Shakman* v. *United States Credit System Co.*, 92 Wis., 366, 374; *Young* v. *American Bonding Co.*, 228 Pa., 373, 380.) These guaranties furnished purchasers additional security and were calculated to make the loans desirable as investments and readily salable at a profit.

The lending fees, extension fees and accrued interest appertain to the business of lending money rather than to insurance and may not reasonably be attributed to the subordinate element of guaranty in respondent's mortgage loan business. The so-called premiums amount to about one-third of total income but they cover agency and other services which generally are not performed under contracts of insurance. There is no showing that these amounts do not include profits arising from such sales or that they are justly chargeable or were intended to apply only to the risks covered. Respondent has not established any basis upon which the interest so retained may reasonably be charged or apportioned to the element of insurance involved in such transactions. And the stipulation in respect of policies issued on loans not made by respondent is too vague to be given weight.

"Premiums" are characteristic of the business of insurance, and the creation of "investment income" is generally, if not necessarily, essential to it. Section 246 does not cover any other class of income. It is not shown that respondent had any investment income within that section. Evidently its guaranties produced less than one-third of its income.

Respondent's business is one which may be and is in fact carried on by corporations organized under the New York banking laws. The element of insurance may not properly be regarded as more than an incident thereof: it certainly is not sufficient to make respondent an "insurance company" within the meaning of that phrase as it is commonly used and understood. There is no warrant for holding that Congress intended to use the expression in any other sense. (*Miller* v. *Robertson*, 266 U. S., 243, 250; *Sacramento Navigation Co.* v. *Salz*, 273 U. S., 326, 329–330.)

This case is not, as respondent contends, ruled against the Government by *United States* v. *Loan & Building Co.* (278 U. S., 55). The opinion in that case shows that loan and building associations exempt from taxes under Revenue Acts of 1918 and 1921 are not strictly confined to the raising of funds by subscription of members for the making of advances to members to enable them to build or buy houses of their own, that the outside operations of the association there considered were not so related to mere money making as to constitute a gross abuse of the name and that the receiving of deposits on interest and making of loans to nonmembers did not disqualify it for the exemption.

In the case before us respondent's charter authority extended not only to the business of insurance but also to other lines including that of investment with or without guaranties as it might choose. As above shown, the element of guaranty involved in its transactions in the tax years was not sufficient to make it an insurance company.

Judgment reversed.

MISCELLANEOUS RULINGS.

TOBACCO.

REGULATIONS 8(1928), ARTICLE 116: Redemption of stamps. XI-2-5352 T. D. 4330

TOBACCO—REDEMPTION OF STAMPS—ACT OF MARCH 3, 1931.

Stamps affixed to packages of tobacco products removed for consumption or sale and afterwards withdrawn from the market may be redeemed. Articles 116, 114, and 108, Regulations No. 8, amended.

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

To Collectors of Internal Revenue and Others Concerned:

The Act of Congress approved March 3, 1931 (Public, No. 828, Seventy-first Congress, H. R. 10658), relating to the redemption of stamps on packages of tobacco, snuff, cigars, and cigarettes, reads as follows:

An Act to amend section 1 of the Act of May 12, 1900 (chapter 393, Thirty-first Statutes, page 177), as amended (United States Code, section 1174, chapter 31, title 26).

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 1 of the Act entitled "An Act authorizing the Commissioner of Internal Revenue to redeem or make allowance for internal-revenue stamps," approved May 12, 1900 (chapter 393, Thirty-first Statutes, page 177), as amended (United States Code, section 1174, chapter 21, title 26), be, and the same is hereby, amended by adding at the close thereof the following: "*And provided further,* That internal-revenue stamps affixed to packages of tobacco, snuff, cigars, or cigarettes which, after removal from factory or customhouse for consumption or sale, the manufacturer or importer withdraws from the market, may, under regulations prescribed by the Commissioner of Internal Revenue with the approval of the Secretary of the Treasury, be redeemed if issued after December 31, 1931, and if claim for their redemption is presented by the manufacturer or importer within three years after the year of issue as indicated by the number or symbol printed thereon by the Government, irrespective of the date of their purchase. Beginning with the year 1933, stamps of any issue shall not be sold until those of the previous year's issue have been disposed of or later than one year after the year of issue."

Pursuant to authority conferred by the Act quoted and in order to harmonize the procedure with respect to the redemption of tobacco, snuff, cigar, and cigarette stamps generally, article 116 of Regulations No. 8, approved April 24, 1928, is amended to read as follows:

ART. 116. *Redemption of stamps.*—Internal revenue stamps issued under authority of law to denote payment of tax on tobacco, snuff, cigars, and cigarettes may be redeemed, subject to the following provisions:

(a) Stamps which have been spoiled, destroyed, or rendered useless or unfit for the purpose intended, or for which the owner may have no use, or which through mistake may have been improperly or unnecessarily used, or where the rates or duties represented thereby have been excessive in amount, paid in error, or in any manner wrongfully collected, may be presented by the owner for redemption. A claim for the value of such stamps must be prepared on Form 843, which may be obtained from the collector. After execution, the claim should be sent to the collector of the district, together with the stamps, for transmission to the Commissioner. If required, the owner must satisfactorily trace the history of the stamps from their issuance to the presentation of his claim.

Where a large number of stamps are to be redeemed the manufacturer should forward them direct to the "Commissioner of Internal Revenue, Tobacco Division, Washington, D. C." Each package should be numbered; should show the total number of packages in the shipment and should bear a factory claim number. The manufacturer must advise the Commissioner of the date and method (whether by mail, express, or freight) of transmission of the stamps to him, and also, of the date of forwarding the claim to the collector.

A claim made for the value of stamps destroyed, as provided in article 107(c), must show that the product to which the stamps were attached was never removed from the factory prèmises and that the destruction of the stamps was supervised by a deputy collector, giving his name. The collector will attach to the claim a copy of the report of the deputy containing the schedule of the stamps. In other cases the stamps must be presented with the claim for redemption or satisfactory evidence submitted showing why they can not be forwarded.

Claims under this subdivision which are not presented within four years after the stamps were purchased from the Government are barred from allowance by the statute of limitation.

(b) Stamps affixed to packages of tobacco, snuff, cigars, or cigarettes which, after removal from factory or customhouse for consumption or sale, are withdrawn from the market by the manufacturer or importer may be redeemed if issued after December 31, 1931, and if claim for their redemption is presented by the manufacturer or importer within three years after the year of issue as indicated by the number or symbol printed thereon by the Government, irrespective of the date of their purchase, upon compliance with the following procedure, viz:

A manufacturer or importer only may file a claim for redemption of stamps under this subdivision. The claim must be made on Form 843, and must show that the stamps on the products withdrawn from the market were purchased from the Government, and were affixed to the packages by the claimant. The stamps must have been issued after December 31, 1931, which fact will be determined by a series number indicating the year of issue printed thereon by the Government, beginning with "Series 102," printed on stamps issued in 1932. The stamps must be such only as are attached to original, full and unbroken statutory packages. They must not be removed from the packages except under the supervision of a deputy collector as hereinafter provided.

Before filing his claim, the manufacturer must assemble his stamped tobacco products withdrawn from the market in a suitable place, other than bonded premises, in the city where his business is carried on or in any city in which there is an office of a collector. The manufacturer must group the packages according to the year of issue, denomination and class of stamps and number of the factory, including district and State where they were affixed, or the brand names of the products. He must also prepare a schedule, in duplicate, showing the number of stamps in each group.

When the grouping is completed and the schedule prepared, the manufacturer should notify the collector of the district to that effect and request the detail of a deputy to verify the schedule and supervise removal of the stamps and disposition of the packages and contents. The deputy so detailed will examine and count the stamped packages and will verify or correct all the entries in the schedule. He will also supervise the removal of the stamps intact from the packages and the destruction of the packages and contents by fire or by some other method which will render them unfit for use. If, however, a manufacturer desires to salvage the contents of the packages, he will be permitted to receive such manufactures on his factory premises, irrespective of where produced, under the provisions of article 108.

The stamps which have been removed from the packages under supervision of the deputy will be delivered by him to the collector if the quantity be small, but if the quantity be large, the manufacturer must comply with the procedure prescribed in subdivision (a) of this article.

An importer filing a claim for the redemption of stamps on tobacco products must furnish satisfactory evidence that he imported the products and withdrew them from the market and must comply in other respects, in so far as practicable, with the foregoing provisions relating to a claim filed by a manufacturer.

The deputy detailed to verify the schedule of stamps will certify to its correctness on both copies and will set forth, also, each step taken by him in connection with his detail. He will then deliver one schedule to the manufacturer or importer, to be attached to and made a part of his claim, and will forward the other to the collector. The schedules must show whether the stamps will be delivered by the deputy to the collector or transmitted direct to the Commissioner. The schedule and stamps delivered by the deputy will be held by the collector until the claim is received, and will be transmitted therewith to the Commissioner.

REGULATIONS 8 (1928), ARTICLE 114: Commissioner to provide stamps. XI-2-5353 T. D. 4330

Article 114 of Regulations No. 8, approved April 24, 1928, is amended by adding two sentences reading as follows:

Stamps issued after December 31, 1931, will bear a series number indicating the year of issue, beginning with "Series 102" printed on stamps issued in 1932. Beginning with the year 1933, stamps of any issue shall not be sold until those of the previous year's issue have been disposed of or later than one year after the year of issue.

REGULATIONS 8 (1928), ARTICLE 108: Receiving tobacco manufactures on factory premises. XI-2-5354 T. D. 4330

Subdivision (a) of article 108 of Regulations No. 8, approved April 24, 1928, is amended to read as follows:

(a) All tobacco manufactures received on the factory premises must be removed from the boxes or other packages, which must then be immediately destroyed. If the stamps affixed thereto are of "Series 102," or of a later series, and if the manufacturer wishes to redeem them, the procedure set forth in article 116(b) shall be followed. Otherwise the stamps affixed to the packages must also be destroyed and no allowance will be made for their value.

DAVID BURNET,
Commissioner of Internal Revenue.

Approved December 31, 1931.

A. W. MELLON,
Secretary of the Treasury.

OLEOMARGARINE.

REGULATIONS 9, SECTION 39: Oleomargarine defined. XI-11-5413 Ct. D. 457

OLEOMARGARINE TAX—ACT OF AUGUST 2, 1886, AS AMENDED—DECISION OF SUPREME COURT.

INJUNCTION.

Section 3224 of the Revised Statutes, prohibiting a suit to enjoin the collection of a tax, is inapplicable where there exist special and extraordinary circumstances sufficient to bring a case within some acknowledged head of equity jurisprudence. Where, therefore, a

product is not oleomargarine or properly taxable under the Act of August 2, 1886, as amended by the Act of May 9, 1902, and enforcement of that Act as amended against the manufacturer of the product would be arbitrary and oppressive, resulting in a discrimination conflicting with the principle underlying the constitutional provisions directing that excises laid by Congress shall be uniform throughout the United States, would destroy its business, ruin it financially, and inflict loss for which it would have no remedy at law, in these special and extraordinary facts and circumstances said section 3224 does not apply and does not prohibit a suit to enjoin the collection of the tax assessed under that Act as amended upon the manufacturer's product.

SUPREME COURT OF THE UNITED STATES. NOS. 251 AND 252.—OCTOBER TERM, 1931.

251. *Peter H. Miller, Individually and as Collector of Internal Revenue for the District of Florida, petitioner,* v. *The Standard Nut Margarine Co. of Florida.*

252. *Josiah T. Rose, Collector of Internal Revenue for the District of Georgia, petitioner,* v. *The Standard Nut Margarine Co. of Florida.*

On writs of certiorari to the United States Circuit Court of Appeals for the Fifth Circuit.

[February 15, 1932.]

Mr. Justice BUTLER delivered the opinion of the court.

No. 251.

Respondent, a manufacturer of "Southern Nut Product," brought this suit in the southern district of Florida to restrain petitioner from collecting from respondent or from dealers selling its product, any tax purporting to be levied under the Oleomargarine Act of August 2, 1886 (24 Stat., 209), as amended by the Act of May 9, 1902 (32 Stat., 194). Petitioner answered denying the essential allegations of the complaint. Respondent applied for a temporary injunction, the court found that it would suffer irreparable injury unless petitioner be restrained pending the final disposition of the case and granted the application. At the trial respondent introduced oral and documentary evidence together with specimens of the product sought to be taxed. The court found that the material allegations of the complaint were established by the evidence and granted permanent injunction. The record states in condensed form the substance of the testimony but does not contain the documents which were made exhibits and introduced in evidence. The Circuit Court of Appeals found, and it appears from the testimony brought up, that omitted exhibits constitute a material part of the evidence received and that the record is consistent with the trial court's conclusion in respect of the facts; it held R. S. section 3224, does not apply and affirmed the decree. (49 F. (2d), 79, 82, 85.)

That section declares (26 U. S. C., section 165): "No suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court." This suit was commenced December 26, 1929. The complaint, the evidence contained in the record and documents of which judicial notice may be taken show the following facts:

In April, 1928, respondent commenced and thereafter carried on at Jacksonville, Fla., the manufacture and sale of Southern Nut Product. It contained no animal fat but was made exclusively of cocoanut oil, peanut oil, salt, water and harmless coloring matter; it was sold in 1-pound cartons for cooking, baking and seasoning. Respondent built up a valuable business in the sale of the product to dealers in Florida and other States.

In January, 1922, the Commissioner of Internal Revenue issued to the Higgins Manufacturing Co. a permit to manufacture and sell "Nut-Z-All" without paying the oleomargarine tax thereon. He revoked the permit in December of the same year and purported to assess such a tax upon some of that product. The company, having paid it under protest to the collector in Rhode Island, brought an action against him in the United States district court for that State to recover the amount so exacted. After hearing evidence, including the testimony of chemists in the Bureau of Internal Revenue called in behalf of the collector, the court in April, 1924, found that the product was not made in imitation or semblance of butter, was not intended to be sold as or for butter and was not oleomargarine or taxable as such. (297 Fed., 644.) Thereupon the

Commissioner of Internal Revenue with the approval of the Secretary of the Treasury promulgated the court's decision as Treasury Decision 3590 [C. B. III-1, 507], thus informing all concerned that the product was not subject to the tax.

In August, 1924, the deputy commissioner, in answer to an inquiry made by the Institute of Margarine Manufacturers as to the taxability of "Nut-Z-All," sent a letter stating: "The court, having held the product to be not taxable as oleomargarine the fact that retailers advertise and sell it as butter, or as a substitute for butter, would not render them or the manufacturers liable under the internal revenue law."

April 1, 1927, the Commissioner, contrary to the court's decree, Treasury Decision 3590 and his deputy's response to the Institute's inquiry, promulgated Treasury Decision 4006 [C. B. VI-1, 333], which declared products similar to "Nut-Z-All" taxable as oleomargarine if colored to look like butter. Then the Higgins Manufacturing Co. brought suit in the Federal Court for Rhode Island to restrain the collector from enforcing the tax on its product. The court, upon the allegations of the complaint admitted by motion to dismiss, found that the facts there alleged in respect of taxability were identical with those shown in the earlier case; that the collector was threatening to enforce the tax which had been adjudged illegal; that if the tax should be collected plaintiff's business would be ruined and, July 18, 1927, granted temporary injunction (20 F. (2d), 948), which was made permanent in December following.

In July, 1927, the Baltimore Butterine Co. brought suit in the Supreme court of the District of Columbia to enjoin the Commissioner and his deputy from enforcing the tax as declared in Treasury Decision 4006 against its product "Nu-ine" which was identical in content and appearance with "Nut-Z-All" made by the Higgins Manufacturing Co. and Southern Nut Product made by respondent in this case. The court held the product not taxable and granted a permanent injunction.

No appeal was taken in any of the cases above mentioned. And the petitioner, by letter, answering an inquiry made by respondent, advised respondent that its product would not be taxable as oleomargarine.

Relying on the decision in the *Higgins Mfg. Co.* v. *Page* (297 Fed., 644 [T. D. 3590, C. B. III-1, 507]), Treasury Decision 3590, the deputy commissioner's letter to the Institute, and the injunctions above referred to, respondent believed the product which it proposed to manufacture and sell would not be taxable as oleomargarine and, upon receipt of petitioner's letter, commenced manufacture and sale of the product.

In 1928, pursuant to instructions sent him by the deputy commissioner stating that respondent's product was held taxable as colored oleomargarine, the petitioner demanded and threatened to collect a tax of 10 cents a pound upon respondent's product. But petitioner made no effort to collect the tax on "Nut-Z-All" which at the time of the trial was being sold in Florida. Excluding the tax from cost, respondent's net profit was approximately 3 cents per pound. The enforcement of the Oleomargarine Act against respondent would impose a tax that respondent would be unable to pay, would subject it to heavy penalties and the forfeiture of its plant together with the materials and manufactured product on hand, and would destroy its business.

The complaint asserts that the exaction of 10 cents per pound while in the guise of a tax, is really a penalty imposed to eliminate competition with butter and is therefore in excess of the power granted to the Congress by the Constitution. But, having regard to *McCray* v. *United States* (195 U. S., 27, 59), we treat the imposition laid by the Act upon oleomargarine as a valid excise tax. The rule that section 3224 does not extend to suits brought to restrain collection of penalties (*Lipke* v. *Lederer*, 259 U. S., 557, 562; *Regal Drug Co.* v. *Wardell*, 260 U. S., 386) does not apply.

Petitioner does not here assign as error the finding below that respondent's product was not oleomargarine. He seeks reversal upon the grounds that the statute forbids injunction against the collection of the tax even if erroneously assessed; that this assessment was made by the Commissioner under color of his office, was not arbitrary or capricious and that, if there is any exception to the application of section 3224, this case is not within it.

We are of opinion that, as held below and here claimed by respondent, the product in question was not taxable as oleomargarine defined by section 2 of the Act of 1886. It is as follows:

"That for the purpose of this Act certain manufactured substances, certain extracts, and certain mixtures and compounds, including such mixtures and

compounds with butter, shall be known and designated as 'oleomargarine,' namely: 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, 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."

That definition remained in force until July 10, 1931. It was amended by the Act of July 10, 1930 (46 Stat., 1022), effective 12 months later, the material parts of which are printed in the margin.[1] The hyphen in the phrase "vegetable-oil" was eliminated and a comma was inserted between those words and "annotto." Words added are shown in italics and words deleted are within brackets.

When the Act of 1886 was passed various imitations of and substitutes for butter, the principal ingredients of which were the fats of cattle and swine, were being manufactured and sold in large quantities. Products such as respondent's which contain no animal fat were unknown and were not made in substantial quantities until much later. There is nothing in the Act, or that has been brought to our attention, to suggest that Congress anticipated the development of the art later to occur. Annotto had long been used to color butter and cheese and was then being used to make oleomargarine resemble butter. It is a coloring material found in association with the oil content of the covering of certain tree seeds. When prepared for sale and use the colorant is contained in a stiff oily mass that was then well-known in the market. The words "vegetable-oil annotto" appropriately describe that substance. The hyphen between "vegetable" and "oil" and the absence of any punctuation mark following them signify that the words so compounded qualify "annotto" and indicate that such coloring material was meant. And that construction is strongly supported by the use in the same connection of the words "and other coloring matter."

Regulations promulgated under the Act omit the hyphen and add a comma, thus making the phrase to read "vegetable oil, annotto." The Commissioner's determination that respondent's product is oleomargarine necessarily was based on that version. It is elementary that tax laws are to interpreted liberally in favor of taxpayers and that words defining things to be taxed may not be extended beyond their clear import. Doubts must be resolved against the Government and in favor of taxpayers. (*United States* v. *Merriam*, 263 U. S., 179, 188 [T. D. 3535, C. B. II–2, 87]; *Bowers* v. *N. Y. & Albany Lighterage Co.*, 273 U. S., 346, 350 [T. D. 4009, C. B. VI–1, 268].) The legislative history and passage of the amendatory Act of 1930 show that the Commissioner as well as the Congress found that an enlargement of the definition was necessary in order to cover products such as respondent's. The language used in the original Act was not sufficiently clear and definite to include products containing no animal fat. The Commissioner's rendition of the governing phrase was without warrant. His determination that respondent's product was oleomargarine and taxable under the Act was erroneous and, in view of his earlier interpretations and the court decisions which had become final, must be held arbitrary and capricious. It was without force. (*Interstate Commerce Commission* v. *Louis. & Nash. R. R. Co.*, 227 U. S., 88, 91; *Kwock Jan Fat* v. *White*, 253 U. S., 454, 457, 464; *United States* v. *Mann*, 2 Brock, 9, 11.)

Independently of, and in cases arising prior to, the enactment of the provision (Act of March 2, 1867, 14 Stat., 475) which became R. S. section 3224, this court in harmony with the rule generally followed in courts of equity held that a suit will not lie to restrain the collection of a tax upon the sole ground of its illegality. The principal reason is that, as courts are without authority to apportion or equalize taxes or to make assessments, such suits would enable

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[1] SEC. 2. That for the purposes of this Act certain manufactured substances, certain extracts, and certain mixtures and compounds, including such mixtures and compounds with butter, shall be known and designated as "oleomargarine," namely: 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, *fish oil or fish fat,* vegetable oil, annotto, and other coloring matter, intestinal fat, and offal fat—*if* (1) made in imitation or semblance of butter, or [when so made] (2) calculated or intended to be sold as butter or for butter, *or* (3) *churned, emulsified, or mixed in cream, milk, water, or other liquid, and containing moisture in excess of 1 per centum or common salt* * * *.

those liable for taxes in some amount to delay payment or possibly to escape their lawful burden and so to interfere with and thwart the collection of revenues for the support of the Government. And this court likewise recognizes the rule that, in cases where complainant shows that in addition to the illegality of an exaction in the guise of a tax there exist special and extraordinary circumstances sufficient to bring the case within some acknowledged head of equity jurisprudence, a suit may be maintained to enjoin the collector. (*Dows* v. *City of Chicago*, 11 Wall., 108; *Hannewinkle* v. *Georgetown*, 15 Wall., 547; *State Railroad Tax Cases*, 92 U. S., 575, 614.) Section 3224 is declaratory of the principle first mentioned and is to be construed as near as may be in harmony with it and the reasons upon which it rests. (*Cumberland Telephone & Telegraph Co.* v. *Kelley*, 160 Fed., 316, 321; *Baker* v. *Baker*, 13 Cal., 87, 95; *Bradley* v. *The People*, 8 Colo., 599, 604, 2 Sutherland, 2d Lewis ed., section 454.) The section does not refer specifically to the rule applicable to cases involving exceptional circumstances. The general words employed are not sufficient, and it would require specific language undoubtedly disclosing that purpose, to warrant the inference that Congress intended to abrogate that salutary and well-established rule. This court has given effect to section 3224 in a number of cases. (*Snyder* v. *Marks*, 109 U. S., 189, 191; *Dodge* v. *Osborn*, 240 U. S., 118, 121; *Dodge* v. *Brady*, 240 U. S., 122.) It has never held the rule to be absolute, but has repeatedly indicated that extraordinary and exceptional circumstances render its provisions inapplicable. (*Hill* v. *Wallace*, 259 U. S., 44, 62; *Dodge* v. *Osborn*, supra, 12; *Dodge* v. *Brady*, supra. Cf. *Graham* v. *du Pont*, 262 U. S., 234, 257 [T. D. 3486, C. B. II–1, 226]; *Brushaber* v. *Union Pacific R. R.*, 240 U. S., 1.)

This is not a case in which the injunction is sought upon the mere ground of illegality because of error in the amount of the tax. The article is not covered by the Act. A valid oleomargarine tax could by no legal possibility have been assessed against respondent and therefore the reasons underlying section 3224 apply, if at all, with little force. (*LeRoy* v. *East Saginaw Ry. Co.*, 18 Mich., 233, 238–239; *Kissinger* v. *Bean*, Fed. Cas. 7853.) Respondent commenced business after the product it proposes to make had repeatedly been determined by the Commissioner and adjudged in courts not to be oleomargarine or taxable under the Act and upon the assurance from the Bureau that its product would not be taxed. For more than a year and a half respondent sold its product relying that it was not subject to tax. If required to pay the tax its loss would be 7 cents per pound. Before the Commissioner's latest ruling respondent had made and sold so much that the tax would have amounted to more than it could pay. Petitioner acquiesced in the injunctions granted in Rhode Island and the District of Columbia and did not assess any tax upon identical products contemporaneously being made by complainants in such suits and directed enforcement against respondent's entire product. Such discrimination conflicts with the principle underlying the constitutional provision directing that excises laid by Congress shall be uniform throughout the United States. It required no elaboration of the facts found to show that the enforcement of the Act against respondent would be arbitrary and oppressive, would destroy its business, ruin it financially and inflict loss for which it would have no remedy at law. It is clear that, by reason of the special and extraordinary facts and circumstances, section 3224 does not apply. The lower courts rightly held respondent entitled to the injunction.

No. 252.

This case was decided in the Circuit Court of Appeals at the same time as No. 251 (49 F. (2d), 85), presents the same question, and is governed by the foregoing opinion.

Decrees affirmed.

XI–2–5355
MS. 122

Schedule of oleomargarine produced and materials used during the month of November, 1931, as compared with November, 1930.

	November, 1931.	November, 1930.
	Pounds.	*Pounds.*
Total production of uncolored oleomargarine	[1] 21,674,845	[2] 28,673,932
Ingredient schedule for uncolored oleomargarine:		
Butter	1,927	102,606
Cocoanut oil	13,160,021	16,795,774
Corn oil	6,593	559
Cottonseed oil	1,411,991	1,975,191
Derivative of glycerine	22,732	16,309
Egg yolk		79
Lecithin	736	1,367
Milk	5,489,290	8,104,310
Mustard oil		3,535
Neutral lard	1,028,037	1,030,189
Oleo oil	1,400,567	2,698,764
Oleo stearine	374,833	486,457
Oleo stock	41,738	86,163
Palm oil	8,500	52,288
Peanut oil	408,976	492,052
Salt	1,452,210	2,353,601
Sesame oil		13,748
Soda (benzoate of)	8,100	9,226
Soya bean oil	1,049	314,210
Whale oil	112	
Total	24,817,412	34,536,428
Total production of colored oleomargarine	[3] 462,718	[4] 959,204
Ingredient schedule for colored oleomargarine:		
Butter	354	6,407
Cocoanut oil	130,509	315,697
Color	540	1,121
Cottonseed oil	45,427	115,592
Derivative of glycerine	44	70
Lecithin		15
Milk	135,872	299,554
Mustard oil	225	
Neutral lard	49,673	106,463
Oleo oil	131,209	248,494
Oleo stearine	4,630	9,085
Oleo stock	5,290	1,945
Palm oil	16,800	14,119
Peanut oil	5,086	13,077
Salt	38,783	84,950
Sesame oil		2
Soda (benzoate of)	31	97
Soya bean oil		947
Total	564,473	1,217,635

[1] Of the amount produced, 19,621 pounds were reworked.
[2] Of the amount produced, 12,856 pounds were reworked.
[3] Of the amount produced, 760 pounds were reworked.
[4] Of the amount produced, 1,536 pounds were reworked.

XI–6–5382
MS. 123

Schedule of oleomargarine produced and materials used during the month of December, 1931, as compared with December, 1930.

	December, 1931.	December, 1930.
	Pounds.	*Pounds.*
Total production of uncolored oleomargarine	[1] 22,636,989	[2] 28,066,303
Ingredient schedule for uncolored oleomargarine:		
Butter	2,619	121,590
Cocoanut oil	13,905,706	16,205,762
Corn oil	6,565	280
Cottonseed oil	1,457,925	2,049,296
Derivative of glycerine	24,107	16,791
Lecithin	1,503	1,339
Milk	5,786,098	7,877,117
Mustard oil		1,099
Neutral lard	1,224,718	960,147
Oleo oil	1,373,927	2,804,669
Oleo stearine	334,558	464,144
Oleo stock	35,305	96,015
Palm oil	20,958	204,858
Peanut oil	389,726	497,981
Salt	1,519,649	2,325,243
Sesame oil		10,500
Soda (benzoate of)	8,310	8,425
Soya bean oil	1,040	299,044
Whale oil	451	
Total	26,093,165	33,944,300
Total production of colored oleomargarine	[3] 536,042	[4] 902,489
Ingredient schedule for colored oleomargarine:		
Butter	60	1,570
Cocoanut oil	121,033	285,213
Color	559	1,401
Cottonseed oil	72,037	128,789
Derivative of glycerine	28	57
Lecithin		5
Milk	162,321	280,487
Mustard oil	600	
Neutral lard	62,336	104,563
Oleo oil	154,771	236,092
Oleo stearine	5,185	10,907
Oleo stock	7,917	3,365
Palm oil	19,238	11,700
Peanut oil	8,370	11,866
Salt	43,628	84,684
Soda (benzoate of)	46	97
Soya bean oil		595
Total	658,129	1,161,391

[1] Of the amount produced, 16,352 pounds were reworked.
[2] Of the amount produced, 16,577 pounds were reworked.
[3] Of the amount produced, 922 pounds were reworked.
[4] Of the amount produced, 2,004 pounds were reworked.

XI–10–5408
MS. 124

Schedule of oleomargarine produced and materials used during the month of January, 1932, as compared with January, 1931.

	January, 1932.	January, 1931.
	Pounds.	*Pounds.*
Total production of uncolored oleomargarine	[1] 19,983,453	[2] 25,143,892
Ingredient schedule for uncolored oleomargarine:		
Butter	3,138	86,718
Cocoanut oil	12,631,090	14,672,976
Corn oil	4,913	
Cottonseed oil	1,315,132	1,806,751
Derivative of glycerine	20,703	13,578
Lecithin	765	1,403
Milk	4,984,188	7,296,776
Mustard oil		26,669
Neutral lard	855,111	692,337
Oleo oil	971,932	2,040,351
Oleo stearine	302,354	425,572
Oleo stock	32,292	60,509
Palm oil	11,313	600,448
Peanut oil	300,072	444,772
Salt	1,319,381	2,040,016
Sesame oil		16,074
Soda (benzoate of)	7,263	8,083
Soya bean oil	629	196,964
Total	22,760,276	30,429,997
Total production of colored oleomargarine	[3] 404,562	[4] 596,247
Ingredient schedule for colored oleomargarine:		
Butter		450
Cocoanut oil	117,710	200,443
Color	443	599
Cottonseed oil	47,568	68,005
Derivative of glycerine	12	45
Lecithin	3	
Milk	121,338	167,331
Mustard oil	170	
Neutral lard	41,402	55,836
Oleo oil	96,317	123,710
Oleo stearine	4,333	3,220
Oleo stock	4,347	1,010
Palm oil	12,108	17,800
Peanut oil	5,326	9,818
Salt	32,765	48,594
Soda (benzoate of)	28	74
Soya bean oil		351
Total	483,870	697,286

[1] Of the amount produced, 11,671 pounds were reworked.
[2] Of the amount produced, 39,954 pounds were reworked.
[3] Of the amount produced, 831 pounds were reworked.
[4] Of the amount produced, 3,184 pounds were reworked.

XI–15–5446
MS. 125

Schedule of oleomargarine produced and materials used during the month of February, 1932, as compared with February, 1931.

	February, 1932.	February, 1931.
	Pounds.	*Pounds.*
Total production of uncolored oleomargarine	[1] 16,852,520	[2] 19,802,694
Total withdrawn tax-paid	17,319,602	
Ingredient schedule for uncolored oleomargarine:		
Butter	2,512	78,214
Cocoanut oil	10,243,566	11,317,625
Corn oil	1,289	160
Cottonseed oil	1,245,039	1,410,843
Derivative of glycerine	24,593	15,070
Lecithin	741	1,069
Milk	4,154,372	5,667,445
Mustard oil		1,750
Neutral lard	765,189	468,067
Oleo oil	961,552	1,584,755
Oleo stearine	310,679	432,075
Oleo stock	19,744	47,247
Palm oil	8,925	600,190
Peanut oil	250,736	361,355
Salt	1,129,437	1,624,962
Sesame oil		3,650
Soda (benzoate of)	5,420	5,885
Soya bean oil	626	186,979
Total	19,124,420	23,807,341
Total production of colored oleomargarine	[3] 379,416	[4] 532,261
Total withdrawn tax-paid	139,318	
Ingredient schedule for colored oleomargarine:		
Butter	60	1,321
Cocoanut oil	117,231	174,786
Color	307	510
Cottonseed oil	52,337	54,214
Derivative of glycerine	11	27
Lecithin	3	
Milk	111,075	146,321
Mustard oil	195	
Neutral lard	34,544	37,630
Oleo oil	86,593	127,045
Oleo stearine	5,065	3,725
Oleo stock	7,223	2,025
Palm oil	25,235	16,985
Peanut oil	3,793	7,323
Salt	31,318	43,842
Soda (benzoate of)	14	41
Soya bean oil		88
Whale oil	292	
Total	475,296	615,883

[1] Of the amount produced, 10,252 pounds were reworked.
[2] Of the amount produced, 28,672 pounds were reworked.
[3] Of the amount produced, 1,013 pounds were reworked.
[4] Of the amount produced, 2,187 pounds were reworked.

XI–19–5475
MS. 126

Schedule of oleomargarine produced and materials used during the month of March, 1932, as compared with March, 1931.

	March, 1932.	March, 1931.
	Pounds.	*Pounds.*
Total production of uncolored oleomargarine	[1] 18, 558, 957	[2] 20, 507, 176
Total withdrawn tax-paid	18, 366, 736	
Ingredient schedule for uncolored oleomargarine:		
Butter	2, 960	56, 157
Cocoanut oil	11, 309, 280	11, 886, 757
Corn oil	4, 114	
Cottonseed oil	1, 381. 450	1, 526, 810
Derivative of glycerine	22, 130	15, 447
Lecithin	585	934
Milk	4, 547, 818	5, 756, 693
Mustard oil		2, 790
Neutral lard	995, 361	530, 240
Oleo oil	1, 153, 203	1, 658, 172
Oleo stearine	361, 479	427, 295
Oleo stock	24, 608	60, 052
Palm oil	10, 500	497, 994
Peanut oil	218, 058	371, 287
Salt	1, 232, 552	1, 669, 947
Sesame oil		4, 725
Soda (benzoate of)	6, 446	5, 533
Soya bean oil	471	165, 529
Total	21, 271, 115	24, 636, 362
Total production of colored oleomargarine	[3] 414, 163	[4] 647, 312
Total withdrawn tax-paid	146, 282	
Ingredient schedule for colored oleomargarine:		
Butter	60	816
Cocoanut oil	119, 870	199, 368
Color	386	817
Cottonseed oil	56, 897	93, 930
Derivative of glycerine	3	21
Lecithin	1	
Milk	123, 488	169, 824
Neutral lard	38, 246	51, 895
Oleo oil	107, 435	130, 475
Oleo stearine	4, 448	9, 555
Oleo stock	8, 308	5, 458
Palm oil	8, 728	29, 530
Peanut oil	4, 876	6, 866
Salt	31, 586	59, 800
Soda (benzoate of)	11	42
Soya bean oil		193
Total	504, 343	758, 590

[1] Of the amount produced, 15,361 pounds were reworked.
[2] Of the amount produced, 21,007 pounds were reworked.
[3] Of the amount produced, 354 pounds were reworked.
[4] Of the amount produced, 2,270 pounds were reworked.

XI–23–5506
MS. 127

Schedule of oleomargarine produced and materials used during the month of April, 1932, as compared with April, 1931.

	April, 1932.	April, 1931.
	Pounds.	*Pounds.*
Total production of uncolored oleomargarine	[1] 16,385,007	[2] 19,088,903
Total withdrawn tax-paid	16,407,772	
Ingredient schedule for uncolored oleomargarine:		
Butter	2,668	52,782
Cocoanut oil	9,918,579	11,171,269
Corn oil	4,969	
Cottonseed oil	1,193,117	1,364,576
Derivative of glycerine	26,445	15,218
Lecithin	355	678
Milk	4,019,611	5,234,714
Mustard oil		2,067
Neutral lard	700,282	804,333
Oleo oil	1,054,002	1,515,691
Oleo stearine	320,700	395,231
Oleo stock	23,450	51,231
Palm oil	10,018	328,695
Peanut oil	222,254	342,547
Salt	1,047,344	1,509,187
Sesame oil		1,650
Soda (benzoate of)	6,363	5,336
Soya bean oil	238	49,661
Total	18,610,395	22,844,866
Total production of colored oleomargarine	298,512	[3] 529,106
Total withdrawn tax-paid	110,644	
Ingredient schedule for colored oleomargarine:		
Butter	60	332
Cocoanut oil	66,910	157,503
Color	199	778
Cottonseed oil	51,981	82,331
Derivative of glycerine	65	18
Milk	87,107	152,583
Neutral lard	29,727	55,231
Oleo oil	71,353	113,282
Oleo stearine	5,562	9,795
Oleo stock	5,005	5,300
Palm oil	10,235	25,388
Peanut oil	4,950	5,204
Salt	25,946	47,527
Soda (benzoate of)	9	18
Soya bean oil		25
Total	359,109	655,315

[1] Of the amount produced, 5,661 pounds were reworked.
[2] Of the amount produced, 16,112 pounds were reworked.
[3] Of the amount produced, 1,247 pounds were reworked.

MISCELLANEOUS.

XI–2–5357
Mim. 3926

Form 1120, Corporation income tax return for calendar year 1931.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C., January 6, 1932.

Collectors of Internal Revenue, Internal Revenue Agents in Charge, and Others Concerned:

Reference is made to Form 1120, Corporation income tax return for the calendar year 1931.

Due to a typographical error, item 22(b) on page 1 of the form reads "Net loss for 1928–1929 (submit schedule)" instead of "Net loss for 1929–1930 (submit schedule)." Taxpayers using this form should make the necessary correction in item 22(b), using either pen and ink or typewriter.

DAVID BURNET, *Commissioner.*

XI–6–5383
Mim. 3932

Forms 1041 and 1065—Fiduciary and partnership returns of income for calendar year 1931.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C., January 27, 1932.

Collectors of Internal Revenue, Internal Revenue Agents in Charge, and Others Concerned:

Reference is made to Form 1041, Fiduciary return of income for the calendar year 1931, and Form 1065, Partnership return of income for the calendar year 1931.

The last sentence in instruction 27 on Form 1041 and the last sentence in instruction 32 on Form 1065, relating to returns of information at the source on Forms 1096 and 1099, read "Such returns covering the calendar year 1931 must be forwarded to the collector of internal revenue for your district in time to be received not later than February 15, 1932."

The above-quoted sentences should read "Such returns covering the calendar year 1931 must be forwarded to the Commissioner of Internal Revenue, Sorting Section, Washington, D. C., in time to be received not later than February 15, 1932." (See T. D. 4302, C. B. IX–2, 143.)

Correspondence and inquiries regarding this mimeograph should refer to the number and the symbols IT:E:JCW.

DAVID BURNET, *Commissioner.*

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[1] XI–26–5531

Disbarments and suspensions from practice before Treasury Department of attorneys and agents.[2]

DISBARMENTS.

The Secretary of the Treasury, after due notice and opportunity for hearing, ordered the disbarment from further practice before the Treasury Department of the following-named attorneys and agents:

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[1] This ruling (5531) includes also rulings Nos. 5346, 5356, 5363, 5370, 5376, 5384, 5391, 5397, 5403, 5409, 5415, 5422, 5429, 5437, 5447, 5454, 5464, 5466, 5477, 5483, 5490, 5497, 5507, 5516, and 5522. These rulings have been thus consolidated because publication of each one separately would be largely duplication.

[2] This list includes all attorneys and agents whose disbarment from practice before the Treasury Department was published during the 12-month period ended June 30, 1932, and all suspensions in effect during the 6-month period January 1–June 30, 1932, inclusive. It does not include those barred from practice by reason of disapproval of their application for enrollment.

Name.	Address.	Date of disbarment.	Cause.
Caldwell, Robert Lee.	Formerly Fort Worth, Tex., now Dallas, Tex.	Apr. 7, 1932	Charged with obtaining $225 from a client by fraudulent pretenses. Charges found proven.
Clark, Earl S.	Providence, R. I.	Oct. 30, 1931	Charged with having prepared a false claim for refund; with having forged the signatures of the taxpayer and notary to such claim in a tax case barred by the statute of limitations, and with having surreptitiously inserted such false claim for refund and other documents into the files of the Bureau of Internal Revenue. Charges found proven.
Curson, Samuel T.	Formerly Hollywood, Calif., later Los Angeles, Calif.	Oct. 28, 1931	Charged with aiding and counseling a taxpayer to make a false income tax return. Charges found proven.
Cutler, H. C.	Seattle, Wash.	Apr. 1, 1931	Charged with making false income tax returns for a taxpayer. Charges found proven.
Davidson, Clifford D.	Baltimore, Md.	June 17, 1931	Charged with the misappropriation of funds of a client to his own use. Charges found proven.
Dow, William J.	Washington, D. C.	May 7, 1932	Charged with having been disbarred as an attorney by the Supreme Court of the District of Columbia. Charges found proven.
Falconer, Robert M.	New York, N. Y.	Oct. 30, 1931	Charged with entering into an agreement to divide the fee in a tax case with a deputy collector. Charges found proven.
Fewkes, John B.	Los Angeles, Calif.	Feb. 27, 1932	Charged with having been convicted of grand theft. Charges found proven.
Forge, G. Wallace.	Formerly Los Angeles, Calif., now Hollywood, Calif.	June 23, 1931	Charged with making a false Federal income tax return for a taxpayer with the intent to aid such taxpayer to evade the payment of taxes legally due the Government. Charges found proven.
Groves, William F.	Elizabeth, N. J.	Dec. 21, 1931	Charged with having been convicted on an indictment for embezzlement of funds belonging to a client. Charges found proven.
Johnson, Sven Elmer.	Formerly Chicago, Ill., later New Orleans, La.	Feb. 27, 1932	Charged with knowingly preparing a false Federal income tax return for a taxpayer. Charges found proven.
Leffler, Louis.	Formerly New York, N. Y., now Brooklyn, N. Y.	Jan. 5, 1931	Charged with having attempted to extort money by threatening to charge a taxpayer with making a false statement in regard to taxes. Charges found proven.
May, Harry P.	Formerly Washington, D. C., now Los Angeles, Calif.	July 6, 1931	Charged with soliciting employment in Federal tax matters, and with entering into an agreement to split fees in Federal tax matters. Charges found proven.
Mueller, F. C.	Formerly Chicago, Ill.	Apr. 29, 1932	Charged with solicitation of employment in Federal tax matters from taxpayers with whom respondent had no previous association. Charges found proven.
Mulford, Elmer W.	Formerly Detroit, Mich.	May 7, 1932	Charged with having been disbarred as an attorney by the circuit court of Wayne County, Mich. Charges found proven.
Norwood, Seth W.	Portland, Me.	July 6, 1931	Charged with knowingly having made a false income tax return for a client. Charges found proven.
Prussian, Aaron.	Formerly New York, N. Y., later Detroit, Mich.	July 8, 1931	Charged with forging the signature of a client to a check drawn on the Treasurer of the United States; uttering such check; and misappropriating the money received on such check. Charges found proven.
Reed, John P.	Chicago, Ill.	Sept. 30, 1931	Charged with having been disbarred as an attorney by the Supreme Court of the State of Illinois. Charges found proven.
Sites, E. S.	Formerly Charleston, W. Va.	Apr. 29, 1932	Charged with misappropriating funds of a client and with conspiracy to extort money from a client. Charges found proven.
Spier, Joseph N.	Brooklyn, N. Y.	Jan. 5, 1931	Charged with having attempted to extort money by threatening to charge a taxpayer with making a false statement in regard to taxes. Charges found proven.
Turner, Alexander.	Dallas, Tex.	July 13, 1931	Charged (1) with issuing checks on banks when respondent had no money on deposit in such banks; (2) with having been convicted for issuing checks when respondent had no money on deposit to pay such checks; and (3) with receiving $250 fee and failing to perform services for such fee. Charges found proven.
Weiss, Henry M.	New York, N. Y.	Apr. 29, 1932	Charged with knowingly preparing fraudulent amended income tax return for a client. Charges found proven.
Wenger, George.	Paterson, N. J.	Apr. 29, 1932	Charged with having been convicted in United States district court for conspiracy to conceal assets in a bankruptcy case. Charges found proven.

DISBARMENT MODIFIED.

By order of the Secretary of the Treasury, the order of disbarment entered against the following-named person on July 20, 1931, was modified as indicated below:

Name.	Address.	Remarks.
Prull, LeRoy A	Boston, Mass	Disbarment ordered July 20, 1931; disbarment modified on Nov. 23, 1931, to terminate on Jan. 20, 1932, and reinstatement to practice to begin on Jan. 20, 1932.

DISBARMENTS TERMINATED.

By direction of the Secretary of the Treasury, the order of disbarment entered against the following-named persons was terminated as indicated below:

Name.	Address.	Remarks.
Sanders, Leo	Formerly Oklahoma City, Okla., later Cincinnati, Ohio, now again Oklahoma City, Okla.	Disbarment terminated on Mar. 14, 1932, and reinstatement to practice to begin on Mar. 14, 1932.
Sullivan, F. J	Formerly Sumter, S. C., now Columbia, S. C.	Disbarment terminated on Feb. 27, 1932, and reinstatement to practice to begin on Feb. 27, 1932.

SUSPENSIONS.

The Secretary of the Treasury, after due notice and opportunity for hearing, ordered the suspension from practice before the Treasury Department for the period stated in each case of the following-named attorneys and agents:

Name.	Address.	Period of suspension.	Cause.
Coopersmith, Morris	New York, N. Y.	1 year, from May 2, 1931.	Charged with testifying falsely in a proceeding before the Committee on Enrollment and Disbarment of the Treasury Department. Charges found proven.
Dusenbery, Samuel	Los Angeles, Calif.	60 days, from Nov. 30, 1931.	Charged with soliciting employment in Federal tax matters. Charges found proven.
Ketchum, George W	Evanston, Ill	30 days, from Apr. 29, 1932.	Charged with distributing business cards, in which he held himself out as a Government income tax agent. Charges found proven.

Resignation from enrollment to practice before the Treasury Department.

The follow-named person tendered his resignation from enrollment to practice before the Treasury Department. By direction of the Secretary of the Treasury, his resignation was accepted and his name ordered stricken from the roll of attorneys and agents enrolled to practice before the Treasury Department. He is therefore no longer entitled to practice before the Treasury Department.

Name.	Address.	Designation.	Date of acceptance.
Adkisson, Jesse D	Formerly West Haven, Conn., now Miami Beach, Fla.	Agent	June 15, 1932.

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